UNIT 1 NATURE AND TYPES OF COMPANIES

Structure

1.0 Objectives

1.1 Introduction

1.2 Meaning and Definition of a Company

1.3 Company vs. Body Corporate

1.4 Is Company a Citizen

1.5 Main Features of a Company

1.6 Lifting the Corporate Veil

- 1.6.1 Under Express Statutory Provisions
- 1.6.2 Under Judicial Interpretations

1.7 Distinction between Company and Partnership

1.8 Distinction between Company and Limited Liability Partnership

1.9 Kinds of Companies

- 1.9.1 On the Basis of Incorporation
- 1.9.2 On the Basis of Liability
- 1.9.3 On the Basis of Control

1.10 Other Kinds of Registered Companies

- 1.10.1 Producer Company
- 1.10.2 One Person Company
- 1.10.3 Small Company

1.11 Association Not for Profit

1.12 Illegal Associations

- 1.12.1 Meaning
- 1.12.2 Exceptions
- 1.12.3 Consequences

1.13 Let Us Sum Up

1.14 Key Words

1.15 Answers to Check Your Progress

1.16 Terminal Questions

1.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a company;
- distinguish between company and body corporate;
- describe the characteristic features of a company;

- explain the concept of corporate veil;
- distinguish between company and partnership;
- distinguish between company and limited liability partnership;
- describe the various types of companies;
- understand associations not for profit; and
- describe an illegal association.

1.1 INTRODUCTION

The Companies Act, 2013 received the assent of the President on 29th August and was notified on 30th August, 2013. It has 470 sections and VII schedules, whereas the Companies Act 1956 had 658 sections and XV schedules. This Act provides detailed rules regarding formation, management and administration and winding up of companies by Tribunals. It has made changes in provisions relating to memorandum, definition of prospectus, appointment of auditors, and accounting standards and financial statements and investigations etc. This Act has been amended by Companies amendment Act 2015, 2017 and 2019. In this introductory unit you will study the meaning and definition of a company, the main features of a company form of business organization, its distinction from partnership as well as limited liability partnership and the various types of companies that can be formed in India.

1.2 MEANING AND DEFINITION OF A COMPANY

The term 'company' may be described to imply an association of persons formed for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. However, the term 'company' is normally reserved for those associated for economic purpose, i.e, to carry on a business for gain. **This should, however, not give you an impression that a company under the companies Act cannot be created for non-economic or charitable purposes. In fact, Section 8 of the Companies Act, 2013 allows formation of non-profit associations as companies.**

Partnerships often describe themselves as 'A, B, C & Company'. But, this does not make the firm a company in the legal sense of the word; it only suggests that there are other persons also in the association.

In legal terminology, a company means a company incorporated or registered under the Companies Act, 2013 or under any of the earlier Companies Acts. Section 2(20) of the Companies Act, 2013 defines a company to mean a company incorporated under this Act or under any previous company law. This definition, however, is not exhaustive because it does not reveal the meaning and characteristics of a company. Thus we have to see definition of a company as given by famous Jurists.

Lord Justice Lindley defines a Company as follows:

"A company is an association of many persons who contribute money or money 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 therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are called 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."

Another definition as given by ***Chief Justice Marshall*** reads as follows:

"A company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

According to **Lord Haney**, "A company is an incorporated association which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal."

From the above definitions, it is clear that a company has a corporate and legal personality. It is an artificial person and exists only in the eyes of law. It has an independent legal entity, a common seal and perpetual succession.

1.3 COMPANY VS. BODY CORPORATE

Body corporate means an association of persons which has been incorporated under some statute having perpetual succession, a common seal and having a legal entity different from the members constituting it. Section 2 (11) of the Companies Act, 2013 defines the expression 'body corporate' as follows:

"Body corporate" or "Corporation" includes a company incorporated outside India, but **does not include—**

i) a co-operative society registered under any law relating to co-operative societies; and

ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf".

A body corporate may be-

a) corporation sole, or

b) corporation aggregate.

A **'corporation sole'** is a body corporate constituted in a single person who, in right of some office or function, has corporate status. Examples of 'corporation sole' are to be found in perpetual offices such as the President, Governors, Crown, Ministers, and a public trustee. A corporation sole is not a "body corporate' for the purposes of the Companies Act, 2013. It is still a legal person and as such person it can be a member of a company- **Star Tile Works Ltd. v. N. Govindan (1956).**

A **'corporation aggregate'** consists of a group of persons together associated so that they form a single person, e.g., a limited company, a trade union.

It may be of interest to note at this stage that because of inclusion of a company incorporated outside India within the definition of body corporate, a number of provisions of the Companies Act, 2013 apply to such companies; for example, Section 380 requires foreign companies carrying on business in India to deliver certain documents to the Registrar of Companies.

The expression 'corporation' or 'body corporate' is, thus, wider than the word 'company'. A company, as noted above, is a corporation aggregate.

1.4 IS COMPANY A CITIZEN?

Although a company is regarded as a legal person (though artificial), it is not a citizen either under the Constitution of India or the Citizenship Act, 1955- **Heavy Engineering Mazdoor Union v. State of Bihar (1969).** The Supreme Court of India in **State Trading Corporation Ltd. v. CTO (1963)** held that a corporation including a company cannot have the status of a citizen under the Constitution of India. Thus, under the Constitution, a company has no fundamental rights which are expressly available to citizens only. It can, however, claim the protection of those fundamental rights which are available to all persons, whether citizens or not, for example, the right to own property.

In **Narasaraopeta Electric Corporation Ltd. v. State of Madras (1951)**, the High Court observed that a company incorporated under the Indian Companies Act does not satisfy the requirements of the definition of 'citizen' in Article 5 of the Constitution and therefore is not a citizen.

A company is also not allowed to lay claim to fundamental rights on the basis of its being an aggregate of citizens. Once a company or a corporation is formed, the business of the company or the corporation is not the business of the citizens but that of the company or corporation formed as an incorporated body and the rights of the incorporated body must be judged on that footing and cannot be judged on the assumption that they are the rights attributable to the business of individual citizens-Supreme Court in **Telco Ltd. v. State of Bihar (1964)**.

Although a company cannot be a citizen, yet it has a nationality, domicile and residence. A company is said to be resident and national of the place and country where is incorporated.

1.5 MAIN FEATURES OF A COMPANY

On analyzing the various legal and juristic definitions of the term company, you will observe that a company formed and registered under the Companies Act has certain special features which distinguish it from the other forms of organisations. The main characteristic features of a company are as follows:

1) **Creation of Law:** A company is an association of persons (except in case of 'One Person Company') registered under the Companies Act. It comes into existence only when it is so registered. Minimum number required for the purpose is 2, in case of a private company and 7, in case of a public company. Only one person can form a 'one person company' (*Section 3*).

2) **Artificial Person:** A company is created with the sanction of law and is not itself a human being. It is, therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.

3) **Separate Legal Entity:** Unlike partnership, company is distinct from the persons who constitute it. Section 9 says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum.

The legal status of a company has been aptly described by the Supreme Court of India in **Tata Engineering & Locomotive Co. Ltd. v. State of Bihar** as follows:

"The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose".

Even though the company lacks physical existence, for purposes of law it is regarded as an independent legal person who has personality of its own and is different from the members constituting the company. Therefore, a company can enter into a contract with any of its members. A person can own its shares and also be its creditor. A shareholder of a company cannot be held liable for its acts and debts even though he virtually holds the entire share capital. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or on its winding up. Similarly, creditors of the company are the creditors of the company alone and they cannot take action against the members of the company.

Even where a single shareholder virtually holds the entire share capital, a company is to be differentiated from such a shareholder. In the well known case of **Salomon v. Salomon & Co. Ltd. (1895-99)**, Salomon was running a shoe business in England. He formed a company known as 'Salomon & Co. Ltd.'. It consisted of Salomon himself, his wife, his four sons and a daughter. The shoe business of Mr. Salomon was sold to the company for £30,000. Mr. Salomon received from the company purchase price in the form of £20,000 fully paid shares of £1 each and £10,000 in debentures which carried a floating charge over the assets of the company and the balance in cash. One share of £1 each was subscribed for in cash by each member of Salomon's family. Salomon was appointed the managing director of the company. During the course of business, the company became liable for some unsecured loan. The company in less than one year ran into financial difficulties and the liquidation proceedings started. On winding up, the assets realized £6,000. The company owed £10,000 to Mr. Salomon and £7,000 to unsecured creditors. Thus, after paying off the debenture holder (Mr. Salomon), nothing was left for unsecured creditors. The creditors claimed priority over the debentures contending that Mr. Salomon and Salomon & Co. Ltd. was one and the same person. The company was only a façade to defraud the innocent creditors. Mr. Salomon should not be treated as a secured creditor, outside creditors should be paid first. The House of Lords held that the company had been validly constituted, and it is independent of its members. So Salomon is entitled to get his money first as he is a secured creditor. The business belonged to company and not to Salomon. Salomon was its agent; the company was not the agent of Salomon.

In T.R. Pratt (Bombay) Ltd. vs. E.D. Sasoon and Co. Ltd., it was observed that under the law, an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is a distinct entity. Similarly, in **Abdul Haq vs. Das Mal**, an employee sued a director of the company for the recovery of the amount of salary due to him. It was held that he could not succeed because the remedy lied against the company and not against the directors or members of the company.

As a consequence of separate legal entity, the company may enter into contracts with its members and vice-versa. Thus, a shareholder can be the creditor of the company.

4) **Limited Liability:** A major advantage enjoyed by a company is that the liability of its members is limited. The company being a separate person, its

members are not as such liable for its debts. You will later study that on the basis of liability, companies may be classified as (i) Companies limited by shares, (ii) Companies limited by guarantee, (iii) Companies limited by guarantee but having share capital, and (iv) Unlimited liability companies.

In case of a *company limited by shares*, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. In case of a *company limited by guarantee*, the liability of the members is limited up to the amount guaranteed by a member. But, in case of a *guarantee company having share capital,* the liability shall be limited to the aggregate of the amount remaining unpaid on the shares held by a member and the amount guaranteed by him.

You may note that, the Companies Act, 2013 allows companies to be formed with liability of members as unlimited. In case of an unlimited liability company, the liability of members shall not be limited to the nominal or face value of the shares held by them; they shall continue to be liable till each paisa of company's debts and liabilities has been paid off. However, the company being a separate legal entity, no suit can be filed by the creditors directly against the members.

5) **Separate Property:** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in **Bacha F. Guzdar *v.* Commissioner of Income Tax, Bombay (supra)**. The Supreme Court held that a shareholder is not the part owner of the company or its property, he is given only certain rights by law, e.g., to vote or attend meetings, to receive dividends.

   In **Macaura *v.* Northern Assurance Co. Ltd. (1925),** it was held that a member does not even have an insurable interest in the property of the company. In this case, Macaura held all except one share of a timber company. He insured the company's timber in his own name. On timber being destroyed by fire, his claim was rejected because he had no insurable interest in that timber. The Court observed: "No shareholder has any right to any item of property of the company for he has no legal or equitable interest therein".

6) **Perpetual Succession:** The term perpetual succession means the continued existence. The existence of the company is not affected by reasons such as the insolvency, death, unsoundness of mind of its members. The company has a perpetual succession. Members may come and members may go but the company goes on. It continues even if all its human members are dead. Even where during the war, all the members of a private company, while in general meeting were killed by a bomb, the company survived. Not even a hydrogen bomb could have destroyed it. In the aforesaid eventuality, the legal successors of the deceased shareholders will become the members. But this does not mean that a company can never come to an end. You learnt that a company is creation of law, it can also be brought to an end by the process of law.

7) **Transferability of Shares:** One particular reason for the popularity of joint stock companies has been that their shares are capable of being easily transferred. The shares of a public company are freely transferable. A shareholder can transfer his shares to any person without the consent of other members. Articles of association, even of a public company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of a public company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the

manner provided for in the articles of association of the company. **The Companies Act, 2013, vide Section 58(2) provides that without prejudice to sub-section (*1*), the securities or other interest of any member in a public company shall be freely transferable Provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. Thus, the present Act upholds shareholders' agreements providing for 'Right of first offer' and 'Right of first refusal' as valid even in case of a public company.**

However, a private company is required to put certain restrictions on transferability of its shares but the right to transfer is not taken away absolutely even in case of a private company.

8) **Common Seal:** A company being an artificial person is not bestowed with body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company. A metallic seal should be used. A company may have a common seal with its name engraved on the same.

   As per Section 22, a company may, under its common seal, through general or special power of attorney empower any person to execute deeds on its behalf in any place either in or outside India. It further provides that a deed signed by such an attorney on behalf of the company and under his seal where sealing is required, shall bind the company and have the effect as if it were under its common seal as per Companies (Amendment) Act, 2015, common seal is optional. In case a company doesn't have a common seal, the authorization shall be made by two directors or by a director and the company secretary, wherever the company has appointed a company secretary. Again, except where so provided in the Act, a document or proceeding requiring authentication by a company may be signed by any key managerial personnel or an officer or employee duly aurhorised by the Board in this behalf and need not be under its common seal [Section 21].

9) **Company may sue and be sued in its own name:** As juristic person, company can sue and be sued in its own name. This is so because a company has a separate legal existence. A company may enter into contracts and can enforce the contractual rights against others and it can be sued by others if it commits a breach of contract.

Check Your Progress A

1) Define a company.

   ....

   ....

   ....

2) Enumerate the three main features of a company.

   ....

   ....

   ....

   ....

3) State, whether the following statements are true or false:

   i) A company is the creation of law.

   ii) A company is an artificial person.

   iii) Since company is an artificial person, it can commit no wrong nor can it be sued in its own name.

   iv) Like a partnership, a company comes to an end when any shareholder of the company dies.

   v) A company although is a corporate person yet it is not a citizen.

   vi) The liability of a member is limited to the face value of the shares held by him.

1.6 LIFTING THE CORPORATE VEIL

Under Para 1.5, you learnt that a company has a separate legal entity independent and different from its members. This principle of separate legal entity was well established in the famous case of **Salomon *v.* Salomon and Company Ltd.** On incorporation a line of demarcation or a veil is drawn between the company and its members. In fact, a company is an association of persons and such persons are the real beneficial owners of all the corporate property. Real persons behind the company are disregarded once they have formed a company and given the status of a legal entity.

As a consequence of this separate legal entity, the company enjoys several advantages which you have studied in foregoing Para. But, the advantages of incorporation are allowed to be enjoyed only by those who want to make an honest use of the 'company'. In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons who are behind the scene and are responsible for the fraud. The corporate veil is said to be lifted when the court ignores the company and concerns itself directly with the officers or members of the company. Prof. Gower has observed, "When the law disregards the corporate entity and pays regard instead to the individual members behind the legal façade, it is known as lifting the veil of corporate personality".

You should, however, note that the power of the court to lift the corporate veil is purely discretionary. The court will lift the corporate veil when it is in the public interest to do so. In **Cotton Corporation of India Ltd. *v.* G.C. Odusumathd (1999**), the Karnataka High Court observed that lifting of the corporate veil of a company, as a rule is, not permissible in law unless otherwise provided by clear words of the statute or by very compelling reasons such as where fraud is intended to be prevented or trading with enemy company is sought to be defeated.

The circumstances under which the courts may lift the corporate veil may broadly be grouped under the following two heads:

A) Under express statutory provisions

B) Under judicial interpretations

Let us now discuss them in detail.

1.6.1 Under Express Statutory Provisions

The Companies Act, 2013 provides for certain circumstances in which the directors or members of the company may be held personally liable. In such cases, while the separate entity of the company is maintained, the directors or members are held personally liable along with the company. These circumstances are as follows:

1) **Mis-statements in prospectus [Sections 34 & 35]** - In case of misrepresentation in a prospectus, the company and every director, promoter, expert and every other person, who authorised such issue of prospectus shall be liable to compensate the loss or damage to every person who subscribed for shares on the faith of untrue statement (Sec. 35).

   Besides, these persons may be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud **(Section 34 and Section 447 read together**). **However, a person may escape the aforesaid conviction if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.**

2) **Failure to return application money [Sec. 39]** - In case of issue of securities by a company to the public, if minimum subscription, as stated in the prospectus has not been received within 30 days of the issue of prospectus or such other period as may be specified by the SEBI, then as per Rule 11 of Companies (Prospectus and Allotment of Securities) Rules, 2014, the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

   In case of default, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

3) **Non-disclosure /Misdesciption of Name [Sec. 12] - *As per Section 12*, a company shall have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed.** Thus, where an officer of a company signs on behalf of the company any contract, bill of exchange, hundi, promissory note, cheque or order for money, such person shall be personally liable to the holder if the name of the company is either not mentioned, or is not properly mentioned. Accordingly, where on a cheque, the name of a company was stated as 'LR agencies limited' whereas the real name of the company was 'L&R Agencies Ltd.' the signatory directors were held personally liable **[Hendon v. Adelman (1973)]**. Besides, the company and its officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

4) **For facilitating the task of an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company [Sec. 219] -** Section 219 provides that if an inspector appointed under Section 210 or 212 or 213 to investigate the affairs of the company considers it necessary for the purposes of investigation, he may investigate into the affairs of another related company in the same management or group as well as into the affairs of any person who is or has at any relevant time been the company's managing director or manager or employee.

5) **For investigation of ownership of company [Sec. 216]** - Under Section 216, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons—

   a) **who are or have been financially interested in the success or failure, whether real or apparent, of the company; or**

   b) **who are or have been able to control or to materially influence the policy of the company.**

6) **Liability for *ultra vires* acts** - Directors and other officers of a company will be personally liable for all those acts which they have done on behalf of a company if the same are *ultra vires*, *i.e,* beyond the powers of the company.

7) **Fraudulent Conduct of business (Section339)**

   Under Section 339 of the Act if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly party to such acts may be held personally liable for any debts and other liabilities of the company. In such a situation, the Tribunal may disregard the legal entity of a company and make the fraudulent persons personally liable for the debts of the company.

8) **Liability under other statutes** - Besides the Act, directors and other officers of the company may be held personal-ly liable under the provisions of other statutes. *For example*, under the *Income-tax Act*, where any private company is wound-up and if tax arrears of the company in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally liable for payment of tax. Similarly, under *Foreign Exchange Management Act, 1999*, the directors and other officers may be proceeded individually or jointly for violations of the Act.

1.6.2 Under Judicial Interpretations

It is difficult to deal with all the cases in which courts have lifted or might lift the corporate veil. Some of the cases where the veil of incorporation was lifted by judicial decisions may be discussed to form an idea as to the kind of circumstances under which the facade of corporate personality will be removed or the persons behind the corpo-rate entity identified and penalised, if necessary.

1) **Protection of revenue** - In ***Sir Dinshaw Maneckjee Petit, Re* (1927)**, the assessee was a millionaire earning huge income by way of dividend and interest. He formed four private companies and transferred his investments to each of these companies in exchange of their shares. The dividends and interest income received by the company was handed back to Sir Dinshaw as a pretended loan. It was held that the company was formed by the assessee purely and simply as a means of avoiding tax and company was nothing more than assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interest and to hand them over to the assessee as pretended loans.

2) **Prevention of Fraud or improper conduct -** Where the medium of a company has been used for committing fraud or improper conduct, courts

have lifted the veil and looked at the realities of the situation. In ***Gilford Motor Company*** **v.** ***Horne*** **[1933]**, 'Horne' had been employed by the company under an agreement that he shall not so solicit the customers of the company or compete with it for a certain period of time after leaving its employment. After ceasing to be employed by the plaintiff, Horne formed a Company which carried on a competing business and caused the whole of its shares to be allotted to his wife and an employee of the company, who were appointed to be its directors. It was held that since the defendant (Horne) in fact controlled the company, its formation was a mere 'cloak or sham' to enable him to break his agreement with the plaintiff. Accordingly, an injunction was issued against him and against the company he had formed restraining them from soliciting the plaintiff's customers.

Similarly, in ***Jones*** **v.** ***Lipman*** **[1962]**, seller of a piece of land sought to evade specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose. It was held that specific performance of the contract cannot be resisted by the vendor by conveyance of the land to the company which was a mere 'facade' for avoidance of the contract of sale and specific performance of the contract was therefore ordered against the vendor and the company.

3) **Determination of the enemy character of a company** - Company being an artificial person cannot be an enemy or friend. However, during war, it may become necessary to lift the corporate veil and see the persons behind as to whether they are enemies or friends. It is because, though a company enjoys a distinct entity, its affairs are essentially run by individuals. In ***Daimler Company Ltd.*** **v.** ***Continental Tyre & Rubber Co. (Great Britain) Ltd.*** **[1916]**, a company was incorporated in London for the purpose of selling tyres manufactured in Germany by a German company. Its majority shareholders and all the directors were Germans. On declaration of war between England and Germany in 1914, it was held that since both the decision-making bodies, the Board of directors and the general body of shareholders were controlled by Germans, the company was a German company and hence an enemy company. Accordingly, the suit filed by the company to recover a trade debt was dismissed on the ground that such payment would amount to trading with enemy and thus against public policy.

4) **Formation of subsidiaries to act as an agent** - In ***Merchandise Transport Limited*** **v.** ***British Transport Commission*** **[1982]**, a transport company wanted to obtain licences for its vehicles, but it could not do so if it made the application in its own name. It, therefore, formed a subsidiary company and the application for licences was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary. Held, the parent and the subsidiary company were one commercial unit and the application for licences was rejected.

   In the ***State of U.P.*** **v.** ***Renusagar Power Co.*** **[1991]**, the Govt. of U.P. announced certain subsidies to companies which produced power for their captive (own) use. Renusagar Power Supply Company was a 100% subsidiary of Hindalco and supplied its entire power output to Hindalco and none else. The Supreme Court held that where the holding company holds 100% shares in a subsidiary company and the latter is created only for the purpose of the holding company, corporate veil can be lifted. Thus, Hindalco was held entitled to the subsidies. 'Hindalco' and 'Renusagar Power Supply Company' were considered as one entity. *You may note here that, in this case corporate veil was lifted for the benefit of the company and not to punish the company, its officers or directors.*

Again, in ***J.B. Exports Ltd.* v. *BSES Rajdhani Power Ltd.* [2007]**, appellant No. 1 company acquired entire share capital of appellant No. 2 company, which was a registered consumer of electricity connection granted at its factory premises and on finding that electricity was being consumed by appellant No. 1, Electricity Board passed impugned order demanding sub-letting charges from appellant No. 2, Court *held that* by applying principle of piercing of corporate veil, both companies appeared to be same entity and, therefore, there was no question of sub-letting.

5) **Where a company acts as an agent for its members/shareholders** - If there is an arrangement between the shareholders and a company to the effect that the company will act as the shareholders' agent for the purpose of carrying on the business, the business is essentially that of the shareholders. Thus, where an arrangement, as aforesaid, prevails, the individual shareholders may be identified for fixing their liability. In ***R.G. Films Ltd's case***, an American company financed and produced a film 'Monsoon' in India. But technically, the film was made in the name of a company incorporated in England. This Brirish company had only a capital of £ 100 divided into 100 shares of £ 1 each. Of this, 90 shares were held by the President of the American company. The Board of Trade declined to register the film as a British film. The view of the Board of Trade was upheld by the Court. The Court held that the British company acted only as an agent of the American company which was the true maker of the film.

6) **In case of economic offences** - In ***Santanu Ray* v. *Union of India* [1989]**, it was held that in case of economic offences a court is entitled to lift the veil of corporate entity and pay regard to the economic realities behind the legal facade. In this case, it was alleged that the company had violated section 11(*a*) of the Central Excises & Salt Act, 1944. The Court held that the veil of the corporate entity could be lifted by adjudicating authorities so as to determine as to which of the directors was concerned with the evasion of the excise duty by reason of fraud, concealment or willful misstatement or suppression of facts or contravention of the provisions of the Act and the rules made thereunder.

7) **Where company is used to avoid welfare legislation** - Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction — ***Workmen of Associated Rubber Industry Ltd.* v. *Associated Rubber Industry Ltd.* [1986]**. In this case, a new company was formed with no assets of its own except those transferred to it by the principal company. Further, the new company had no business of its own; it only received dividends on shares transferred to it by the principal company. Thus, the principal company was able to reduce its gross profits and consequently the amount of bonus to workmen was also reduced. The Supreme Court rejected the independent status of the new company and directed that the amount paid to the new company as dividend should also be taken into account determining the gross profit of the principal company.

8) **Where company is used for some illegal or improper purpose** - Courts have shown themselves willing to lift the veil where device of incorporation is used for some illegal or improper purpose - ***PNB Finance Limited* v. *Shital Prasad Jain* [1983].** Again, in ***SEBI v. Libra Plantation Ltd. [1999]***, Bombay High Court allowed the property acquired under fraudulent schemes to be chased even in the hands of third persons.

9) **To punish for contempt of court** - Company being an artificial person cannot disobey the orders of the court. Therefore, the persons at fault should be identified **[*Jyoti Limited* v. *Kanwaljit Kaur Bhasin* (1987)]**.

10) **For determination of technical competence of the company** - The Supreme Court in ***New Horizons Ltd.* v. *Union of India* [1995]** held that the experience of the promoters could well be considered as the experience of the company in determining its technical competence. *Once again, you may note that the veil in this case was lifted for the benefit of the company.*

11) **Where company is a mere sham or cloak** - In ***Delhi Development Authority* v. *Skipper Construction Company (P.) Ltd.* [1996]**, the Supreme Court held that the fact that the director and members of his family had created several corporate bodies did not prevent the court from treating all of them as one entity belonging to and controlled by the director and his family if it was found that these corporate bodies were mere cloaks and that the device of incorporation was really a ploy adopted for committing illegalities and/or to defraud people.

1.7 DISTINCTION BETWEEN COMPANY AND PARTNERSHIP

You learnt that a company is an artificial person created by law, with limited liability and perpetual succession as its main features. Let us now study the difference between a company and another popular association of persons formed to run business in India, namely, Partnership.

The main points of difference between a company and a partnership are as follows:

1. **Mode of creation** - A company comes into existence only when it is registered under the Companies Act.

   A partnership, on the other hand, is created by mutual agreement between partners. Registration of partnership firm is not compulsory under the Partnership Act, 1932. An unregistered partnership, therefore, is not an illegal association.

2. **Membership**

   a) Minimum - The minimum number of members in a partnership is two whereas the minimum number of members in a private company is two and in case of public company, seven.

   b) Maximum - In partnership, the maximum number of partners is 50. The maximum number of members in private company is 200 (excluding employee and ex-employee members and joint shareholders counted as a single member) but in a public company there is no limit on the maximum number of members.

3. **Legal status** - A company has a separate legal personality of its own whereas a partnership is not a distinct person. A partnership, commonly called a firm, has no legal existence apart from its members. Firm is only a convenient way of addressing the partners collectively. A company being a juristic person is quite distinct from its members.

4. **Liability of members** - The liability of every shareholder of a limited liability company is limited up to the nominal value of shares held by him or up to the amount of guarantee given by him. The creditors of a company can proceed only against the company and not against any member or members. Even in case of unlimited liability company, the company being an entity distinct from the members, the creditors are not allowed to proceed against members individually or even jointly; they can only proceed against the company. But in partnership the liability of partners is unlimited and partners are severally and jointly liable for the debts of the firm. Creditors of the firm are the creditors of all the partners and they can proceed against the partners individually as well as collectively.

5. **Transfer of shares** - Shares in a public company are freely transferable. A private company does place restrictions on free transferability of shares without denying transferability. In partnership, no partner can transfer or sell his share in the firm without the consent of all the other partners.

6. **Perpetual succession** - A company enjoys perpetual succession. The existence of the company is not affected by the death, insolvency, insanity or separation of a member. But, it is not so in case of partnership. Unless otherwise agreed, death, insolvency, etc. of a partner dissolves the firm.

7. **Management** - The affairs of a company are managed by a Board of directors. Directors on the Board are elected, appointed or reappointed by shareholders in a general meeting. Members of a company have no role in managing the affairs of the company. Every partner, on the other hand, unless otherwise provided in the partnership deed/agreement, can participate in management of the firm.

8. **Agency relationship** - A shareholder is not an agent of the company and thus has no power to bind the company by his acts. In partnership, every partner is an agent of the firm and that of other partners. A partner is bound by all the acts of other partners done within the scope of his apparent or ostensible authority.

9. **Property** - In the case of a company, the property of the company is in the name of the company and is owned by it. It does not belong to the individual shareholders of the company. During the lifetime of the company, no shareholder has any legal or equitable interest in any property of the company. But, in the case of partnership, the partners are the joint owners of the property of the firm.

10. **Statutory requirements** - A company is required to comply with various statutory formalities, such as maintaining statutory books, getting the accounts audited by chartered accountants, whereas a partnership firm is not required to perform any such statutory obligations.

11. ***Powers*** - The powers of the company are contained in the object clause of the memorandum of association. A change can be effected by following the rigid procedure as laid down in the Act. In partnership, the partners can do

anything which they agree to do. Changes in partnership deed can be effected by mutual consent.

12. ***Dissolution*** - A company's existence will come to an end only according to the provisions laid down in the Companies Act, 2013. A partnership firm can be dissolved at any time by an agreement between the partners or in case of partnership at will, by the withdrawal of even one partner.

13. **Governing legislation** - A company is governed by the Companies Act, 2013, SEBI Regulations, Listing Requirements of Stock Exchanges. A partnership, on the other hand is governed by the Partnership Act, 1932.

1.8 DISTINCTION BETWEEN COMPANY AND LIMITED LIABILITY PARTNERSHIP

Limited Liability Partnership (LLP) Act, 2008, is a new piece of legislation. This Act enables formation of partnerships with liability of partners being kept limited like that of share holders as in case of companies. Thus, the public has been given a choice to form a partnership either under the partnership law, i.e, Partnership Act, 1932 or under Limited Liability Partnership Act, 2008. Although, in case of a Limited Liability Partnership, the liability of partners is limited but it differs from a company in many respects. The main points of distinction between a 'limited liability partnership' and 'limited liability company' are as follows:

1. **Regulating Act:** A Limited Liability Partnership is regulated by the Limited Liability Partnership Act, 2008, whereas a company is governed by the Companies Act, 2013.

   The name of a company must end with words 'Limited or Private Limited' whereas of Limited Liability Partnership with words 'LLP' or 'Limited liability partnership'.

2. **Minimum and Maximum Number of Members**: In case of Limited Liability Partnership, minimum numbers of partners required are 2 whereas in case of public company minimum number of members required are 7. There is no limit to maximum number of partners in case of Limited Liability Partnership but in case of a private company number of members cannot exceed 200.

3. ***Governance Structure***: A basic difference between a Limited Liability Partnership and a joint stock company lies in that the governance structure of a company is regulated by statute (i.e., Companies Act, 2013) through memorandum ad articles of association whereas for a Limited Liability Partnership it would be by contractual agreement between partners.

4. ***Management***: In the case of a Limited Liability Partnership, management rests with those partners (including designated partners) who are authorized by Limited Liability Partnership agreement. But in the case of a company the right to control and manage the business is vested in the Board of Directors elected by the shareholders. Thus, the management ownership divide inherent in a company is not there in a limited liability partnership.

5. ***Transfer of Interest***: In the case of a limited liability partnership, a partner's economic rights (i.e. right to a share of the profits and losses and to receive contribution at the time of winding up) shall be transferable (Section 42). However, such transfer shall not by itself cause the disassociation of the partner and a dissolution and winding-up of the Limited Liability Partnership.

Further, such transfer would not make the transferee a 'partner' of the Limited Liability Partnership entitled to participate in its management (Section 42). For becoming a partner of Limited Liability Partnership, unless otherwise provided in the Limited Liability Partnership agreement, consent of all the existing partners is required (Schedule I appended to Limited Liability Partnership Act). But in the case of a public company a shareholder can transfer his shares freely without restriction and the transferee succeeds to all the rights of membership.

6. ***Audit***: The audit of the accounts of a company is a legal necessity but it is not so in the case of a Limited Liability Partnership. If the capital contribution does not exceed Rs.25 lakhs or if the annual turnover does not exceed Rs. 40 lakhs [Rule 24(8) of the Limited Liability Partnership Rules, 2009] audit is not compulsory.

7. ***Meeting:*** Annual General meeting of shareholders of a company is compulsory by law but in Limited Liability Partnership, the annual meeting of partners is not mandatory.

Check Your Progress B

1) What is meant by corporate veil?

....

....

....

2) List any four circumstances when the corporate veil can be pierced.

....

....

....

....

3) Enumerate three main points of difference between a company and a partnership.

....

....

....

....

4) What are the main points of difference between a company and a limited liability partnership (LLP).

....

....

....

....

5) Fill in the blanks:

a) The effect of incorporation is that the company is regarded as a …………………………………… person.

b) If an officer of a company, while entering into contract on behalf of the company, fails to disclose his .... capacity, he becomes personally liable on such contract.

c) When two nations are at war, the corporate veil of the company can be lifted to ascertain the .... of the company.

d) The corporate veil can be lifted due to Court's intervention and under ....

e) The liability of each member of Limited Liability Partnership is ....

6) State, whether the following statements are true or false:

i) A company comes into existence when the company is registered.

ii) Registration of a company, though desirable, is not compulsory.

iii) After registration, a company ceases to be an association of persons and acquires a juristic status.

iv) For the recovery of his debts, a creditor of a company can proceed against private properties of a member.

v) In case of a company, except a private company, any member may freely transfer his shares to any person.

vi) A shareholder is not an agent of the company.

vii) A person can be a member and a creditor of a company at the same time.

1.9 KINDS OF COMPANIES

Companies can be classified according to various bases. These are:

1) On the basis of incorporation
2) On the basis of liability
3) On the basis of control

See figure 1.1 to have an overall view of the different types of companies:

1.9.1 On the Basis of Incorporation

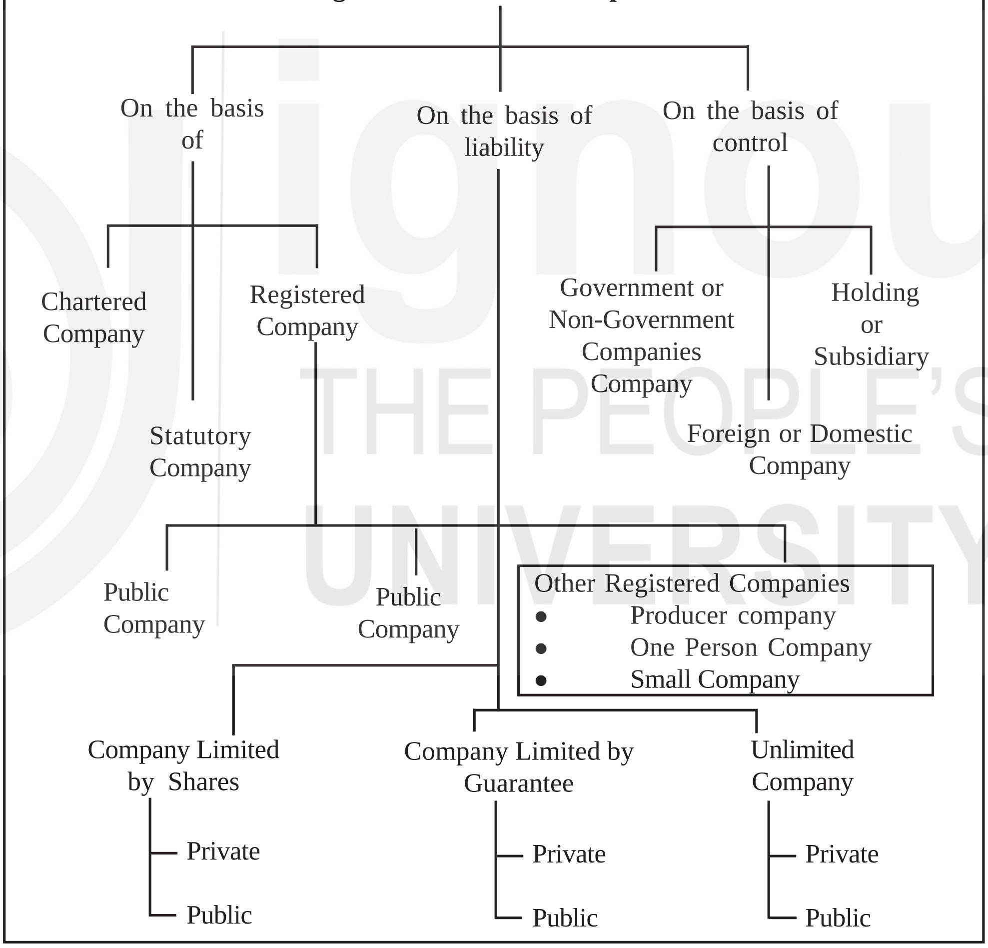
Depending upon the mode of incorporation, joint stock companies may be divided into the following three categories:

i) **Chartered Company:** A company incorporated under a special charter granted by the King or Queen of England is called 'chartered company'. A chartered company is regulated by its charter and the Companies Act does not apply to it. The charter also prescribes the nature of business and the powers of the company. The familiar examples of chartered companies are the East India Company and the Bank of England. *This type of company cannot now be formed in India*.

ii) **Statutory Company:** A statutory company is one which is created by a special Act of Parliament or a State Legislature. Such companies are usually formed for achieving a purpose related with public utilities. The nature and powers of such companies are laid down in the Special Act under which they are created. However, the provisions of the Companies Act are also applicable to them in so far as they are consistent with the provisions of the Special Act. A statutory company also has a separate legal entity and it is not required to use the word 'limited' after its name. The audit of such companies is conducted by the Controller and Auditor General of India (C&AG) and the annual report of working is required to be placed before the Parliament or State Legislature, as the case may be. Familiar examples of such companies are Reserve Bank of India, The Life Insurance Corporation of India, The Food Corporation of India, State Bank of India, etc.

iii) **Registered or Incorporated Company:** A registered company is one which is registered in accordance with the provisions of the Companies Act 2013 and also includes companies formed and registered under any of the previous Acts. A registered company comes into existence only when it receives the certificate of incorporation. Registered Companies are governed by the provisions of the Companies Act, 2013.

Figure 1.1 : Kinds of Companies



A registered company may either be a private company or a public company. A ***private company*** is one which by its articles of association (a) restricts the right of transfer of shares; (b) except in case of a one person company limits the number of its members to two hundred (not including members who are the present or past employees); (c) prohibits any invitation to the public to subscribe for any securities of the company [Section 2(68)].

On the other hand, a ***public company*** is one which is not a private company but subsidiary of a public company even where such subsidiary company continues to be a private company in its articles [Section 2 (71].

The minimum number of members required to form a private company is two, while for the public company the minimum number is seven.

1.9.2 On the Basis of Liability

On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee; or (iii) an unlimited company.

1) **Company Limited by Shares**: 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 is termed “a company limited by shares” [Section 2 (22)]. Such a company is commonly called Limited Liability Company although the liability of the company is never limited; it is the liability of its members which is limited. The liability of members can be enforced at any time during the existence and also during the winding-up of the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. However, there is no liability to pay any balance amount due on the shares, except in pursuance of calls duly made in accordance with law and the articles, while the company is a going concern or of calls made in the event of winding of the company.

2) **Company Limited by Guarantee**: A company limited by guarantee may be defined as a company having liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound-up [Section 2 (21)].

   Such a company may or may not have share capital. If a company limited by a guarantee is formed without any share capital, then the members would be liable to pay only the guaranteed amount and that too when the company goes into liquidation. But if the company limited by guarantee is formed with share capital, then the members are also liable to pay the unpaid amount on their shares. But the guaranteed amount can be called up only at the time of winding-up of the company.

3) **Unlimited Company**: A company having no limit on the liability of its members is an unlimited company [Section 2(92]. Thus, in the case of an unlimited liability company, the liability of each member extends to the whole amount of the company’s debts and liabilities. It may be seen that the liability of members of an unlimited company is similar to that of the partners but unlike the liability of partners, the members of the company cannot be directly proceeded against. Company being a separate legal entity, the claims can be enforced only against the company. Thus, creditors shall have to institute proceedings for winding-up of the company for their claims. But the official liquidator may call upon the members to discharge the debts and liabilities without limit.

An unlimited company may or may not have share capital.

Under Section 18, a company registered as an unlimited company may subsequently convert itself into a limited liability company. Any debt, liabilities, applications or contracts in regard to or entered into, by or on behalf of the unlimited liability company before such conversion shall not be affected by such conversion.

1.9.3 On the Basis of Control

Let us study the classification of companies on the basis of control, i.e., who effectively controls the affairs of the company. On this basis, the companies may be grouped as follows:

i) Holding and Subsidiary Companies

ii) Government Company

iii) Foreign Company

i) **Holding and Subsidiary Companies**

Generally speaking, if one company controls another company, the controlling company may be termed as the 'Holding company' and the company so controlled as a 'Subsidiary'.

According to Section 2 (*87*) "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[1] either at its own or together with one or more of its subsidiary companies:

A company (let's call it Company 'S') shall be deemed to be the subsidiary of another company (let's call it Company 'H') only in the following cases:

a) When the company (Company 'H') controls the composition of Board of directors of other company (Company 'S')

b) When the Company 'H' holds more than half of the total share capital of Company 'S'. Again, where Company 'H' together with Company 'S' holds more than half of the total share capital of company 'Z', then company 'Z' will be subsidiary of Company 'H'.

c) When Company 'S' is a subsidiary of a Company 'T' which itself is a subsidiary of Company 'H'.

Only in any of the above cases, would the Company 'S' be deemed a subsidiary of Company 'H'.

As you have just learnt from the above discussion, a holding company is usually a very major shareholder of its subsidiary but both continue to enjoy separate legal entities in the eyes of the law. Unless there is a specific contract between the two companies, one cannot be said to be the agent of another. A subsidiary company also cannot be said to be a part of the holding company.

ii) **Government Company**

Section 2 (45) of the Companies Act,2013 defines a Government company to mean any company (registered under the Companies Act) in which not less than 51% of the paid- up share capital is held by:-

i) the Central Government; or

ii) any State Government or Governments; or

iii) partly by the Central Government and partly by one or more State Governments.

A subsidiary of a Government company shall also be treated as a Government company.

Engineers India Ltd. (EIL), BHEL, and Hindustan Aeronautics Ltd. (HAL), are examples of Government companies. A statutory corporation formed under special

Act of Parliament of State Legislature, like Life Insurance Corporation of India, is not a 'company' under the Companies Act, and as such is not a Government company. These are corporations as distinguished from Government companies and are incorporated as well as governed by respective separate Acts.

A government company registered under this Act is not an agent of the government. It enjoys, like any other company registered under the Companies Act, an entity distinct from its members. Employees of such a company cannot be said to be the employees of the Government. Again, like any other company, it may be registered as a private company or a public company. Further, like any other company, it is governed by the provisions of the Companies Act 2013.

iii) **Foreign Company**

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.

However, *as per Section* 386(C), *having a share transfer office or share registration office will constitute a place of business.*

Section 380 requires the following documents to be filed with the Registrar of Companies within thirty days of the establishment of place of business in India by a Foreign Company:

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 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.

Where any alteration is made or occurs in the documents delivered to the Registrar under this section, the foreign company shall, within thirty days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form.

Again, as per Section 382, a foreign company is obliged to conspicuously exhibit on the outside of every office or place, where it carries on business in India as well as in every prospectus issued by it:

i) the name of the company,

ii) the country in which it is incorporated,

iii) the fact that liability of its members is limited.

The aforesaid should also be stated on all business letters, bill heads, letter paper, all notices and other official publications of the company in legible English and also in a language in general use in the locality in which the office or place is situated.

Section 381 requires that every foreign company, except a foreign company or such class of foreign companies which have been exempted by the Central Government, shall, in every calendar year:

a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having annexed or attached thereto such documents as may be prescribed; and

b) deliver a copy of those documents to the Registrar.

Provisions of Section 92 of the Act relating to the filing of the annual return with the Registrar of Companies are also applicable to a foreign company.

1.10 OTHER KINDS OF REGISTERED COMPANIES

Other kinds of registered companies include:

i) Producer Company

ii) One Person Company

iii) Small Company

1.10.1 Producer Company*

Based on the recommendations of Dr. Alagh Committee, the following is the summary of important provisions relating to Producer Companies:

1. **Meaning of Producer Company:** A producer company means a body corporate engaged in any activity connected with or related to any primary produce. 'Primary *produce'* means (*i*) produce of farmers, arising from agriculture (including animal husbandry, bee farming, etc.); *OR* (*ii)* from any other primary activity which promotes the interest of farmers or consumers; *OR* (*iii*) produce of persons engaged in handloom, handicraft and other cottage industries; *OR* (*iv*) by-products or ancillary of the aforesaid activities.

2. **Minimum and Maximum Number of Members:** Any ten or more producers** who are individuals or any two or more producer institutions*** or a combination of ten or more individuals and producer institutions may form and incorporate a company as a Producer Company. However, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company.

---

* It may be noted that vide Section 465 of the Companies Act, 2013, producer companies shall continue to be governed by the existing provisions of the Companies Act, 1956 until a special Act is enacted.

** **Producer**' means any person engaged in any activity connected with any primary produce. [Section 581A(k).

*** **Producer Institution** means a producer company or any other institution having only producer(s)/producer company(ies) as its members whether incorporated or not having any of the objects referred to in Section 581B and which agrees to make use of the services of the producer company(ies) as provided in its articles.

There is no ceiling on maximum membership.

3. **Share Capital:** The share capital of a producer company shall consist of equity shares only.

4. **Transferability and Transmission of Shares:** Shares of a member of a producer company shall not be transferable except to an active member with the previous approval of the Board. Shares, if allowed to be transferred, shall be at par value only.

   However, in the event of death of a member, shares will be registered in the name of his nominee who must be a producer.

5. **Liability of Members:** Liability of members of a Producer Company shall be limited to the amount, if any, unpaid on the shares held by them.

6. **Promoters' Remuneration:** The Producer Company may, with the approval of its members at its first general meeting, reimburse to its promoters all direct costs associated with the promotion and registration of the company including registration, legal fees, printing of a memorandum and articles.

7. **Status of a Private Company:** On registration, the Producer Company shall become a body corporate as if it is a private limited company without, however, any limit to the number of members thereof and without use of the word private as part of its name. As per Section 581F, name of a producer company shall end with the words 'Producer Company Limited'.

8. **Voting Rights of Members:**

   a) Where the membership consists (i) solely of individual members; or (ii) of individuals and producer institutions, the voting rights shall be based on a single vote for every Member, irrespective of his shareholding or patronage of the Producer Company.

   b) In a case the membership consists of Producer institutions only, the voting rights of such Producer institutions shall be determined on the basis of their participation in the business of the Producer Company in the previous year, as may be specified by Articles. However, during the first year of registration of a Producer Company, the voting rights shall be determined on the basis of the shareholding by such Producer institutions.

9. **Cessation of Membership:**

   Whereas, no person, who has any business interest which is in conflict with business of the Producer Company, shall become a member of that Company, a member, who acquires any business interest which is in conflict with the business of the Producer Company, shall, cease to be a member of that Company and be removed as a member in accordance with articles. Again, a person will cease to be a member, where he ceases to be a primary producer. He will, however, be paid par value of his shares or any other value that may be determined by the Board.

10. **Benefits to Members:**

   a) Members shall not receive full value of the produce pooled or supplied. 'Withheld price' shall be paid later in cash or equity shares, as per the decision of the Board.

   b) Every member shall receive a limited return on the capital contributed by the members.

c) Members may be allotted bonus shares.

d) Surplus, if any, after making (i) provision for limited return and reserves (as required under Section 581(ZI) (ii) providing for the development of the business of the Producer Company; (iii) providing for common facilities; may be distributed to members as bonus in proportion to their respective participation in business. This may be given in cash or by way of equity shares.

11. **General Meetings:**

i) **First AGM:** The first annual general meeting (AGM) of a producer company shall be held within 90 days of incorporation to discuss appointment of directors, and adoption of articles of association. *No extension of time is permissible.*

ii) **Subsequent AGMs:** Gap between two AGMs must not be more than 15 months. Registrar of Companies may extend this period for a maximum period of 3 months.

iii) **Time and Place of AGM:** Provisions in this regard are same as applicable to other companies. Thus, AGMs should be held at the registered office, on a day which is not a public holiday and during business hours.

iv) **EGM (Extraordinary general Meeting):** An EGM shall be called by the directors on a requisition duly signed by 1/3rd or more of the members who are entitled to vote thereat. *No requirement for quorum has been prescribed for EGM.*

v) **Notice:** Notice of every general meeting shall be sent to : (a) every member; and (b) the auditor.

vi) **Quorum:** Quorum for AGM shall be 1/4th of total number of members. Articles may however fix higher quorum.

1.10.2 One Person Company (OPC)

Section 2 (62) of the Companies Act, 2013 defines 'One Person Company' to mean a company with only one person as its member. Section 3 (1) (c) provides 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 by subscribing his name to a memorandum and complying with the requirements of the Act in respect of registration.

An One Person Company may be registered as 'limited by shares' or 'limited by guarantee'.

However, the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form (Form No. INC.3), who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Such other person may withdraw his consent in such manner as may be prescribed.

On the death of the promoter member of an OPC, the person nominated by such promoter member shall be the person recognised by the company as having title to all the shares of the member and shall be entitled to the same dividend and other rights and liabilities to which such sole promoter member of the company was entitled or liable.

The member of One Person Company may at any time change the name of such other person by giving notice and shall intimate the Registrar any such change within such time and in such manner as may be prescribed.

The words ''One Person Company'' shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

Relaxations available to One Person Company

Relaxations given to an OPC include:

1. There is no need to prepare a cash-flow statement [Section 2(40)].
2. The annual return can be signed by the Director and not necessarily a Company Secretary (Section 92).
3. There is no necessity for an Annual General Meeting (AGM) to be held (Section 96).
4. Specific provisions related to general meetings and extraordinary general meetings would not apply (Sections 100 to 111).
5. Compliance can be said to have been done if the resolutions are entered in the minutes' book of the company (Section 122).
6. It would suffice if one director signs the audited financial statements (Section 134).
7. Financial statements can be filed within six months from the close of the financial year as against 30 days (Section 137).
8. An OPC need to hold only one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days (Section 173).

Special Provisions applicable to One Person Companies

Where the OPC limited by shares or by guarantee enters into a contract with the sole member of the company who is also the director of the company, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract (Section 193). This will not apply to contracts entered into by Company in the ordinary course of its business.

As per the Rules framed by the Central Government:

1. Only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a One Person Company or be appointed as a nominee for the sole member of a One Person Company. The term "resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding financial year **(Rule No. 3.1**).
2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company (Rule No. 3.2).
3. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest (Rule No 3. 4).

4. Such Company cannot be incorporated or converted into a company under section 8 of the Act (Rule No 3.5) or carry out Non-Banking Financial Investment activities including investment in securities of any body corporate (Rule No 3.6).

5. Where the paid up share capital of a One Person Company exceeds 50 lakh rupees and its average annual turnover during the relevant period exceeds 2 crore rupees, it shall cease to be entitled to continue as a One Person Company. ***(Rule No 3.7)*. *It may convert itself into a private or public company within a period of 6 months from the date its paid up capital exceeds Rs. 50 lakh and turnover exceeds Rs. 2 crore (Rule No. 6).***

6. **Conversion of One Person Company into a private company or a public company:** *One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to 2 or minimum of 7 members and 3 directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion i.e. Conversion of companies already registered* ***(Rule No 6)***. **However, such a company cannot convert voluntarily into any kind of company unless two years is expired from the date of its incorporation *(Rule No. 3. 7)*.**

1.10.3 Small Company

The concept of Small Company has also been introduced for the first time in the Companies Act, 2013. According to Section 2 (85) of the Companies Act, 2013 as amended by the (Amendment) 2017 ''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 ten crore rupees; and

ii) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

However, the expression 'small company' shall not include:

a) a holding company or a subsidiary company;

b) non-profit association (i.e, companies registered under Section 8 of the Companies Act, 2013);

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

In such company there is no need to prepare cash flow statement, annual return can be signed by the Director or Secretary and to hold only one meeting in one half of calendar year and gap between two meetings should not be more than 90 days.

1.11 ASSOCIATIONS NOT FOR PROFIT (SECTION 8)

An "Association not for profit" (companies with charitable objects) is an association which is formed not for making profits but for the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object. Such an association may or may not be registered as a company under the Companies Act. When such an association is registered as a company with limited liability, it may be given a licence by the Central Government.

The Central Government may grant such a licence if it is proved to the satisfaction of the Central Government that a person* or an association of persons proposed to be registered under this Act as a limited company:

i) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

ii) intends to apply its profits, if any, or other income in promoting its objects; and

iii) intends to prohibit payment of any dividend to its members.

When the above conditions are fulfilled, the Central Government may, by licence, direct that the person or association may be registered as a company with limited liability without the addition to its name of the word "Limited" or the words "Private Limited".

Examples of such companies registered under Section 8 include Mohan Bagan Club, Gymkhana Club, Delhi District Cricket Association (D.D.C.A.) etc.

- **Alteration of Memorandum and Articles of Association**

  Such an association shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

- **Partnership Firm may become Member**

  It may be noted that a partnership firm may become a member of such a company. However, on dissolution of the firm, its membership will come to an end [Section 8(3)]. Moreover, one person company can not be formed or converted into a company under Section 8 [Rule 3 (5)] Companies (Incorporation) Rules, 2014.

- **Conversion of a company formed under Section 8 into any other kind**

  A company registered under section 8 which intends to convert itself into a company of any other kind may do so by passing a special resolution at a general meeting for approving such conversion and also complying with the prescribed procedure (Rule 21 of the Companies (Incorporation) Rules, 2014).

1.12 ILLEGAL ASSOCIATIONS

1.12.1 Meaning

Section 464 of the Companies Act, 2013 read along with Rule 10 of the Companies (Miscellaneous) Rules, 2014 provides that no association or partnership consisting of more than 50 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or

* You may note that under Section 8, the use of the word 'person' appears to allow even a single person to form a company for the objects specified.

partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. Thus, if such an association is formed and not registered under either the Companies Act or any other law, it will be regarded as an 'Illegal Association' although none of the objects for which it may have been formed is illegal.

1.12.2 Exceptions

a) **A Hindu undivided family (HUF) carrying on any business,** that is, a joint Hindu family may carry on any business, even for earning profits and with any number of members without being registered or formed in pursuance of any Indian Laws as required by Section 464 of the Act, and yet it will not be illegal association. But, where two joint Hindu families join hands to carry on business, the provisions of Section 464 become applicable. However, in such a case, in reckoning the number of members of such an association, the minor members shall be excluded. As regards adult members, both male and female members shall be taken into account.

b) **An association or partnership, if it is formed by professionals who are governed by special Acts.**

1.12.3 Consequences

Following are the effects of an association being illegal:

1. Every member of such an association or partnership carrying on business shall be punishable with fine which may extend to one lakh rupees.
2. Every member is personally liable for all liabilities incurred in the business.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to him because it cannot contract any debt.
6. It cannot be wound-up even under the provisions relating to winding-up of unregistered companies.
7. *Can a member sue for partition or dissolution or accounts of an illegal association?* The question was brought before the High Court of Allahabad in ***Mewa Ram* v. *Ram Gopal* (1926)**. It was held that where an association was illegal and the business had been carried for some years, none of its members could sue for partition because partition would involve realisation of the assets of the company and payment of its debts, the very things which would be done in a suit for dissolution of partnership or winding-up of a company.

   It should be noted that while an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognise its very existence.
8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members **(Kumar Swami Chettiar v. M.S.M. Chinnathambi Chettiar).**
9. The profits made by an illegal association are, however, liable to assessment to income-tax **(Gopalji Co. v. CITA).**

Check Your Progress C

1) What is a statutory company?

....

....

....

....

2) What is meant by a registered company?

....

....

....

....

....

3) What is meant by a company limited by guarantee?

....

....

....

....

4) What is a Government Company?

....

....

....

....

5) What do you mean by 'Illegal Association'?

....

....

....

....

6) Fill in the blanks:

a) An incorporated company can come into existence as a chartered company, as a statutory company and as .... company.

b) In a company limited by guarantee, a member is required to pay the guaranteed sum only if the company is ....

c) A government company is one in which not less than .... per cent of the paid up share capital is held by the Central Government.

d) An auditor for a government company is appointed by the ....

e) A foreign company which establishes a place of business in India after the commencement of the Companies Act, 2013, shall deliver to the Registrar of Companies, necessary documents for registration within …………………………………… days of establishing the place of business in India.

f) Under Section ……………… of the Act, any association created not for profit may be exempted by the Central Government and be registered with limited liability without using the word 'limited' as its last word.

7) State, whether the following statements are true or false:

   i) Once a company has been registered as an unlimited company, it cannot be converted into a limited company without dissolving the company.

   ii) A Government company is not governed by the provisions of the Companies Act, 2013.

   iii) In a Government company, company's paid up share capital can be held partly by the Central Government and partly by one or more State Governments.

   iv) A foreign company may carry on business in India even without establishing place of business in India.

   v) A foreign company is a company registered in India and carries on its business in a foreign company.

   vi) In case of a holding company and a subsidiary company both companies continue to enjoy separate legal status.

   vii) A private company which is a subsidiary of a public company is a public company.

   viii) A partnership firm can be a member of an association not for profit.

   ix) An illegal association has no independent personality.

8) State which of the following alternative is correct:

   a) A private company

   i) must have at least 7 members, ii) cannot have more than 50 members, iii) must prohibit any invitation to public to subscribe for its shares, iv) must file a statement in lieu of prospectus

   b) An illegal association is

   i) a partnership formed for illegal activities, ii) a partnership with more than 100 partners, iii) a partnership dissolved by a court of law, iv) a HUF with more than 100 members

1.13 LET US SUM UP

A Company implies an association of persons for some common object or objects. A 'company' under the Act is defined to mean a "company formed and registered under the Companies Act, 2013 or under any of the previous Company laws.

A company is characterised by the following features: (1) It is an incorporated association registered under the Act. (2) On registration, it becomes a body corporate and thus acquires an entity distinct from the members constituting it. (3)

Although, a company is recognised as a person enjoying the rights and obligations thereof, it is an artificial person and exists only in contemplation of law. (4) The liability of members of a limited liability company is limited to the extent of the amount unpaid on the shares held by him or the amount guaranteed by him. (5) A company being a distinct entity, the property of the company is also separate. Shareholders are not the part owners of the undertakings. A member does not even have an insurable interest in the property of the company. (6) The shares of a company are movable property, transferable in the manner provided by the articles of the company. (7) A company being an artificial person cannot be incapacitate by illness or otherwise. Members may come and go but the company can go on forever. (8) A company has to work through the agency of human beings. It may have a common seal.

A company is an entity distinct from the members but is an artificial person. The persons who are engaged to manage its affairs may commit certain illegal acts or frauds in its name. It may, therefore, become necessary to identify and hold these individuals personally liable for their deeds. In other words, the veil of corporate personality may be pierced or lifted. The circumstances under which the corporate veil can be lifted as follows:

a) Under Express Statutory Provisions

b) Under judiciary interpretation

Under express statutory provisions corporate veil is lifted in the following circumstances:

(1) Misrepresentations in prospectus; (2) Failure to return application money; (3 Mis-description of name; (4) For investigating the affairs of the company; (5) For investigation of ownership of company; (6) Where the business of the company is found to have been carried for fraudulent purpose; (7) For ultra vires acts; (8) For violations of the provisions of other statutes;

Under judiciary interpretations the corporate veil is lifted in the following cases:

(a) Where the medium of body corporate is used to evade taxes; (b) Where body corporate is used to commit fraud or improper conduct; (c) For determination of the enemy character of the company; (d) Where subsidiaries are formed to act as mere agents of the holding company; (e) Where a company acts as an agent for its shareholders; (f) Where company is used to avoid welfare legislation; (g) Where company is used for some illegal or improper purpose; (h) Punishment for contempt of Court ; (i) For determination of technical competence of the company; (j) Where company is a mere sham or cloak.

A ‘company’ should, however, be distinguished from a ‘body corporate’. The expression body corporate is a wider expression than company. Body corporate includes, besides a company, a company incorporated outside India, public financial institutions, nationalised banks and any other association of persons declared as a body corporate by the Central Government.

A company is a person in the eyes of law. It also has a domicile and nationality. The courts have held that company is not a citizen and therefore cannot be said to have the fundamental rights expressly conferred upon citizens, only. However, those fundamental rights which are available to all persons, whether citizens or not, like the right to own property are available to the company.

A ‘company’ differs from a ‘partnership’ on the following grounds viz., mode of creation, number of minimum and maximum member, legal status, liability of members, transfer of shares, agency of members, management, perpetual succession, powers, dissolution and legal obligations.

Companies may be classified into the following categories (i) Chartered companies; (ii) Statutory companies; and (iii) Registered Companies. A registered company may be either a company limited by shares or a company limited by guarantee or an unlimited company. Such company may, either be a private company or a public company. Foreign companies are those which are incorporated outside India, but have a place of business in India.

A company is deemed to be the holding company of another, if that other is its subsidiary. A company is deemed to be a subsidiary of another company only if:

i) the other company controls the composition of its board of directors;

ii) the other company holds more than half of the nominal value of its equity share capital; or

iii) it is subsidiary of any other company which, in turn, is the subsidiary of holding company.

Producer companies have been added to Companies Act 1956 by the Companies (Amendment) Act 2002. These are companies in which any ten or more producers who are individuals or any two or more producer institutions may form and incorporate a company as a Producer Company.

One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

‘‘Small Company’’ means a company, other than a public company (*i*) paid-up share capital of which does not exceed fifty lakh rupees; and (*ii*) turnover of which as per its last profit and loss account does not exceed two crore rupees

An association or partnership which is formed with more than fifty persons according to Section 464, Companies Act 2013 must be regarded as an illegal association. However, a joint Hindu family carrying on a business, a stock exchange and associations not for profit-making are not illegal associations. Every member of an illegal association shall be personally liable for all liabilities incurred in such business.

1.14 KEY WORDS

Company: An association of persons registered under the Companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

Chartered Company: A company which is incorporated under a special Royal Charter granted by the King or Queen of England.

Statutory Company: A company which is created by a special Act of Parliament or State Legislature.

Company limited by shares: A company having the liability of its members limited to the value of shares held by them.

Company limited by guarantee : A company having the liability of its members limited to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound-up.

Government Company: A company in which not less than 51 per cent of the paid up capital is held by the Government.

Private Company: A private company is one which by its articles of association (a) restricts the right of transfer of shares; (b) limits the number of its members to 200 (not including the present or past employee members); (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company and (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives. The minimum number of members required to form a private company is 2.

Public Company: A public company is one which is not a private company is a private company but subsidiary of a public company. The minimum number of members required to form a public company is seven.

Unlimited company: A company in which the liability of the members is unlimited.

Perpetual Succession: Continued existence irrespective of the life or sanity of its members.

Foreign Company: A company incorporated outside India but having a place of business in India.

Corporate Veil: A line of demarcation or a veil is drawn between the company and its members.

Producer Company: A company formed by any ten or more individuals, each of them being a producer or any two or more producer institutions or a combination of ten or more individuals and producer institutions.

One person Company: One-person Company is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

Small Company: ''Small Company'' means a company, other than a public company:

i) paid-up share capital of which does not exceed fifty lakh rupees; and

ii) turnover of which as per its last profit and loss account does not exceed two crore rupees.

1.15 ANSWERS TO CHECK YOUR PROGRESS

A 3) i) True; ii) True; iii) False; iv) False;

v) True; vi) True

B 5) a) separate legal

b) representative

c) enemy character

d) express statutory provisions

e) unlimited

6) i) True; ii) False; iii) False; iv) False;

v) True; vi) True; vii) True

C 6) a) registered

b) wound up

c) fifty one

d) Comptroller and Auditor General of India

e) Thirty

f) 8

7) i) False; ii) False; iii) True; iv) True; v) False; vi) True; vii) True; viii) True; ix) True

8) a) (iii); b) (ii)

1.16 TERMINAL QUESTIONS

1) Company is an artificial person by law with a perpetual succession and is different from the members constituting it. Comment.
2) Describe the main characteristics of a company.
3) Discuss the concept of corporate veil. Under what circumstances can this veil be lifted?
4) Distinguish between a company and a partnership.
5) Distinguish between ‘company’ and ‘body corporate’.
6) Write a note on government company
7) Briefly discuss different types of companies.
8) What is a foreign company? Describe special provisions relating to a foreign company.
9) Define a holding company and a subsidiary company. When can a company be called a subsidiary of another company? Explain.
10) What do you mean by an illegal association? What are the consequences of forming such an association?
11) Briefly discuss ‘One Person Company’ and ‘Small Company’.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 2 PUBLIC AND PRIVATE COMPANIES

Structure

2.0 Objectives

2.1 Introduction

2.2 Private Company

2.3 Public Company

2.4 Distinction between a Private Company and a Public Company

2.5 Privileges and Exemptions Available to a Private company

2.6 Conversion of a Private Company into a Public Company

2.7 Conversion of a Public Company into a Private Company

2.8 Let Us Sum Up

2.9 Key Words

2.10 Answers to Check Your Progress

2.11 Terminal Questions

2.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a private and a public company;
- distinguish between private and public companies;
- explain the privileges and exemptions available to private company; and
- describe how a private company is converted into a public company and vice-versa.

2.1 INTRODUCTION

You have learnt in Unit 1 that the Companies Act, 2013 provides for a variety of companies that may be promoted and registered under the Act. The two common types of companies which may be registered under the Act are:

a) **Private companies.**

b) **Public companies.**

These companies may be incorporated either as limited liability companies or as unlimited liability companies.

2.2 PRIVATE COMPANY

By virtue of section 2 (68) as amended by the Companies (Amendment) Act, 2015, a private company means a company having a minimum paid up share capital as may be prescribed and which by its articles of association:

a) restricts the right of members to transfer their shares;

b) Except in case of a one person company limits the number of its members to two hundred.

c) Prohibits any invitation to the public to subscribe for any securities of company.

a) **Restrictions on the Right of Members to Transfer their Shares**. The articles of association of a private company must specifically have a provision restricting the right of the members to transfer their shares, if any. It means that the shares of private company are not as freely transferable as those of the public companies. But it does not mean that the shares of a private company cannot be transferred at all. One of the restrictions generally contained is that whenever a member of a private company desires to transfer his shares, he must first offer them to the existing members at a price to be determined by the directors. This restriction is placed so as to preserve the private character of its shareholding. That is why, a private company is sometimes called a 'closed' corporation. The Act, however, does not specify the manner in which this restriction is to be imposed. You should note that a private company having no share capital need not contain this restriction in its articles.

b) **Restriction on Maximum number of Members :**Except in case of a one person company it limits the number of its members to two hundred. Where two or more persons hold one or more shares jointly, they shall for the purposes of this clause be treated as a single member.

Again, (*i*) persons who are in the employment of the company; and

(*ii*) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members;

c) **Prohibition on Invitation to Public:** This restriction implies that a private limited company must not issue a prospectus or any other public invitation, directly or indirectly to the general public so as to invite them to invest in its shares or debentures. The question arises as to how would one ascertain whether an invitation made by the company is in the nature of public invitation or not. The public may include any section of the public whether selected as members or the debenture holders of the company or as customers of the person issuing the prospectus, or in any other manner. The invitation cannot be treated as one made to the public when it can, under all circumstances, be properly regarded as a domestic or private concern of the persons making the invitation and those receiving it. However, an invitation to 200 or more persons will constitute an invitation to public. You will study this aspect in more details in the unit relating to Prospectus.

In view of the aforesaid definition, a private company must, in its articles, incorporate the said restrictions, limitations and prohibitions.

A private company may be (a) a company limited by shares or (b) a company limited by guarantee or (c) an unlimited company.

Number of Debenture holders may exceed 200

It may be noted that it is only the number of members that is limited to two hundred. Private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures cannot be made.

Other requirements relating to a private company

1. ***Minimum number of members*** - As per section 3, for forming a private company, two or more persons are required to subscribe their names to a Memorandum of Association.

   Any person who is competent to contract can be a subscriber. A company being a legal person can subscribe but a partnership firm cannot do so. Similarly, minor cannot be a signatory to the Memorandum since he is not competent to contract.

2. ***Use of words 'Private Limited'*** - Section 4 requires that the words 'Private Limited' or any acceptable abbreviation thereof, such as 'Pvt. Ltd.' must be added at the end of the name of a private limited company.

2.3 PUBLIC COMPANY

Section 2 (71) of the Companies Act, 2013 as amended by the Companies (Amendment) Act 2017 defines a *public company* to mean a company which:

a) is not a private company,

b) has a minimum paid-up share capital, as may be prescribed;

c) further, a company which is subsidiary of a company, not being a private company shall be deemed to a public company for the purpose of this Act even where such subsidiary company continues to be a private company in its articles.

Minimum number of members required to form a public company, as per Section 3, is seven.

A public company, like a private company, can also be (a) a company limited by shares or (b) a company limited by guarantee, or (c) an unlimited company.

2.4 DISTINCTION BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

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

1. ***Minimum Number of Members* [Section 3]:** 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. ***Maximum Number of Members*:** In case of private company the maximum number must not exceed two hundred whereas there is no such restriction on the maximum number of members in the case of a public company.

3. ***Transferability of Shares* [Sections 44]**: As per Section 44, the shares of any member in a company shall be movable property transferable in the manner provided by the articles of the company. In a private company, by its very definition, articles of a private company have to contain restrictions on transferability of shares.

4. ***Prospectus* [Section 2 (68)]:** A private company cannot issue a prospectus, while a public company may, through prospectus; invite the general public to subscribe for its securities.

5. ***Minimum number of Directors* [Section 149]**: A private company must

have at least two directors, whereas a public company must have at least three directors.

6. ***Retirement of Directors* [Section 152]**: Directors of a private company are not required to retire by rotation, but in case of a public company at least 2/3rds of the directors must be such whose period of office is subject to retirement by rotation.

7. ***Quorum for General Meetings* [Section 103]**: Unless the articles of the company provide for a larger number, ***in case of a public company***, the quorum shall be —

   i) five members personally present if the number of members as on the date of meeting is not more than one thousand;

   ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;

   iii) thirty members personally present if the number of members as on the date of the meeting exceeds five thousand;

   ***In the case of a private company*, unless Articles provide for a higher number**, two members personally present, shall be the quorum for a meeting of the company.

8. ***Managerial Remuneration* [Section 197]**: In a private company, there are no restrictions on managerial remuneration, but in the case of a public company total managerial remuneration cannot exceed 11 per cent of the net profits. The remuneration payable to each managing/whole time director or manager cannot exceed 5 per cent of the net profits unless approval of the Central Government has been taken. Likewise, there are restrictions on the remuneration payable to ordinary directors also.

9. ***Public Deposits*:** A public company is free to accept deposits from the public (subject, however, to the provisions of sections 76). A private company cannot accept deposits from the public.

Check Your Progress A

1) Define a private company.

....

....

....

....

2) What is a public company?

....

....

....

....

....

3) Give four important distinctions between a public and a private company.

....

....

....

....

4) Fill in the blanks:

   a) A private company must have at least ……………………… members and at the most ……………………… members.

   b) At least ……………………… directors of public company must retire by rotation.

   c) A private company cannot invite ………………….. from public.

5) State whether the following statements are true or false:

   i) The minimum number of members in a public company is seven.

   ii) A public company need not issue a prospectus before issue of its shares.

   iii) The memorandum of association of a private company needs to be signed by only two members.

   iv) A company is called a private company because it restricts the transfer of shares.

   v) A public company must have at least five directors.

2.5 PRIVILEGES AND EXEMPTIONS AVAILABLE TO PRIVATE LIMITED COMPANIES

A private company enjoys certain privileges and exemptions from certain provisions of the Companies Act. The basic reason for granting these privileges and exemptions is that the private companies by restricting their membership to not more than 200 and because of prohibition on public subscription to shares or debentures or deposits do not involve the public money. Hence less public accountability and as such it need not be subject to such rigorous surveillance as a public company is required to be. However, a private company shall lose these privileges and exemptions, where it fails to abide by the restrictive clauses of Section 2 (68), whether directly or indirectly.

The privileges and exemptions available to a private company include:

1. **Minimum number of members** - A minimum of two persons (as against seven persons in the case of public company) may form a private company [Section 3].

2. **Minimum number of Directors** - A private company need not have more than two directors as against minimum three in the case of a public company [Section 149].

3. **Quorum for general meetings** - Unless Articles provide for a higher number, quorum required for the general meeting of the shareholders in the case of a private company is 2 members personally present as against 5, 15 or 30 members personally present depending upon the number of members as on the date of meeting being up to 1000, 5000 or more than 5000; in case of a public company (Section 103).

4. **Managerial Remuneration** - A private company is exempted from the

provisions of section 197 which fixes the overall limit to the managerial remuneration at 11 per cent of net profits. Thus, a private company may remunerate its managerial personnel by such higher percentage of profits, or in any manner, as it may deem fit [Section 197].

5. **Rotational Retirement of Directors** - All directors of a private company can be non-rotational directors [Section 152].
6. **Filling casual vacancies** - The provisions relating to manner of filling of casual vacancies among directors and the duration of the period of office of those so appointed do not apply to a private company [Section 161].
7. **Special disqualifications for appointment as directors** - A private company may, by its articles of association, provide special disqualifications for appointment of directors in addition to those contained in section 164 (1 & 2) [Section 164 (3)].
8. **Restrictions on number of directorships** - No person can be a director in more than 10 public companies whereas he can become a director in maximum 20 private companies provided none of those companies is a public company or a holding or subsidiary of a public company [Section 165].
9. **Independent directors - A** private company is exempted from the requirement of appointment of independent director(s) [Section 149].
10. **Audit Committee** - A private company is not required to constitute audit committee of the Board [Section 177].
11. **Kinds of shares** - Under section 43, a private company may issue shares other than equity or preference shares, if so provided in its Memorandum or Articles of Association - Vide MCA Notification dated 5.6.2015.
12. **Rights Issue** - In case of rights issue under section 62, as against minimum period of 15 days, a private company may close its offer of rights issue before that. In other words, it need not keep its rights issue open for minimum period of 15 days - Vide MCA Notification dated 5.6.2015.
13. **ESOPs :** For issue of shares to its employees under Employee’s Stock Option Scheme, a private company may pass an ordinary resolution as against special resolution - Vide MCA Notification dated 5.6.2015.
14. **Loan for purchase of its own securities :** A private company may provide loans for purchase of its own shares provided the following conditions are satisfied:
    a) No other body corporate should have invested any money;
    b) Borrowing from banks, FIIs or bodies corporate should be less than double of its paid up capital or Rs. 50 crore, whichever is lower;
    c) The private company should not have defaulted in repayment of borrowings as may be existing on the date of the transaction.
15. **Exemption from filing Board resolutions :** A private company has been exempted from filing resolutions of the Board of directors with the Registrar of Companies.
16. **Participation of interested director in Board meeting :** Under section 184**,** an interested director of a private company can participate in the Board meeting after declaring his interest.

Check Your Progress B

1) State whether the following statements are true or false:

   i) A private company must have at least three directors.

   ii) The prospectus of a private company must be filed with the Registrar of Companies five weeks before the allotment of shares.

   iii) A private company can start business immediately after incorporation.

   iv) A private company is not required to observe any restrictions on the amount of managerial remuneration payable to its directors.

   v) A private company may allot shares without issuing a prospectus.

2.6 CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

As per Section 14, the following steps shall be necessary for conversion of a private company into a public company:

1. **Special Resolution:** A private company may convert itself into a public company by amending its Articles of association. Section 14 of the Companies Act, 2013, in this regard, provides that a private company can amend its Articles for the purpose by passing a special resolution. Thus, where a special resolution is passed thereby deleting the statutory requirements as laid down in Section 2 (68) of the Act which make a company a private company, a private company can become a public company. So, where Articles of a private company are amended to raise its membership beyond 200; or permitting free transferability of shares; or to extend invitation to public to subscribe to its shares or debentures or any other security, it becomes a public company with effect from the date of such alteration. As a consequence, the company shall cease to enjoy the privileges and exemptions conferred on a private company and the provisions of the Companies Act shall apply to it as if it were a public company.

2. **Increase in membership**: If the number of members is less than seven, it must be raised to not less than seven [Section 3].

3. **Increase in number of directors:** If the number of directors is less than three, it must be raised to not less than three [Section 149].

4. **Dropping word 'Private":** The word 'private' will be dropped from the name (Sec. 13).

5. **Filling of Altered Articles:** Every alteration of the articles under this section shall be filed with the Registrar in *Form No. INC. 27*, 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.

6. **Alteration to be noted in every copy:** Every alteration made in the articles of a company shall be noted in every copy of the articles [Section 15 (1)].

If default is made in complying with the aforesaid provision, the company, and every officer of the company who is in default, shall be punishable with fine, which may extend to one thousand rupees for every copy of the articles issued without such alteration [Section 15 (2)].

Where by passing resolutions a final decision had been taken by the company to convert itself into a public company with immediate effect; prescribed Form had been filed along with said resolutions, Supreme Court held that it was sufficient for the purpose of arriving at a *prima facie* conclusion that the company had altered its status and had become a public company even though the necessary alterations had not been effected in the records of the Registrar of Companies – ***Ram Purshotam Mittal* v. *Hillcrest Realty Sdn. Bhd.* [2009]** 94 SCL 120 (SC).

2.7 CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

For conversion of a public company into a private company, Section 14 of the Companies Act, 2013 provides as follows:

i) **Passing of a Special Resolution:** Special resolution at a general meeting of shareholders should be passed authorising the conversion of public company into a private company and altering the articles so as to contain the matters specified in Section 2 (68), namely the three restrictive clauses providing for limiting the total number of members to 200; restricting free transferability of shares and prohibiting invitation to public for subscription of its shares, debentures or any other security.

ii) **Changing the name of the company**: Company's name ought to be changed by, adding the word 'Private' before the word Limited. As per section 13, it does not require special resolution to be passed.

iii) **Obtaining the approval of the Central Government**: Second Proviso to section 14(1) as amended by the Companies (Second Amendment) Ordinance 2019, provides that no alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government which shall make such order as it may deem fit.

iv) **Filing with the Registrar:** Every alteration of the articles and a copy of the order of the Central Government approving the alteration as per sub-section (*1*) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of 15 days in the prescribed manner and the Registrar shall register the same. [(Section 14(2))].

Check Your Progress C

1) Choose the most appropriate answer to the following questions:

   a) In case of conversion of a private company into a public company, the company:

      i) can continue with two directors and less than seven members.

      ii) must increase the number of members to at least seven but can continue with two directors.

      iii) must increase the number of directors to three and members to at least seven

   b) In case of conversion of a public company into a private company, the company:

      i) must pass a special resolution in general body meeting

ii) must obtain approval of the Central Government

iii) must pass a special resolution in general body meeting as well as obtain approval of the Central Government.

2) State whether the following statements are True or False:

i) The special resolution altering the articles so that a private company is converted into a public company, can be passed only at a general meeting.

ii) A copy of the altered articles must be filed with the Registrar within one month of passing the resolution.

iii) As soon as a private company becomes a public company it will have to raise the number of its members to at least seven.

iv) Conversion of a private company to public and vice-versa, does not affect the legal identity of the company.

2.8 LET US SUM UP

The Companies Act 2013 provides for a variety of companies that may be promoted and registered under the Act. However, two basic types of companies which may be registered under the Act are 'private' and 'public' companies. However, Companies Act, 2013 has provided for formation of 'One Person Company' and 'Small Company'. Though these companies have certain distinctive features but are to be treated as private companies. Companies may further be incorporated as limited liability companies or as unlimited liability companies.

A private company is defined to mean a company by its articles: (i) restricts the right to transfer its shares, if any; (ii) prohibits invitations to the public to subscribe for any shares in, or debentures of or any other security of , the company; (iii) limits the total number of members to 200.

A public company is defined under section 2 (71) of the Companies Act, 2013 to mean a company which: (a) is not a private company; (b) has a minimum paid share capital as may be prescribed.

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

A private company enjoys certain privileges and exemptions from the provisions of the Companies Act, for instance, it can be formed with just 2 members; it can have only two directors; it can pay its managerial personnel any amount as remuneration.

A private company may be converted into a public company by passing a special resolution and meeting the minimum requirements of a public company like 7 members, 3 directors, etc. Similarly, a public company can also be converted into a private company by passing a special resolution and the approval of the Central Government.

2.9 KEY WORDS

Private Company: A private company is one which (a) restricts the right of transfer of shares; (b) limits the number of its members to two hundred (not including the present or past employees); (c) prohibits any invitation to the public to subscribe for any shares, debentures or any other security of the company.

Public Company: A public company is one which is not a private company and has a minimum paid share capital as may be prescribed.

Share: Unit in which the total capital of the company is divided.

Quorum: Minimum number of persons required to constitute a valid meeting.

2.10 ANSWERS TO CHECK YOUR PROGRESS

A 4) a) two, two hundred

b) two thirds

c) subscription for shares, debentures or any other security

5) i) True; ii) True; iii) True; iv) True; v) False

B 1) i) False; ii) False; iii) False; iv) True v) True

C 1) a) iii b) iii

2) i) True; ii) False; iii) True iv) True

2.11 TERMINAL QUESTIONS

1) Define a private company. Distinguish between a private company and a public company.
2) Enumerate privileges enjoyed by a private company.
3) Describe the procedure for converting a private company into a public company.
4) Define a public company. Describe the procedure for converting a public company into a private company.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 3 PROMOTER

Structure

3.0 Objectives

3.1 Introduction

3.2 Promoter: Meaning and Importance

3.3 Functions of a Promoter

3.4 Legal Position of Promoters

3.5 Duties of a Promoter

3.6 Liabilities of a Promoter

3.7 Remuneration of a Promoter

3.8 Position of Preliminary or Pre-incorporation Contracts

  3.8.1 Liability of Promoters vis-à-vis Pre-incorporation Contracts

3.9 Let Us Sum Up

3.10 Key Words

3.11 Answers to Check Your Progress

3.12 Terminal Questions

3.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and importance of promoter;
- describe the functions of a promoter;
- enumerate duties and liabilities of a promoter;
- describe remuneration payable to a promoter; and
- explain the position of preliminary or pre-incorporation contracts.

3.1 INTRODUCTION

In Unit 1 you learnt about the various types of companies that can be formed. The formation of a company is a lengthy process, involving different stages. The first stage in the process of formation of a company is the 'promotion'. At this stage the idea of carrying on a business is conceived by a person or by a group of persons called promoter(s). For incorporating a company various formalities are required to be carried out. The promoters perform these functions and bring the company into existence. In this Unit, you will learn about the meaning and functions of promoters, their legal position and their duties. You will also learn about the legal position of pre-incorporation contracts entered by promoter.

3.2 PROMOTER: MEANING AND IMPORTANCE

You learnt that a company is an artificial person created by law. A company is born only when it is duly incorporated. For incorporating a company various documents are to be prepared and other formalities are to be completed. All this work is done by promoters. Gerstenberg has defined promotion *as the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.* After the idea is conceived, the promoters make detailed investigation to find out the weakness and strong points of the idea, determine the amount of capital required and estimate the operating expenses and probable income. On being satisfied about the economic viability of the idea, the promoters take all the necessary steps for incorporating the company.

According to **L. J. Bowen**, *the term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence.*

Justice C. Cockburn described a promoter as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose".

Section 2 (69) of the Companies Act, 2013 defines the term promoter as a person:

a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

However, a person who is acting merely in a professional capacity shall not be treated as a promoter.

The following description of promoter brings out the nature of activities that a promoter is usually associated with.

These are:

1) He undertakes to form a company and see it going.

2) He undertakes a number of operations necessary to form a company.

3) He advices, directs and instructs the Board of Directors.

4) He has a control over the affairs of the Company, directly or indirectly.

A company may have more than one promoter. The promoter may be individual, firm, an association of persons or a body corporate. Even if a person has taken a very minor part in the promotion activities, he may still be a promoter. But a person cannot be held as promoter merely because he is a signatory to the memorandum or that he has provided money for the payment of formation expenses or has worked in a professional capacity, for example, in preparation of the documents to be filed for registration of the company or even securing certificate of incorporation of the company. Thus, a solicitor who drafts the articles, or the accountant who values assets of a business to be purchased are merely giving professional assistance to the promoter. However, where he goes further than this, *for example*, by introducing his clients to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter.

A person cannot, however, become a promoter merely because he signs the memorandum as a subscriber for one or more shares **[Official Liquidator v. Velu Mudaliar].**

From the above, it should be clear that *a promoter is one who performs the preliminary duties necessary to bring a company into existence*. Thus, the true test to describe a person as a promoter lies in finding out whether he is keen to form a company and takes steps to give it a concrete shape.

The promoters, in fact, render very useful services in the formation of a company. They render a very useful service to society and they play an important role in the industrial development of a country. A promoter has been described as a creator of wealth and an economic prophet. The promoters carry considerable risk because if the idea goes wrong then the time and money spent by them will be a waste.

3.3 FUNCTIONS OF A PROMOTER

You learnt that a promoter plays a very important role in the formation of a company. You have also noted that a promoter may be an individual, an association or a company. In their capacity as promoters, they perform the following functions in order to incorporate a company and to set it going:

i) **To originate the scheme for formation of the company**: Promoters are generally the first persons who conceive the idea of business. They carry out the necessary investigation to find out whether the formation of a company is possible and profitable. Thereafter, they organize the resources to convert the idea into a reality by forming a company. In this sense, the promoters are the originators of the plan for the formation of a company.

ii) **To secure the co-operation of the required number of persons willing to associate themselves with the project**: The promoters, in accordance with whether they want to incorporate a private or public company, try to secure the co-operation of persons needed to form the company. Minimum number of members required to form a public company is seven and that for a private company the minimum number is two. Depending upon the form chosen, the promoters may decide upon the number of primary members.

iii) **To seek and obtain the consent of the persons willing to act as first directors of the company**: In Unit 1, you learnt that the company has a system of representative management and is managed by individuals appointed as directors. The first directors of the company are, however, are either the promoters themselves or are appointed by them. The promoters seek the consent of some individuals whom they consider appropriate so that they agree to be the first directors of the proposed company. Many a time, promoters themselves become the first directors of the company.

iv) **To settle about the name of the company**: The promoters have to seek the permission of the Registrar of Companies for selecting the name of the company. The promoters usually give three to four names in order of preference. The promoters should ensure that the names selected are not identical with or too closely resemble the name of another existing company. They should also ensure that the suggested names also conform to the draft rules and other guidelines issued by the Ministry of Corporate Affairs in this regard. We shall discuss the provisions with respect to the name of the company in detail in Unit 6.

v) **To get the documents of the proposed company prepared**: You will study that certain documents like the Memorandum of Association and the Article of association are required to be filed with the Registrar of Companies before the company is registered and brought into existence. As the company itself does not exist before incorporation, this work of preparation of these documents has to be undertaken by the promoters. The promoters, on the advice of legal experts get the Memorandum and Articles of Association prepared and arrange for their printing. In case the proposed company is a public limited company, intending to issue shares to the public after incorporation, the promoters must also arrange to get the prospectus prepared and printed.

vi) **To appoint bankers, brokers and legal advisers for the company**: The incorporation of a company involves a lot of legal formalities. The promoters may need to consult the legal experts on several of these matters. They, therefore, appoint solicitors to assist them in the process of formation of the company. The company is formed for the purpose of carrying on business and as such deals with funds and their management. The promoters must, therefore, also appoint bankers for the company who will receive share application moneys. If the proposed company is a public limited company and proposes to raise funds from the public, the promoters must also ensure the success of the first capital issue made by the company by appointing underwriters and brokers.

vii) **To settle preliminary agreements for acquisition of assets**: The promoters may be required to acquire a suitable site for the factory, make arrangements for plant and machinery and may even make tentative arrangements for key personnel. Sometimes, in order to run the business, the company may be required to take over property of a running business. Promoters fulfill the function of seeing that such property and business is acquired by the proposed company on justifiable terms.

viii) **To enter into preliminary contracts with the vendors**: In respect of the properties and assets mentioned above, the promoters would need to settle the terms of contracts with the third parties from whom these properties are to be bought. These contracts are called preliminary contracts.

ix) **To arrange for filing of the necessary documents with the Registrar**: The promoters are required to pay the stamp duty, filing fee and other charges for registration of the company. The promoters are to see that the various legal formalities for incorporating the company are duly complied with.

3.4 LEGAL POSITION OF PROMOTERS

You learnt that promoters are responsible for the formation of a company. The promoters occupy an important position and have wide powers relating to the formation of a company. It is, however, interesting to note that so far as the legal position is concerned, *a promoter is neither an agent nor a trustee of the proposed company*. He is not the agent because there is no company yet in existence and he is not a trustee because there is no trust in existence. But it does not mean that the promoter does not have any legal relationship with the proposed company. *The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed.* Lord Cairns has correctly stated the position of promoter in **Erlanger v. New Sombrero Phosphate Co. as follows:**

"the promoters of a company stand undoubtedly 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 a trading corporation".

Similarly, it was observed in **Lagunas Nitrate Co. v. Lagunas Syndicate (1899)**, that : "The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become share-holders in it." Lord Justice Lindley in **Lidney & Wigpool Iron Ore Company v. Bird [1866]** 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 perfectly well settled that a promoter of a company is accountable to it for all monies 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."

You would recall from what you have studied in the contract of agency and partnership that a fiduciary relationship means a relationship of utmost trust and confidence and implies disclosure of all material facts. Being in a fiduciary position, the promoter must not make, either directly or indirectly, any profits at the expense of the company that he promotes, without the knowledge and consent of the company.

Check Your Progress A

1) Who is a promoter?

....

....

....

....

2) List the four most important functions of a promoter.

....

....

....

3) What is meant by 'fiduciary relation'?

....

....

....

4) State in three lines the legal position of promoters.

....

....

....

5) State, whether the following statements are true or false:

   i) A promoter can be an individual, a group of persons or a company.

   ii) Promotion is the first step for the formation of the company.

   iii) All the persons associated with the formation of the company are promoters of the company.

   iv) The promoter is a person who brings the company into existence.

   v) A promoter cannot be allowed to make any secret profits.

   vi) A promoter stands in a fiduciary relationship towards the company he promotes.

   vii) The promoters in fact act as agent of the company which is being promoted.

3.5 DUTIES OF A PROMOTER

In the above Section, you have just learnt that the promoter occupies a position of total confidence and trust in relation to the company promoted by him. The promoter in this fiduciary capacity has the following important duties:

1) **Not to make any secret profit:** A promoter cannot make any direct or indirect profits out of the promotion of the company. Since, he occupies a position of trust, it is his duty to be honest and uphold the trust of his position.

   In this connection, you must clearly understand that the law does not forbid the promoter from making a profit. The law prohibits only the making of secret profits i.e. the profits which the promoter has not disclosed to the company.

   What may constitute secret profit was best illustrated in the case of **Gluckstein v. Barnes (1900),** In *this case,* a syndicate of persons was formed to buy a property called 'Olympia' and re-sell this 'Olympia' to a company to be formed for the purpose. The syndicate first bought the debentures of the old Olympia Company at a discount. Then they bought the company itself for £ 1,40,000. Out of this money provided by themselves, the debentures were repaid in full and a profit of £ 20,000 made thereon.

   They promoted a new company and sold Olympia to it for £ 1,80,000. The profit of £ 40,000 was revealed in the prospectus but not the profit of £ 20,000.

   Held, profit of £ 20,000 was a secret profit and the promoters of the company would be bound to pay it to the company because the disclosure of the profit by themselves in the capacity of directors of the purchasing company was not sufficient.

   Disclosure to be made to whom?: You have learnt that a promoter is allowed to make a profit out of promotion but with the consent of the company. But, the company being an artificial person, the problem is to discover as to who may consent on behalf of the company.

In **Lagunas Nitrate Co. *v.* Lagunas Syndicate Ltd. [1899]** it was held that the initial shareholders' consent may either be obtained individually or by way of an ordinary resolution to that effect. If the company issues a prospectus, disclosure to shareholders may be made in it, and each shareholder's subscription for shares on the basis of the prospectus would then be deemed to indicate his consent to the retention of profit disclosed by the promoter.

Thus, the promoters have to ensure that the real truth is disclosed to those who are induced by the promoters to join the company.

When a promoter makes a secret profit, the company has the following remedies against him:

a) *Rescission of the contract* – The company may on learning of the secret profit, rescind the contract entered into by the promoter to make the said profit.

b) *Order for refund* – The company may require the promoter to refund the amount of secret profit.

c) *Suit for breach of duty* – The company may sue the promoter for misfeasance, as the promoter, by making the secret profit, has defaulted in his duty towards the company.

2) **To make full disclosure to the company of all relevant facts:** In keeping with his fiduciary capacity, a promoter is bound to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with the company. You should bear in mind that while making a disclosure the promoter must make the full and complete disclosure. If he contracts to sell his own property to the company without making a full disclosure, the company may either repudiate the contract or affirm the contract and recover the profits made by the promoter. Let us explain these fiduciary duties of the promoter with the help of an example.

   'A' was the owner of some arid land. He and some of his friends, decided to form a company to manufacture microchips. They appointed the first directors of the company and 'A' sold his own land to the company at a price higher than the actual valuation of the land. When the company was formed, the purchase agreement of land was approved at the meeting of the shareholders but the fact of A's ownership and the profit made by him were not disclosed at the meeting. Subsequently, when the company went into liquidation, the liquidator filed a suit against 'A' to recover the profits made by him in the sale of land. You would observe that in this case 'A' had defaulted in his duty to make full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure by the promoters of the profit they were making, the company is entitled to rescind the contact. 'A' could have retained the profits made by him if he had made a full disclosure to the directors of the company, all the relevant facts of the transaction including his personal interest and the profit made

3) **To give the benefit of negotiations to the company:** The promoter must pass on to the company, the benefit of any negotiation or agreement that he carried in his capacity of a promoter. *For example*, when he has

negotiated a certain price for some land for the company, he must sell the property to the company at the negotiated price. If he charges a price higher than the negotiated price, the company may rescind the contract on discovering the truth of the matter. If, due to some reason, the contract could not be rescinded, the company is entitled to claim damages from the promoters and the amount of damages shall be equal to the amount of profits made by promoters. However, it should be remembered that secret profits on the sale of property can be recovered from the promoter only when the property was bought and sold to the company while he was acting as a promoter. The promoter must act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.

4) **Duty of promoter towards future allottees:** The promoters stand in a fiduciary position towards the company. It does not mean that they stand in such relation only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at his instance contains all material facts and particulars and does not contain any misstatements.

Termination of promoters' duties: A promoter's duties do not come to an end on the incorporation of the company, or even when a Board of directors is appointed. They continue until the company has acquired the property or business which it was formed to manage and has raised its initial share capital - **[Lagunas Nitrate Co. v. Lagunas Syndicate Ltd. (supra)]**, and the Board of directors has taken over the management of the company's affairs from the promoters - **[Twycross v. Grant (1877)]**.

3.6 LIABILITIES OF A PROMOTER

You have just gone through the duties of a promoter in his fiduciary capacity and learnt that in the event of any breach, the promoter can be made liable to hand over to the company, any secret profit made by him. The company can also file a suit for rescission of the contract of sale made by the promoter, if the promoter has not made a disclosure of his interest to the company.

The liability of the promoter, under the Companies Act, is discussed below:

i) Section 26 enumerates the *matters that should be stated and the reports that should be set out in the prospectus.* If this provision is not complied with, the promoters may be held liable under Section 35 to compensate the shareholders.

ii) Section 35 provides for *civil liabilities for any misstatements made in the prospectus.* Under this section a promoter can be held liable for any false statements in the prospectus, by a person who has subscribed for the shares and debentures of the company acting on the faith of the prospectus. The promoter may be held liable to pay compensation to every person who subscribes for shares or debentures for any loss or damage sustained by him on account of the untrue statements made in the prospectus. However, Section 35 enumerates certain grounds on which the promoter can avoid his liability. These remedies are common to all persons who can be held liable for misstatement in the prospectus. You will study more about these remedies in Unit 8 of this course.

iii) Section 34 contains provisions relating to *criminal liabilities for issuing a prospectus which contains untrue statements.* It is clearly provided that in addition to the civil liability mentioned in the above two cases, the promoters can be held criminally liable if the prospectus issued by them contained misstatements. The criminal liability for the purpose is contained in Section 447 of the Companies Act, 2013 which provides for imprisonment for a term which shall not be less than six months but which may extend to ten years. Besides, the promoter shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Further, the Section provides that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

The promoter may have to bear this criminal liability for misstatements unless he can prove that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

iv) Section 300 states *the power of the Tribunal to order examination of all the promoters held guilty of fraud in promotion, formation, business or conduct of affair of a company. The Section provides that i*f in the event of winding-up of the company, the Company Liquidator's report alleges a fraud in the promotion or formation of the company, the Tribunal may order the examination of the promoter(s).

v) Section 340 of the Act provides for the *liability for misfeasance or breach of trust for misapplication of funds* during the formation of the company. Like any other director or officer of the company, a promoter can also be held liable if he had misapplied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

vi) The promoters are *personally liable for pre-incorporation contracts*. Even the death of the promoter does not relieve him from this liability. You shall learn about pre-incorporation contracts in Section 3.8 of this Unit.

Check Your Progress B

1) List the duties of promoters.

....

....

....

2) Fill in the blanks:

a) A promoter plays a very important role in the ……………………… of a company.

b) Besides an individual even an ……………………… may be a promoter.

c) Promoter ……………………… the idea of setting up a business and then organise ……………………… to convert this idea.

d) ……………………… directors of the company are generally appointed by the promoters.

e) The promoters enter into ……………………… for acquisition of assets for the company.

f) A promoter can be made liable to hand over to the company any ……………………… made by him.

g) A promoter stands in a ……………………… relationship towards the company.

3.7 REMUNERATION OF PROMOTERS

You have noted through the above paragraphs that the promoter occupies a unique position in relation to the company. Before the company is brought into existence he has to complete all the formalities, spend considerable skill and effort and organise necessary resources so that the company can be formed. He has to incur preliminary expenses as well. For all these important activities and his considerable effort he should be suitably remunerated. But, he cannot claim as a matter of right any remuneration from the company. He, therefore, is not entitled to recover any remuneration for his services unless the company after getting formed enters into a specific contract with the promoter for this purpose. You must note that even if the promoter has entered into a contract with the prospective directors before the incorporation, he has no valid claim against the company for remuneration. This is so because the directors cannot enter into any contract on behalf of a company that is not yet in existence. **There are also cases where** the articles of a company **may** specifically provide that a specified sum may be paid to the promoters as remuneration for their services. **While this provision gives the director an authority to make such payment,** it does not give the promoters a right to claim remuneration or to sue the company, for the same. In actual practice, therefore, the company, once it is registered, usually agrees to pay some remuneration for the valuable service rendered by the promoters. This remuneration may be paid to the promoters in any of the following ways:

i) He may sell his own property to the company for cash or against fully paid shares in the company at an overvaluation after making full disclosure to an independent Board of directors or to the intended shareholders.

ii) He may take commission on the shares sold.

iii) He may be paid a lump sum by the company.

iv) He may be allotted fully paid-up shares of the company either for free or at a heavy discount.

Whatever be the nature of remuneration or benefit, it must be disclosed in the prospectus.

3.8 POSITION OF PRELIMINARY OR PRE-INCORPORATION CONTRACTS

In order to fulfill the necessary formalities and organise the required resources for the formation of the company, the promoters of a company enter into contracts for a company which is yet to be incorporated. These contacts are generally entered into by the promoters in order to acquire some property or some rights of the company that they are interested in promoting. *All such contracts entered into by the promoters with the third parties for the proposed company (before incorporation) are called 'preliminary contacts'.*

You must note that such preliminary or pre-incorporation contacts are not legally binding on the company even after its incorporation. The reason for this is that before incorporation the company cannot enter into contracts as it has no legal entity. Not only this, the company cannot ratify such contracts after incorporation because, for valid ratification, the principal must have been in existence at the time when the promoters entered into such contracts. A company can neither sue nor be sued on such contracts since a company before incorporation is a non-entity. The position of these contracts can be explained as follows:

i) **On registration, the company is not bound by the preliminary contracts –** A company is not bound by the preliminary contracts even if the company has taken the benefit of the work on its behalf under the contract. For example, a solicitor was appointed by the promoters of the company and was instructed by them to prepare the articles and the memorandum of the company. The solicitor also paid the necessary registration fee of the company These promoters later became the directors of the company. The solicitor sued for his expenses and the fees paid by him. It was held that since the company was not in existence when these expenses were incurred, the company is not bound to pay.

ii) **The company cannot enforce preliminary contracts –** You must note that just as the company cannot be held liable for the preliminary contracts, it also cannot enforce such contracts made before incorporation, by the promoters. This means that on account of a preliminary contract the company does not get a right to sue the third party for fulfillment of the contract. For example, 'X' the owner of a piece of land in Assam agreed to lease it to a company to be formed by promoters A, B and C. The promoters later on formed a company called M. Pvt. Ltd. On some prospecting of the land, it was discovered that there was a definite possibility of striking oil in that land. Subsequently 'X' refused to grant the lease to the company M. Pvt. Ltd. It was held that the company cannot sue 'X' and cannot claim specific performance as it was not even in existence when the lease was signed.

iii) **The company cannot ratify the preliminary contracts –** After incorporation the Company cannot ratify the contracts formed before its existence. You will recall from your study of the Unit on agency that for valid ratification of a contract, it is essential that the principal must exist of the date when the contract is originally entered into. And as the company does not exist on the date of contract, it cannot ratify a preliminary contract on being incorporated. In the case of **Kelner v. Baxter,** it was held as the company was not in existence when the preliminary contracts were made, it could not be bound by any purported ratification. What the company can do is to enter into a new contract with the vendors after incorporation to give effect to the terms of the contract made before incorporation.

In relation to the above principles, important provisions have been made in out country in the Specific Relief Act, 1963. These provisions provide an important exception to the above principles. According to Section 15 and 19 of the Specific Relief Act "where the promoter of the company have before its incorporation, entered into contract for the purpose of the company and such contracts are warranted by terms of incorporation, specific performance may be obtained by or against the company, if the company has accepted the contract after the incorporation and has communicated such acceptance to the other party.

In the above paragraph the term "contracts for the purposes of the company" means contracts which are necessary for the incorporation and working of the company. **For example,** contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the production work in the company are contracts for the purposes of the company. It should be clear to you now that in order to be enforceable, it is necessary that the company after its incorporation accepts the contract and communicates its acceptance to the other contracting company.

3.8.1 Liability of Promoters vis-à-vis Pre-incorporation Contracts

The promoters are personally liable for contracts made for a company which is not yet in existence. You have already learnt that the company is neither bound nor entitled on account of a preliminary contract. Therefore, it is the promoters alone who remain personally liable for the preliminary contracts. The reason for this is that the preliminary contract is made for a company which, as known to both the contracting parties, is as yet non-existent. The contract, therefore, is deemed to be personally entered into by the promoters and they will be held personally liable for the performance of these contracts.

The preliminary contracts made by the promoters generally contain a provision that if the company adopts the agreements on incorporation, the liability of the promoters shall come to an end and if the company does not adopt the preliminary contract within a specified period either party may rescind the contract. In such a case liability of the promoter will cease on the expiry of the specified period.

In **Phonogram Limited v. Lane** [1982], it was observed that although a contract made before a company's incorporation cannot bind the company, it is not wholly devoid of legal effect, even if all the persons who negotiated the contract are aware that the company has not yet been incorporated. In the referred case, a person attempting to incorporate a Pop Group had obtained financial assistance from a recording company. He was held personally liable to refund the amount on his project failing to materialise.

The contract takes effect as a personal contract with the persons who purport to contract on the company's behalf - **Kelner v. Baxter (supra).** Promoters shall be liable to pay damages for failure to perform the promises made in the company's name. **This shall be so, even where the contract expressly provides that only the company's paid up capital shall be answerable for performance - *Scot* v. *Lord Ebury* [1867].**

Check Your Progress C

1) List the ways in which the promoter can be remunerated.

....

....

....

....

2) What is a pre-incorporation contract?

....

....

....

....

3) State, whether the following statements are true or false:

   i) A promoter is entitled to be suitably remunerated for the services rendered during formation of the company.

   ii) In the absence of a contract with the company, the promoter cannot recover the payments he has made in connection with the formation of the company.

   iii) If the promoter has made the necessary disclosures, he can sell his own property to the company at a higher price.

   iv) The liability of the promoter for the preliminary contracts ceases as soon as the company is formed.

   v) Upon registration the company is not bound by the preliminary contracts.

   vi) If all the members of the company agree, the company can ratify the preliminary contracts.

   vii) A preliminary contract cannot be enforced by the company against the third parties.

   viii) Promoters are personally liable for preliminary contracts.

3.9 LET US SUM UP

Promotion denotes preliminary steps taken for the purpose of registration and floatation of the company. The persons who undertake these steps are called promoters. However, the persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves. The status of a promoter is generally terminated when the Board of directors has been formed and they start governing the company.

The Act contains no provisions regarding the duties of promoters, it merely imposes liability on promoters for untrue statements in prospectus, they are parties to, and for fraudulent trading. The Courts have, however, charged them with two fiduciary duties, namely, (i) not to make any secret profit out of promotion; and (ii) to disclose to the company any interest which he has in a transaction entered into by it.

A promoter is not entitled to any remuneration for his services from the company unless there is a valid contract, enabling him to do so, between him and the company. Alternatively, Articles may authorise the directors to pay them.

A pre-incorporation contract is void *ab initio* unless the company adopts the same procedure after incorporation and the contract is warranted by the terms of incorporation.

3.10 KEY WORDS

Promoter: The person who performs various functions in relation to the formation of a company.

Fiduciary relation: The relationship based on mutual trust and confidence.

Preliminary contracts: The contracts made before the incorporation of the company.

Ratification: To approve of an act already done.

Secret Profits: Profits made without making a full disclosure of all relevant facts.

Prospectus: A document issued by the company inviting public to subscribe for its shares, debentures or deposits.

3.11 ANSWERS TO CHECK YOUR PROGRESS

A 5) i) True ii) True iii) False iv) True
v) True vi) True vii) True

B 2) a) formation
b) association or a company
c) conceives, resources
d) first
e) preliminary contracts
f) secret profits
g) fiduciary

C 3) i) False ii) True iii) True iv) False
v) True vi) False vii) True viii) True

3.12 TERMINAL QUESTIONS

1) Define the term ‘promoter’ and explain the functions performed by him.
2) Discuss the legal position of a promoter.
3) “Promoter is not a trustee or an agent of the company but he stands in fiduciary position towards it.” Comment.
4) What are the duties of a promoter towards a company promoted by him?
5) Discuss the liabilities of a promoter.
6) Is a promoter entitled to remuneration for the services rendered by him during the formation of the company? Explain.
7) What do you understand by preliminary contracts? Discuss (a) the position of the company in relation to the preliminary contracts, and (b) the liability of the promoter for preliminary contracts.
8) Why pre-incorporation contracts are not binding on the company?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 4 FORMATION OF A COMPANY

Structure

4.0 Objectives

4.1 Introduction

4.2 Stages in the Formation of a Company

4.3 Promotion

4.4 Documents to be Filed with the Registrar

4.4.1 E-Filing of Documents

4.5 Incorporation

4.5.1 Conclusiveness of Certificate of Incorporation

4.5.2 Effects of Registration

4.6 Commencement of Business

4.7 Let Us Sum Up

4.8 Key Words

4.9 Answers to Check Your Progress

4.10 Terminal Questions

4.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the stages in the formation of a company;
- enumerate the documents to the filed with the Registrar of Companies;
- explain the effects of registration;
- describe the procedure for obtaining the certificate of commencement of business; and
- discuss the commencement of business.

4.1 INTRODUCTION

In Unit 1 you learnt that a company is an artificial person created by law and has a distinct separate legal entity of its own. You have also learnt in Unit 3 that before a company is actually formed, certain persons known as 'promoters', make a detailed investigation and, after satisfying themselves about the viability of the business, take certain steps to form the company. In this unit, you will learn about the various stages involved in the formation of a company and the documents which are required to be filed with the Registrar of Companies and E-filing of documents. You will also learn about the commencement of business.

4.2 STAGES IN THE FORMATION OF A COMPANY

The formation of a company is a lengthy process. It involves the following three stages:

1) Promotion
2) Registration or incorporation, and
3) Commencement of business

Each of the above stages comprises specific activities to be undertaken.

4.3 PROMOTION

You have already learnt in Unit 3 about the activities carried out by promoters to bring a company into existence. After discovery of the business idea and judging its soundness, the promoters organise the necessary resources for giving shape to their business idea. They negotiate for, and obtain the required property, the necessary plant and machinery and arrange for the capital necessary for the company. The promoters will also talk to persons who are willing to take the responsibility of becoming the first directors of the company.

It should be noted that a company can be formed only for a lawful purpose. The purpose of the company may be unlawful if it is (a) against any provisions of the company law, or (b) against the provisions of any other law, applicable in India.

You would recall from Unit 2 that promoters may form the company with limited liability or with unlimited liability. In case of a company with limited liability, the liability of members may be limited either by shares or by guarantee.

The promoters then obtain the approval of the proposed name from the Registrar of Companies. Application can now be made online also. Normally, the promoters are supposed to have about 3 to 4 proposed names, so that there is a possibility that at least one of these will be approved.

Section 4 (2) of the Companies Act, 2013 provides that no company shall be registered by a name which is:

a) 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.

You will study in detail about this aspect in Unit 6 dealing with Memorandum of Association.

Before an application for registration is filed with the Registrar of Companies, the promoters shall take the necessary steps for preparing the important documents such as 'memorandum of association' and 'articles of association'. For this, the promoters may seek the help of a legal expert, a solicitor, chartered accountant, cost accountant, or a company secretary. These documents should be duly printed. The memorandum and articles have to be stamped and the value of the stamp differs from State to State as per the respective State stamp laws.

Section 7(a) and the rules framed by the Central Government require that 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 at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any. The witness shall also verify his/their ID. However, it is not necessary that the promoters themselves should sign the memorandum and articles. The written consent of directors to act as such is also to be filed. The directors are required to give a written undertaking to take up and pay for their qualification shares, if any, prescribed in the Articles.

Besides, there shall be filed an declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.

A statutory declaration to the effect that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with; is also to be filed. The aforesaid declaration is to be signed by:

i) an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, **and**

ii) a person named in the articles as a director, manager or secretary of the company.

Besides these steps, depending upon the peculiar nature of the company and its objects, the promoters may be asked to comply with certain other requirements. These may include (i) obtaining the licence under the Industries (Development and Regulation) Act, 1951, (ii) obtaining clearance from the Ministry of Environment, (iii) entering into preliminary contracts, and (iv) preparing prospectus.

Check Your Progress A

1) What is meant by promotion of a Company?

....

....

....

....

2) Fill in the blanks:

   i) For formation of a company, the promoters have to pass through .... stages.

   ii) The three stages for the formation of a company are promotion, ... and the commencement of the business.

   iii) Promotion of a company begins with the ....

   iv) A company may be formed only for a .... purpose.

v) A company not having any limit on the liability of its members is known as an .... company.

vi) In accordance with Section 5 of the Act, no company shall be registered by a name which is .... in the opinion of the ....

vii) The rules framed for the internal management of the affairs of the company are termed as ....

viii) Before delivering the memorandum and articles to the Registrar for registration of the company, these documents will be .... by the .... of the proposed company.

ix) The subscribers to the memorandum of association shall sign in the presence of at least one ....

4.4 DOCUMENTS TO BE FILED WITH THE REGISTRAR

After the promoters have got the necessary documents prepared, these are required to be filed with the Registrar of Companies. The documents that are necessary for the purpose of registration are as follows:

1) **Memorandum of Association:** The Memorandum of Association is the charter of the company. It needs to be originally prepared for every company. It defines the objectives for which the company is being formed. The memorandum by its clauses, describes the whole character of the company. This includes its objectives, its name, the nature of liability of its members, the State in which its registered office shall be located, the capital which the company is authorised to have. Besides, Memorandum must also state the names, addresses and other prescribed particulars of persons who subscribe their names to the memorandum of association.

   The memorandum defines the powers of a company and its relations with third parties.

   The memorandum of a company has to be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

   For purposes of registration, the promoters have to file with the Registrar of Companies, a duly signed and properly stamped printed Memorandum of Association.

   You should note that in case of a private company the memorandum of association should be signed by at least two persons in contrast to seven in case of a public company.

2) **Articles of Association:** The Articles of Association contain the rules and regulations for managing the internal affairs of the company and, therefore, govern the relationship between the company and its members. All companies are required to have articles of association. However, any company may adopt all or any of the regulations contained in the model articles applicable to the company. Model articles in relation to different kinds of companies are contained in Tables F, G, H, I and J in Schedule I to the Companies Act 2013.

In case of any company, which is registered under the Act, 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 be deemed to be the regulations of that company.

The articles of association should also be signed separately by subscribers and they should also be attested by a witness. Once again, note that in case of a private company the articles of association should be signed by at least two persons as against seven persons in case of a public company.

3) **Declaration by subscribers to the memorandum and first directors:** There shall be filed a declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief. (Section 7(1)(c).

4) **A list of persons who have agreed to become the first directors of the company should also be filed:** There shall be filed the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

   Besides, the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed must also be filed with the Registrar of Companies.

5) **Address for communication:** Address for communication till the company acquires its registered office shall also be supplied.

   However, company must, as per Section 12, acquire its registered office within thirty days of its incorporation for the purpose of receiving and acknowledging all communications and notices as may be addressed to it.

   Section 12 and the rules made in this regard also require the company to furnish to the Registrar verification of its registered office within a period of 30 days of its incorporation in the prescribed Form No.2.25.

6) **Statutory declaration:** Lastly, the promoters must file a statutory declaration to the effect that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.

   The aforesaid declaration is to be signed by:

   i) an advocate, or

   ii) a chartered accountant, or

   iii) cost accountant, or

iv) company secretary, in practice and engaged in the formation of the company;

And by a person named in the articles as a director, manager or secretary of the company.

4.4.1 E-Filing of Documents

Sections 398 to 402 of the Companies Act 2013 contain provisions relating to electronic filing of forms, returns and documents with the Registrar and provisions of value added services.

Filing of applications, documents, inspection etc. in electronic form

Section 398 of the Act empowers the Central Government to make rules for filing, maintenance and inspection of various applications, form etc. through the electronic mode.

Further, Section 400 clarifies that the electronic form shall be exclusive or in alternative or in addition to the physical form. Once again, the Central Government is empowered to make rules in this respect.

Providing value added services through electronic form [Section 401]

The Central Government may provide such value added services through the electronic form and levy such fees as may be pre-scribed.

Application of provision of Information Technology Act, 2000 (Section 402) – You may note that all the provisions of the Information Technology Act, 2000 relating to the electronic records (including the manner and format in which the electronic records shall be filed), insofar as they are not inconsistent with this Act, shall be applicable to the records in electronic form under section 398 [Section 402].

Advantages of e-Filing

Adopting international best practices, MCA-21 application adds immense value to the stakeholders. Advantages of E-Filing include:

- Business shall be enabled to register a company and file statutory documents quickly and easily.
- Public to get easy access to relevant records and get their grievances redressed effectively.
- Professionals to be able to offer efficient services to their client companies.
- Financial institutions to find registration and verification of charges easy.
- Government to ensure proactive and effective compliance of relevant laws and corporate governance.
- MCA employees shall be enabled to deliver best services.

Launch of MCA-21 Programme

The Ministry of Corporate Affairs launched MCA-21, a major E-Governance initiative on 26 July, 2006. MCA-21 envisages e-filing of all documents relating to company matters on the MCA portal.

Salient Features of the MCA-21 include:

- Corporations, professionals and the public at large will no longer need to visit the Registrar of Companies offices and would be able to interact with the Ministry using the MCA-21 portal from their offices or home or by going to the facilitation centres, which have been set-up.

- The users will have multiple options to make payments in the online mode either through credit cards or the Internet banking facility. Besides this, the traditional payment through demand draft would be accepted against a system-generated challan at the specified bank branches across the country.
- The system would also enable the stakeholder to track the service request through a Service Request Number (SRN)

The statutory filing of forms and returns in the offices of ROCs is now on the basis of new E-forms only; all manual filing of documents has been discontinued.

Permanent documents of existing companies like, Memorandum of Association, Articles of Association, current charge documents, etc. are presently maintained in paper form across various Registrar of Companies (RoC) offices. Almost all of these documents have been converted into electronic format. The scope of E-filing covers only the offices of RoCs, Regional Directors and the Headquarters at New Delhi and it does not include Official Liquidators, Tribunal and Courts.

The present scope of the MCA 21 includes services provided by the Secretariat at New Delhi, the four Regional Directorates (RDs) and the 20 offices of the Registrar of Companies (RoC) located all over the country. The E-filing facility includes:

- Registration and incorporation of new companies
- Filing of Annual Returns and Balance Sheets
- Filing of forms for change of names/address/Director's details
- Registration and verification of charges
- Inspection of documents
- Applications for various statutory services from MCA
- Investor grievance redressal

For the purpose of standardization and better understanding, the e-Forms have been grouped under the following broad categories:

a) **New Company Registration**

b) **Compliance Related Filing**: Whether annually or event based include Annual Return, Balance Sheet and Profit & Loss Account, Return of allotment, Return of buy back of securities, Return of deposits, Return of appointment of managing director, whole-time director, Notice of appointment of auditor, Statutory report, Cost audit report, etc.

c) **Change services:** It covers matters in respect of any change in the capital structure, changes in the registered office or the persons appointed as directors, secretaries and authorized representatives.

d) **Charge Management:** For registration of charge created or modified and satisfaction of charge, to be filed with the ROC. It also includes filing of e-Forms for appointment and cessation of receiver and filing of accounts by receiver. Various Forms have been deleted which includes Form 13, relating to charges.

e) **Investor Services:** E-filing system accepts complaints filed against a company by an investor as part of investor services. There is a specific e-Form for this purpose.

f) **Application for Registrar of Companies approval:** Registrar of Companies (ROC) is having powers to give direction in relation to the matters pertaining to the change of name of an existing company and the conversion of a public company to private company. In addition, ROC approval is required in case of extension of time period for holding AGM, holding AGM at place other than registered address, declaring a company as defunct, extension of the period of annual accounts, amalgamation of companies, forms relating to winding up, etc. The MCA has also prescribed several new e-Forms, for which there were no prescribed Forms available.

g) **Informational Services:** It covers those forms which are to be filed with ROC for informational purposes, in compliance with the provisions of the Companies Act, viz., declaration of solvency in case company decides to buy back its shares, form for filing of resolutions and agreements, form regarding place where books of account are kept, form in case company decides to transfer its shares to another company, etc.

In the e-filing system search facilities are available for viewing public documents, getting certified copies, finding the Corporate Identity Number (CIN), checking company name, finding name availability. The categories of public documents includes incorporation documents, charge documents, annual returns and balance sheets, change in directors and other documents.

Five Step e-Filing Process

Step 1 : Register Yourself

Step 2 : Download e-Form

Step 3 : Complete e-Form

Step 4 : Submit e-Form

Step 5 : Make Payment

Check Your Progress B

1) List the documents which are required to be filed with the Registrar for the purpose of incorporation of the company.

....

....

....

....

....

2) State, whether the following statements are true or false:

   i) The memorandum of association of a company defines the objectives for which a company is formed.

   ii) The articles of association govern the relationship between the company and third parties.

iii) The relations between the company and its members are regulated by its articles of association.

iv) For the registration of a private company it is necessary that the articles of association are filed with the Registrar.

v) The list of directors of a private company alongwith their written consent to act as such must be filed with Registrar.

3) State the salient features of MCA-21.

....

....

....

....

4) What are the five steps of e-filing process?

....

....

....

....

5) State which of the following statements is correct:

a) A company may file its returns with the ROC:

i) in e-Form or deliver a copy in the physical form.

ii) only in the prescribed e-Forms.

b) The manner and format in which e-records are to be filed shall be governed by:

i) The provisions of the Companies Act, 2013.

ii) The provisions of the Information Technology Act, 2000.

4.5 INCORPORATION

When the necessary documents have been delivered to the Registrar and the requisite fees paid, the Registrar shall scrutinize these documents and if he is satisfied that (a) all the documents are in order; (b) all the requirements of the Companies Act in respect of registration have been complied with, and (c) the object for which the company is to be formed are lawful; he shall enter the name of the company in the Register of Companies maintained by his office. He would then issue a Certificate in the prescribed form, under his signature, certifying that the company is incorporated. The Certificate contains the name of the company, the date of its issue, and the signature of the Registrar with his seal. Certificate of Incorporation constitutes the company's birth Certificate and the company becomes a body corporate, with perpetual succession and may have a common seal. The company comes into existence on the date given in the Certificate of Incorporation.

If the Registrar is of the view that there are some minor defects in any document, he may require that the defects be rectified. But, if there are some material and substantial defects, the Registrar may refuse to register the company.

Allotment of Corporate Identity Number (CIN): As per Section 7(3), on and from the date mentioned in the certificate of incorporation , the Registrar shall allot to the company a corporate identity number (CIN), which shall be a distinct identity for the company and which shall also be included in the certificate.

4.5.1 Conclusiveness of Certificate of Incorporation

As per the Companies Act, 2013, Certificate of incorporation given by the Registrar of Companies in respect of any association shall not be conclusive where the Certificate was obtained by furnishing any false or incorrect particulars of any information or suppression of any material information.

Consequences of incorporating a company by filing false information/ suppression of information.

You should note that sub-sections (5), (6) and (7) of Section 7 make furnishing of any false or incorrect particulars of any information or suppression of any material information punishable with a minimum six months imprisonment which may extend up to ten years **and also** fine which shall not be less than the amount involved in the fraud but which may extend to three times the amount involved in the fraud.

Besides the aforesaid penalty, the Tribunal may, on an application made to it, and on being satisfied that the situation so warrants,—

a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

b) direct that liability of the members shall be unlimited; or

c) direct removal of the name of the company from the register of companies; or

d) pass an order for the winding up of the company; or

e) pass such other orders as it may deem fit.

However, before making any order, as aforesaid,—

i) the company shall be given a reasonable opportunity of being heard in the matter; and

ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

You should also note that the Certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company mentioned in the objects clause of the memorandum of association. As such, if a company has been registered whose objects are illegal, the incorporation does not validate the illegal objects. In such a case the only remedy available is to wind up the company.

4.5.2 Effects of Registration

You have just learnt that the Certificate issued by the Registrar of Companies is called the ‘Certificate of incorporation’. This Certificate is a very important document for the company because the company begins its corporate life from the date of the Certificate.

On filing of documents like memorandum of association, articles of association, the declarations, etc., the Registrar shall issue a Certificate of Incorporation to the company. In this Certificate, he shall certify that the company has been incorporated. If the company is a limited company, the Registrar shall further certify that the company is a limited company.

From the date of incorporation i.e., the date mentioned in the Certificate of incorporation the company becomes a legal person distinct from its members. Section 9 describes the effects of registration in the following words:

"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".

Thus, on incorporation, the following effects follow:

i) From the date of incorporation, the original subscribers to the memorandum as well as the other persons who may, from time to time, become members of the company, shall constitute a body corporate by the name contained in the memorandum of association. You would recall from Unit 1 that a company after incorporation becomes a body corporate distinct from its members. It becomes a legal person. The company's life starts from the date of its incorporation.

ii) The company acquires a perpetual succession. The consequences of it may be understood better by an example. If a company had ten shareholders and all of them die at the same time in a train accident, the company's existence will not be affected. In other words, we may say that the members may come and members may go, but the company goes on till it is wound up.

iii) The company can sue and be sued in its own name.

iv) Liability and debts of the company are not the liability of the shareholders/ members. They are, however, liable to contribute to the assets of the company, in the event of its being wound-up, to the extent of the amount remaining unpaid on the shares held by them or amount guaranteed, as the case may be.

v) The company will hold its property in its own name. The property of the company cannot be said to be the joint property of the shareholders.

vi) The memorandum and articles of association become binding on the members and the company. Articles are deemed to be a contract between the company and its members and would, after incorporation, govern the rights (a) of members against the company; (b) of company against the members, and (c) between members inter se, i.e., amongst themselves.

4.6 COMMENCEMENT OF BUSINESS

As per Section 10(A) Company incorporated after the commencement of the companies (Amendment) Act 2019 and having a share capital shall not commence any business or exercise any borrowing power unless (a) a declaration is filed by the director of the company within 180 days of the date of incorporation of the company that every subscribes to the memorandum has paid the value of the shares, and b) the registered office of the company so incorporated has been verified by filing return as provided in subsection (2) of section 12.

Penalty

In case of default in complying with this section the company shall be liable to a penalty of fifty thousand rupees and every officer in default shall be liable to a penalty of one thousand rupees each day during which the default continues but not exceeding an amount of one lakh rupees. This also shall qualify as a ground for striking off the name of the company from the register of the companies by the Registrar.

Further section 12(a) as amended empowers the Registrar to physically verify whether or not the company is carrying on business from its registered office. If the company is found to be not carrying any business, the Registrar may initiate action for removal of the name of the company from the register of company. This is to check the increase and functioning of shell companies.

Check Your Progress C

1) What is meant by Certificate of incorporation?

....

....

....

2) What are the effects of incorporation?

....

....

....

....

3) State, whether the following statements are true or false:

   i) A company comes into existence from the date of incorporation, mentioned on the Certificate of incorporation.

   ii) The Registrar issues the Certificate of Incorporation under his signature.

   iii) Only a public company acquires perpetual succession after incorporation.

   iv) A company incorporated after companies Amendment Act 2019 can commence its business immediately after registration.

4.8 LET US SUM UP

The incorporation of a company consists of three stages, viz., promotion, incorporation and commencement of business. In the promotion stage, the promoters of the company conceive the business idea and organise all the resources needed for forming the company. They also get the necessary documents prepared, printed and file them in the office of the Registrar of Companies, along with the prescribed fee for registration. On scrutiny of these documents, if the Registrar is satisfied that all the formalities prescribed by the Companies Act have been complied with, he issues to the company, under his signatures, a Certificate of Incorporation. The documents can also be filed online. Ministry of Company Affairs (MCA) launched MCA 21, a major E-Governance initiative on 26 July, 2006. With the launch of MCA-21, the Ministry of Corporate Affairs (MCA) has moved from the traditional paper-based operation to e- governance.

The E-filing facility includes registration and incorporation of new companies, filing of Annual Returns and Balance Sheets, filing of forms for change of names/ address/Director's details, registration and verification of charges, inspection of documents, applications for various statutory services from MCA, investor grievance redressal etc.

In the e-filing system search facilities are available for viewing public documents, getting certified copies, finding the Corporate Identity Number (CIN), checking company name, finding name availability.

A company incorporated after the commencement of companies (Amendment) Act 2019 and having a share capital shall not commence its business or exercise any borrowing power unless a declaration is filed by the director of the company and registered office has been verified by filing return.

4.9 KEY WORDS

Conclusive: Final, which does not require any other evidence.

Debenture: A document or certificate signed by the officer of a company acknowledging indebtedness for money lent and a guaranteeing repayment with interest.

Incorporated: Constituted as a body corporate legally authorised to act as a person.

Inter-se: Between or amongst themselves.

Promoter: Those who undertake the formation of a company.

Statutory declaration: A declaration made in compliance of a written law.

MCA-21: An E-governance initiating of Ministry of Corporate governance. It envisages e-filing of all documents relating to a company on MCA portal.

4.10 ANSWERS TO CHECK YOUR PROGRESS

A. 1) For answer to this question please refer to 4.2 of this Unit.

2) i) three

ii) incorporation

iii) discovery of the business idea

iv) lawful

v) unlimited

vi) Undesirable, Central Government

vii) Articles of association

viii) signed, subscribers or promoters

ix) witness

B. 1) For answer to this question please refer to 4.4 of this Unit.

2) i) True ii) False iii) True iv) True v) True

5) a (ii), b (i)

C. 3) i) True ii) True iii) False iv) False

4.11 TERMINAL QUESTIONS

1) What are the different stages in the formation of a company? Discuss.

2) Discuss the documents that are required to filed with the Registrar of Companies for the purposes of registration.

3) What do you mean by incorporation of a company? What are the effects of registration of a company?

4) "The Certificate of incorporation is a conclusive proof that all the requirements of the Act in respect of formation of the company, have been complied with"? Explain.

5) A private company was incorporated with the object of running lotteries in the State of Tamilnadu. The activities of the company were challenged on the ground that it is illegal to run lotteries. the company stated that once the company has been incorporated, the nature of the business of the company is not open to examination and the Certificate of incorporation is conclusive.

(**Hint:** You have learnt in Section 4.5 above that the Certificate of incorporation is not conclusive with respect to the legality of the objects of the company, mentioned in its object clause and that the incorporation does not validate the illegal objects. Hence, the company may be restrained from operating lotteries.)

6) What are the advantages of E-filing? Explain.

7) Discuss the features of MCA-21.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 5 AUTHORITIES UNDER COMPANIES ACT, 2013

Structure

5.0 Objectives

5.1 Introduction

5.2 National Company Law Tribunal

- 5.2.1 Qualifications
- 5.2.2 Selection
- 5.2.3 Term of Office
- 5.2.4 Resignation and Removal of President and Members
- 5.2.5 Jurisdiction
- 5.2.6 Miscellaneous Provisions
- 5.2.7 Powers of National Company Law Tribunal
- 5.2.8 Appeal to Appellate Tribunal

5.3 National Company Law Appellate Tribunal

- 5.3.1 Qualifications
- 5.3.2 Selection
- 5.3.3 Term of Office
- 5.3.4 Resignation and Removal of Members
- 5.3.5 Appeal to Supreme Court
- 5.3.6 Mediation and Conciliation Panel
- 5.3.7 Powers of National Company Law Appellate Tribunal

5.4 Special Courts

- 5.4.1 Jurisdiction
- 5.4.2 Appeal and Revision
- 5.4.3 Fines
- 5.4.4 Cognizance

5.5 Other Authorities

- 5.5.1 Registrar
- 5.5.2 Regional Directors
- 5.5.3 National Financial Reporting Authority
- 5.5.4 Serious Fraud Investigation Office

5.6 Let Us Sum Up

5.7 Key Words

5.8 Answers to Check Your Progress

5.9 Terminal Questions

5.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the constitution of National Company Law Tribunal and National Company Law Appellate Tribunal;
- enumerate qualifications, selection and term of office of members of National Company Law Tribunal and National Company Law Appellate Tribunal;
- describe the special courts; and
- discuss about Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office.

5.1 INTRODUCTION

There are three main authorities under the Companies Act, 2013. They are:

1) National Company Law Tribunal (NCLT)
2) National Company Law Appellate Tribunal (NCLAT) and
3) Special Courts

There are other authorities also. These are Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office. The NCLT and NCLAT were established under Companies Act, 2013. The Special Courts were first introduced by Companies Act, 2013. The objective is to provide for a single judicial forum to adjudicate all disputes concerning the affairs of Indian Companies except any criminal prosecution. In this block you will learn about NCLT, NCLAT, Special Courts and other authorities, i.e, Registrar, Regional Director, National Financial Reporting Authority and Serious Fraud Investigation Office.

5.2 NATIONAL COMPANY LAW TRIBUNAL

National Company Law Tribunal (NCLT) is a quasi-judicial body that adjudicates issues relating to Indian companies. This was established under Companies Act 2013 and was constituted on 1st June 2016 by government of India. All the disputes under Companies Act such as arbitration, compromise, arrangements and reconstruction and winding up are disposed off by the NCLT.

The NCLT (Tribunal) consists of a President and such member of two types of members (a) Judicial members (b) Technical members, as the Central Government may deem necessary.

5.2.1 Qualifications

Qualifications of President and Judicial and Technical Members are as follows:

Section 409 prescribes the qualifications for appointment of president and members.

A. **President:** The President shall be a person who is or has been a Judge of a High Court for five years.

B. **a) Judicial Member:**

A Judicial member is not qualified unless he

i) is or has been a Judge of a High Court; or

ii) is or has been a District Judge for at least five years; or

iii) has, for at least ten years been an advocate of a court. Any period during which the person has held Judicial office or office of a member of a Tribunal or any post, under Union or State, requiring special knowledge of law after he becomes an advocate shall also be counted.

b) Technical member:

i) He should have at least fifteen years as a member of Indian Corporate Law Service or Indian Legal Service, and has been holding the rank of secretary or additional secretary to the Government of India or above in that service.

Or

ii) is or has been in practice as a Chartered Accountant or Cost Accountant or Company Secretary for at least fifteen years

Or

iii) is a person of proven ability, integrity and standing having professional experience not less than fifteen years, in law, industrial financial, industrial management or administration, industrial reconstruction, investment and accountancy.

Or

iv) is or has been, for at least five years, a presiding officer of a labour court, or Tribunal, National Tribunal Constituted under Industrial Disputes Act 1947.

5.2.2 Selection (Section 412)

The President of the Tribunal shall be appointed after consultation with the Chief Justice of India.

The members of the Tribunal shall be appointed on the recommendation of the Selection Committee consisting of

a)	Chief Justice of India or his nominee	- Chairperson
b)	A Senior Judge of Supreme court or a Chief Justice of High Court	- Member
c)	Secretary in the Ministry of Corporate Affairs	- Member
d)	Secretary in the Ministry of Law and Justice	- Member

The Committee shall determine its own procedure for recommending persons under subsection (2). Any vacancy or defect in the constitution of selection committee will not make any appointment invalid. The Chairperson shall have a casting vote if there is a equality of votes on any matter in a meeting of Selection Committee.

5.2.3 Term of Office

The president and every other member of the Tribunal shall hold office for five years from date of appointment and may be reappointed for another term of five years.

A member of the Tribunal shall hold office until he attains:

in case of president, the age of sixty seven years and in case of any other member, the age of sixty five years and shall not be eligible for appointment as member if he has not completed fifty years.

5.2.4 Resignation and Removal of President and Members

The president or any other member can resign by giving a notice in writing under his hand addressed to the Central Government, or until person duly appointed as his successor enters upon his office or until the expiry of his term office, whichever is earliest.

As per Section 417 the Central Government may, after consultation with Chief Justice of India, remove from office of the President or any other member who:

a) has been adjudged an insolvent; **or**

b) has been convicted of an offence which in the opinion of the central government involves moral turpitude; **or**

c) has become physically or mentally incapable of acting as such president or member. **or**

d) has acquired such financial or other interest as is likely to affect predecially his functions as president or member **or**

e) has so abused his position as to render his continuance in office prejudicial to public interest.

The president or member shall be given a reasonable opportunity of being heard, on any grounds from (b) to (e) before removal.

5.2.5 Jurisdiction

The Tribunal has jurisdiction on the matters under companies act 2013 which include :-

1) Cancellation/Variation of shareholder rights (Section 48)
2) Redemption of preference shares (Section 54)
3) Transfer and Transmission of shares (Section 56)
4) Rectification of register of members (Section 59)
5) Reduction of shares capital (Section 66)
6) Petition of Debentures trustee (Section 71)
7) Public Deposits (Section 73)
8) Repayment of Deposits (Section 74)
9) Power to call annual general meeting or meeting of members (Section 97, 98)
10) Disqualification of a Director (Section 164)
11) Protection of employees during investigation (Section 218)
12) Compromise or arrangement with Creditors (Section 230, 231)
13) Merger and Amalgamation (Section 232)
14) Oppression and Mismanagement (Section 241)

15) Removal of name of a company from register of Company

16) Revival and Rehabilitation of Sick Company (Chapter XIX)

17) Winding Up (Section 271)

18) Fraudulent Preferable (Section 238)

19) Deposit of monies in Schedule Bank by Company Liquidator (Sector 350)

5.2.6 Miscellaneous Provisions

1) Any person aggrieved by an order of that Tribunal may prefer an appeal to the Appellate Tribunal (Section 421).

2) The Central Government may specify the number of benches of the Tribunal. The Principal Bench shall be at New Delhi (Section 419).

3) Procedure as laid down in code of Civil Procedures 1908 shall be followed by Tribunal (Section 424).

4) The president and members shall be protected of action taken in good faith (Section 428).

5) Vacancy or defect in constitution of Tribunal shall not invalidate acts or proceedings (Section 431).

6) The Tribunal may, in any proceedings relating to a sick company or winding up may seek assistance of metropolitan magistrate, Chief Judicial Magistrate or District Collector or to take into custody or under its control all property, books of accounts or other documents (Section 429).

5.2.7 Powers of the National Company Law Tribunal

The powers of National Company Law Tribunal are as follows:

a) **The Power as a Civil Court** : The Tribunal shall enjoy the same powers as a civil court under the code of the Civil procedure 1908, on the following matters.

   i) Summoning and enforcing the attendance of any person and examining him on oath;

   ii) requiring the discovery and production of documents ;

   iii) receiving evidence on affidavit;

   iv) subject to provision of sections 123 and 124 of the Indian Evidence Act 1972, requisitioning any public record, document or a copy of such record or document from any offices;

   v) issuing commissions for the examination of witness or documents;

   vi) dismissing a representation for default or deciding it exparte;

   vii) any other matter which may be prescribed, Section 424 (2).

b) **Execution of an order**: An order made by the Tribunal may be enforced in the same manner as a decree made by a court in a suit.

c) **Power to punish for contempt**: The Tribunal shall have the same power and authority to punish for contempt as the high court under the provisions of contempt of Court Act 1970 (Section 425).

d) **Power to seek assistance of Chief Metropolitan Magistrate etc.** : In any proceeding relating to winding up of a company or rehabilitation of a sick company, the Tribunal may seek the help of Chief Metropolitan Magistrate, Chief Judicial Magistrate etc for the purpose of taking into custody property, books of account or other documents.

5.2.8 Appeal to Appellate Tribunal

Any person aggrieved by an order of the Tribunal may, within forty five days from the date on which the copy of the order was made available, file an appeal to the NCLAT. If the person was prevented from filing the appeal within forty five days due to sufficient cause, the NCLAT may extend the period by another 45 days. The NCLAT by order may confirm, modify, or set aside the order of the Tribunal appealed against after giving the parties a reasonable opportunity of being heard. A copy of the order shall be sent to tribunal and parties to appeal. If the order was made by tribunal with the consent of the parties, no appeal to NCLAT is possible.

5.3 NATIONAL COMPANY LAW APPELLATE TRIBUNAL

National Company Law Tribunal has primary jurisdiction whereas National Company Law Appellate Tribunal has appellate jurisdiction. It is a higher forum than National Company Law Tribunal. It was established under Section 410 of Companies Act 2013 and constituted with effect from 1st June 2016.

National Company Law Appellate Tribunal (Appellate Tribunal) hears appeals against order of the NCLT and National Financial Reporting Authority (NERA). It has a chairperson and two types of members (a) Judicial members and (b) Technical members. Such number of both types of members not exceeding eleven, as the Central Government may deem fit, to be appointed by the Central Government notification.

5.3.1 Qualifications

The qualifications of Chairman and Members are as follows:

The **Chairperson** shall be a person who is a or has been a judge of a Supreme Court or Chief Justice of a High Court.

A **Judicial member** shall be a person who is or has been a judge of a High Court or is a Judicial member of NCLT for five years.

A **Technical member** shall be a person of proven ability, integrity and standing having special knowledge and experience of not less than twenty five years, in law, industrial finance, industrial management, industrial reconstruction, investment and accountancy, labour matters or such other disciplines related to management, conduct of affairs, revival, rehabilitation, and winding up of companies.

5.3.2 Selection

The Selection for chairperson and member of NCLAT, is same as for National Company Law Tribunal (Section 5.2.2)

5.3.3 Term of Office

The chairperson or a member shall hold office for a term of five years from the date of taking charge and can be re-appointed for a period of another five years.

Chairperson shall hold office upto the age of seventy years and a member shall hold office upto sixty seven years of age.

A member will be appointed if has not completed the age of fifty years.

5.3.4 Resignation or Removal of Members

For a chairperson and members of a NCLAT – same as discussed in point 5.2.4.

5.3.5 Appeal to Supreme Court

An appeal against the order of the Appellate Tribunal may be filed by the aggrieved person to Supreme Court. An appeal within sixty days must be filed by aggrieved person to Supreme Court against order of NCLAT. It may be extendable by another sixty days if the person was prevented by sufficient cause to file within time.

The Tribunal and Appellate Tribunal shall be guided by the principle of natural justice and therefore have the power of regulate their own procedure. They shall not be bound by the procedure laid down in the code of Civil Procedure, 1908. However, while laying down the procedure they shall consider the other provisions of this act and rules made thereunder. The party to any proceeding or appeal before the Tribunal or Appellate Tribunal, has right either to appear in person or through one or more duly authorised Chartered Accountant, Company Secretary or Cost Accountant or Legal Practitioner or any other person to present his case before the Tribunal or Appellate Tribunal.

5.3.6 Mediation and Conciliation Panel (Section 442)

The Central Government maintains a panel of experts called "Mediation and Conciliation Panel", with prescribed qualifications and such number as it may decide. This panel mediates between parties during the pendency of any proceedings before central government or Tribunal or Appellate Tribunal. The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may suo motu, refer any matter pertaining to such proceeding to such member of experts from mediation and conciliation panel as the Central Government or Tribunal or the Appellate Tribunal, as the case may be, deem fit. The party also can file objections against its recommendations to Central Government or Tribunal or Appellate Tribunal as the case may be.

5.3.7 Powers of National Company Law Appellate Tribunal

The powers of National Company Law Appellate Tribunal are same as given in point 5.2.7

Check Your Progress A

1. What qualifications the President and Judicial members of National Company Law Tribunal should have?

   ....

   ....

   ....

2. What are the qualifications of a Technical member of National Company Law Appellate Tribunal?

   ....

....

....

3. List any five matters on which the National Company Law Tribunal has Jurisdiction?

....

....

....

....

4. Fill in the blanks.

   a) National Company Law Tribunal consists of a President __________ and ____________

   b) The President of National Company Law Tribunal is appointed in consultation with ___________

   c) The term of office of President and members of National Company Law Tribunal is __________ years.

   d) The _________________ of National Company Law Tribunal should be either or a Judge of Supreme Court or Chief Justice of a High Court.

   e) Chairperson of National Company Law Appellate Tribunal (NCLAT) shall hold office upto the age of _____

5.4 SPECIAL COURTS

The Central Government, for speedy trial of offences under the Act may establish or designate special courts by notification. The special courts shall consist of :

a) A single judge, holding office as a session judge or additional sessions judge in case of offences punishable under Company Act, 2013 with imprisonment of two years or more and

b) A Metropolitan Magistrate or judicial Magistrate of First class in Case of other offences (Section 435).

They shall be appointed with concurrence of Chief Justice of a High Court.

5.4.1 Jurisdiction

1) The Special Courts have jurisdiction to all those offences under Companies Act 2013 with imprisonment of two years or more.

2) All other offences shall be tried as the case may be by a Metropolitan Magistrate or a Judicial Magistrate of the first class having jurisdiction to try any offence under this act or under any previous Company Law.

3) The special Courts try in a summary way any offence which is punishable with imprisonment not, exceeding three years. However, In summary trial, the sentence of imprisonment be passed not exceeding one year. If in the course of summary trial it appears to the special court that the sentence of imprisonment is likely to be granted is exceeding one year or it is undesirable to try the case summarily, it may proceed with the case as a regular trial.

5.4.3 Appeal and Revision

The High Court can hear the appeal or revision against the order of special court.

5.4.4 Fines

The amount of fines, partly or wholly shall be applied in or towards payment of costs of proceedings, or reward to person who gave information.

5.4.5 Cognizance

The court shall take cognizance of an offence against a company or any officer there off only on complaint in writing by Registrar or a member or by an authorised person.

All offences under the Act shall be deemed to be non-cognizable except in case of investigation by Serious Fraud Investigation Office. Compensation shall be paid if a person is accused without reasonable cause by the special court or court of session.

5.5 OTHER AUTHORITIES

Besides the authorities mentioned in earlier points, the following other authorities also overview and regulate the companies under companies Act. 2013

1) The Registrar of Companies (ROC)
2) Regional Director
3) National Financial Reporting Authority (NFRA)
4) Serious Fraud Investigation office (SFIO)

5.5.1 The Registrar

Registrar means a 'Registrar' or an additional, a Joint, or Deputy or an Assistant Registrar, having the duty of registering companies and discharging various functions under the Act, Section 2(75).

Registrar of Companies (ROCs) are the field officers who deal directly with the companies registered or intended to be registered within their territorial jurisdiction. There is a Registrar of Companies for each state. He is full time officer appointed by Central Government and is responsible for administration of Company Law in that state. Certain powers are vested in the Registrar of Companies, under various sections of the Act.

The Registrar of Companies has certain duties after the necessary documents are filed by the companies for registration, record or filing. He is required to examine or cause to be examined the documents. He needs to take a decision within 30 days from the date of filing documents. If such documents are found to be defective or incomplete in any respect, the ROC shall direct the company to rectify it.

5.5.2 Regional Directors

There are seven directorate of Regional Directors. They are at Ahmadabad, New Delhi, Mumbai, Chennai, Kolkata, Shillong and Hyderabad, covering North Western region, North Region, Western region, Southern Region, Eastern Region, North Eastern Region and South Eastern region respectively. The Ministry of

Corporate affairs is empowered to appoint Regional Directors for carrying out various functions under the act. Certain powers and functions of the Central Government have been delegated to the Regional Directors in pursuant of Section 458. The Regional Director shall exercise the power and functions of the Central Government so delegated to it under various sections.

5.5.3 National Financial Reporting Authority (NFRA)

The Central Government may by notification, constitute a National Financial Reporting Authority.

It is an apex body for the purpose of various matters relating to accounting and auditing standards. It would be responsible for matters relating to formulation, monitoring and enforcement of accounting standards. The NFRA shall make (a) recommendations to the Central Government on formation and laying down of accounting and auditing policies and standards to be adopted by companies or class of companies or auditors, as the case may be; (b) monitor and enforce the compliance with accounting standards and auditing standard in such a manner as may be prescribed. (c) Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service and such other related matters as may be prescribed and (d) performs such other functions relating to clauses a, b and c as may be prescribed. It is vested with the powers of a civil court. It can own its own or on a reference made to it by Central Government, investigate any body corporate, or persons or professionals or other misconduct by any member or firm of Chartered Accountants (Section 132).

5.5.4 Serious Fraud Investigation Office (SFIO)

Serious Fraud Investigation Office **(**SFIO) has been constituted under section 211 and 212 of Companies Act, 2013, is a multi disciplinary organisation having experts from financial sector, capital market, accounting, forensic, audit, taxation, law, information technology, company law, customs and investigation.

This office is empowered to investigate frauds relating to a company. Where Central Government is of the opinion, that it is necessary to investigate the affairs of a company by Serious Fraud Investigation Office, it may assign the investigation to Serious Fraud Investigation Office. The Central Government may make that assignment to this office in following circumstances:

a) On receipt of a report of the Registrar or an inspector;

b) On intimation of a special resolution passed by the Company that its affairs are required to be investigated;

c) In the public interest;

d) On request from any department of Central or State Government.

It has the exclusive jurisdiction and once a case has been assigned to SFIO no other agency shall initiate or proceed with investigation. It has a power to arrest and seek information and explanation from any person involved in the fraud.

Check Your Progress B

1. What are ‘Special Courts’?

   ....

   ....

....

....

2. What is the National Financial Reporting Authority?

....

....

....

....

3. What is 'Serious Fraud Investigation Office?

....

....

....

....

4. Fill in the blanks

   1) The Central Government maintains the panel of experts called ______________

   2) A single judge holding office as ______________ may be appointed in special courts.

   3) There are ______________ Regional Director's Offices.

   4) The National Financial Reporting Authority is responsible for _________________ standards.

5.6 LET US SUM UP

The Companies Act 2013 has specified certain authorities to overview and regulate the companies. These are : National Company Law Tribunal, National Company Law Appellate Tribunal and Special Courts. Both have President and Judicial as well as technical members. Both President or chairman have term of office of five years. The president of the NCLT is appointed after consultation with Chief Justice of India. The members of the Tribunal are appointed on the recommendations of selection committee. The Selection Committee of NCLAT is same as of NCLT. The Central Government for speedy trail of offences under the act may establish or designate special courts.

There are other authorities as well. They are the Registrar, Regional Directors, National Financial Reporting Authority and Serious Fraud Investigation office.

5.7 KEY WORDS

National Company Law Tribunal: A quasi judicial body that adjudicates issues relating to Indian Companies.

National Company Law Appellate Tribunal: A higher forum than NCLT which generally review decisions of NCLT.

Special Courts: These are set up by Central Government for speedy trials.

Serious Fraud Investigation Office: It empowered to investigate fraud relating to companies.

5.8 ANSWERS TO CHECK YOUR PROGRESS

A) a) Judicial and Technical members

b) Chief Justice of India

c) Five years

d) Chairperson

e) 70 years

B) 1) Medication and conciliation panel

2) Sessions judge

3) Six

4) Accounting and Auditing

5.9 TERMINAL QUESTIONS

1) Discuss the powers of the National Company Law Tribunal. What is its Constitution?

2) What are the Special Courts? Explain.

3) Explain in detail about National Company Law Appellate Tribunal.

4) Write a note on Registrar of Companies.

5) Discuss the role of National Financial Reporting Authority.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 6 MEMORANDUM OF ASSOCIATION

Structure

6.0 Objectives

6.1 Introduction

6.2 Meaning and Purpose of Memorandum

6.3 Memorandum of Association – Whether an Unalterable Charter

6.4 Form of Memorandum

6.5 Contents of Memorandum

- 6.5.1 The Name Clause
- 6.5.2 The Registered Office Clause
- 6.5.3 Objects Clause
- 6.5.4 Liability Clause
- 6.5.5 Capital Clause
- 6.5.6 Association Clause or Subscription Clause

6.6 Doctrine of *Ultra Vires*

6.7 Alteration of Different Clauses in the Memorandum

- 6.7.1 Change of Name
- 6.7.2 Change of Registered Office
- 6.7.3 Change in Objects Clause
- 6.7.4 Change in Liability Clause
- 6.7.5 Change in Capital Clause

6.8 Let Us Sum Up

6.9 Key Words

6.10 Answers to Check Your Progress

6.11 Terminal Questions

6.0 OBJECTIVES

After studying this Unit, you should be able to:

- understand the meaning and purpose of Memorandum of Association;
- describe the different forms of Memorandum of Association relevant to different kinds of companies;
- list the different clauses of the Memorandum of Association;
- explain the doctrine of *ultra vires*; and
- describe the procedure for alteration of various clauses of Memorandum of Association.

6.1 INTRODUCTION

In the previous Block, you have learnt that company form of organization offers certain distinctive advantages over partnerships. Limited liability and separation of management from ownership allows professionalism in handling large scale enterprises. Therefore, company form of organization has become very popular particularly where huge funds are required. A company to be formed requires certain documents to be filed with the Registrar of Companies. The most important document to the filed is the memorandum of association. *In this unit*, you will learn the meaning and purpose of the memorandum of association. You will also learn the contents of this document and how the different clauses of the memorandum can be altered.

6.2 MEANING AND PURPOSE OF MEMORANDUM

According to Section 2(56) of the Companies Act, 2013 "Memorandum" means "Memorandum of association of a company as originally framed or altered from time to time in pursuance of any previous company law or of this Act". This definition neither states the nature of this document nor is indicative of its importance. Therefore we study the definition of Memorandum of Association given by Jurists. **According to *Palmer***, the memorandum of association is a document of great importance in relation to the proposed company. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers, that will be *ultra vires* (beyond powers of) the company and so void.

In the famous case of **Ashbury Railway Carriage & Iron Co. Ltd. v. Riche (1875)**, Lord Cairns observed :

"The memorandum of Association of a company defines the limitation on 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 power which by law are given to the corporation and it states, if it is necessary to state, negatively, that nothing shall be done beyond that ambit . . . ."

Thus, Memorandum of Association 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. An intending shareholder can find out the purposes for which his money is going to be used by the company and what risk he is taking in making the investment. Likewise, anyone dealing with the company, say, the supplier of goods or money will know that the transaction he intends to make with the company is within the objects of the company and not *ultra vires* its objects. In short, Memorandum of Association is the constitution of a Company. It is the edifice on which the structure of the Company stands.

6.3 MEMORANDUM OF ASSOCIATION – WHETHER AN UNALTERABLE CHARTER

You have noted under **Para 6.2** that the Memorandum of Association not only defines the powers of the company but also confines them. A company cannot act beyond the powers given to it by the Memorandum. Any action outside the scope of Memorandum shall be void and inoperative. The purpose of the Memorandum is to enable the shareholders, creditors and those who deal with the company to know what its permitted range of activities is. It tells the shareholders the purposes for which their money is likely to be used.

Memorandum of Association is a document on the basis of which a company is formed. Therefore, it is but desirable that the clauses of this document should not be allowed to be changed frequently. It is for this purpose that the Companies Act has laid down elaborate rules for making alterations in the Memorandum. Section 13 of the Act provides that except the capital clause (which may be altered by passing an ordinary resolution), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. The provisions referred in section 13 relate to the name, registered office, objects, and liability clauses. These are deemed to be the conditions contained in the Memorandum. For making alterations in the name clause or shifting of the registered office from one State to another, it is necessary to obtain the approval of the Central Government. Again, for alteration of objects by 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 the dissenting shareholders have been 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 (SEBI).

Thus, we can state that though Memorandum of Association is the charter of the company, but it is not unalterable. The different clauses of this document can be altered by following the procedure laid down in the Act in this respect.

6.4 FORM OF MEMORANDUM

Section 4 (6) requires that the memorandum of a company shall be drawn up in such a form as is given in Tables A, B, C, D & E in Schedule I to the Act as may be applicable in the case of the company.

Sections 3 and 4 read with section 7 and the rules made thereunder require the memorandum to be signed by at least seven persons in case of a 'public company' (two in the case of 'private company' and only one person, in case of 'one person company') in the presence of at least one witness, who will attest the signature(s). Each of the subscribers must write opposite his name the number of shares he takes. The signatories to the Memorandum shall add their address, description and occupation. Similar particulars of the witness (es) should also be entered.

Table A =	Company Limited by Shares
Table B =	A Company Limited by Guarantee not having share capital
Table C =	A Company Limited by Guarantee having share capital
Table D =	An Unlimited Company and not having share capital
Table E =	An Unlimited Company and having share capital

You may note that the rules framed by the Central Government, in this regard further provide that 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/their ID for their identification and satisfied myself of his/her/their identification particulars as filled in.

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. He shall also write against the name of the subscriber, the number of shares taken by him. 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.

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 in 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.

For the first time detailed procedure has been provided in the rules for signing of the memorandum where subscriber to the memorandum is a foreign national residing outside India.

6.5 CONTENTS OF MEMORANDUM

Section 4 requires the *memorandum of a company* to contain the following:

a) the name of the company, with 'limited' or 'private limited' as the last word(s) of the name in the case of a public company or a private company, as the case may be. This does not apply to companies registered under section 8 (companies with charitable objects. In case of one person company, Section 12 requires that the words 'One Person Company' must be mentioned in brackets below the name of the company.

b) the name of the State, in which the registered office of the company is to be situated;

c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

d) the liability of members of the company, whether limited or unlimited, and also state:

   i) 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

   ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute—

   A) 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

B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

e) in the case of a company having a share capital,—

i) 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; and

ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

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

It may be noted that the memorandum of association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect (Section 6).

Now, let us discuss in detail, the various clauses of Memorandum of Association.

6.5.1 The Name Clause [Sec. 4(1)(a)]

A company being a distinct legal entity must have a name of its own to establish its separate identity. The promoters are free to choose any suitable name for the company provided:

1) The last word(s) in the name of the company, if limited by shares or by guarantee is 'limited' or 'private limited', as the case may be. However, an "association not for profit", incorporated as a company and licensed by the Central Government, may not use the word 'limited' or 'private limited' as part of its name, even though the liability of its members is limited (Section 8).

2) The name stated in the memorandum is not—

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

   b) 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.

Further, 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. Thus, words like President, Prime Minister, Central, Municipal, Panchayat may not be allowed; or

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

Undesirable Names

Rule 8 of the Companies (Incorporation) Rules, 2014, as amended by Companies (Incorporation) Rule, 2019 framed by the Central Government under the Companies Act, 2013, in this regard, provides as follows:

- In determining whether a proposed name is identical with another, the differences on account of the following shall be disregarded. In other words, the proposed name cannot be merely different with respect to, *inter alia*, the following:
  - the type and case of letters, spacing between letters and punctuation marks;
  - joining words together or separating the words;
  - using different phonetic spellings or spelling variations , for example, P.Q. Industries limited is existing then P and Q Industries or Pee Que Industries or P n Q Industries or P & Q Industries will not be allowed. Similarly if a name contains numeric character like 3, resemblance shall be checked with 'Three' also;
  - the addition of an internet related designation, such as .com, .net, .edu, .gov, .org, .in;
  - the addition of words like New, Modern, Nav, Shri, Sri, Shree, Sree, Om, Jai, Sai, The, etc;
  - different combination of the same words, e.g., if there is a company in existence by the name of "Builders and Contractors Limited", the name "Contractors and Builders Limited" will not be allowed unless it is change of name of existing company;
  - if the proposed name is the Hindi or English translation or transliteration of the name of an existing company or limited liability partnership in English or Hindi, as the case may be.
- Again, a name shall be considered undesirable if:-
  - it attracts the provisions of section 3 of the Emblems and Names (Prevention and Improper Use) Act, 1950 (12 of 1950);
  - it includes the name of a registered trade mark or a trade mark which is subject of an application for registration, unless the consent of the owner or applicant for registration, of the trade mark, as the case may be, has been obtained and produced by the promoters;
  - it includes any word or words which are offensive to any section of the people;

A name shall also generally be considered undesirable if:-

- the proposed name is identical with or too nearly resembles the name of a limited liability partnership;
- the name reflects objects of the company and is not in consonance with the principal objects of the company as set out in the memorandum of association;
- the company's main business is financing, leasing, chit fund, investments, securities or combination thereof, such name shall not be allowed unless

the name is indicative of such related financial activities, viz., Chit Fund/ Investment/ Loan, etc.;

- it resembles closely the popular or abbreviated description of an existing company or limited liability partnership;
- the proposed name is identical with or too nearly resembles the name of a company or limited liability partnership incorporated outside India and reserved by such company or limited liability partnership with the Registrar:

But, if a foreign company is incorporating its subsidiary company in India, then the original name of the holding company as it is may be allowed with the addition of word India or name of any Indian state or city, if otherwise available;

- the proposed name implies association or connection with embassy or consulate or a foreign government;
- the proposed name includes or implies association or connection with or patronage of a national hero or any person held in high esteem or important personages who occupied or are occupying important positions in Government;
- the proposed name is vague or an abbreviated name such as 'ABC limited' or '23K limited' or 'DJMO' Ltd: abbreviated name based on the name of the promoters will not be allowed. For example:- BMCD Limited representing first alphabet of the name of the promoter like Bharat, Mahesh, Chandan and David.

An existing company may, however, use its abbreviated name as part of the name for formation of a new company as subsidiary or joint venture or associate company;

- the proposed name is identical to the name of a company dissolved as a result of liquidation proceeding and a period of two years have not elapsed from the date of such dissolution (since the dissolution of the company could be declared void within the period aforesaid by an order of the Tribunal under section 356 of the Act).
- it is identical with or too nearly resembles the name of a limited liability partnership in liquidation or the name of a limited liability partnership which is struck off up to a period of five years;
- the proposed name include words such as 'Insurance', 'Bank', 'Stock Exchange', 'Venture Capital', 'Asset Management', 'Nidhi', 'Mutual fund' etc., unless a declaration is submitted by the applicant that the requirements mandated by the respective regulator, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;
- the proposed name includes the word "State", the same shall be allowed only in case the company is a government company.
- the proposed name is containing only the name of a continent, country, State, city such as Asia limited, Germany Limited, Haryana Limited, Mysore Limited;
- the name is only a general one, like Cotton Textile Mills Ltd. or Silk Manufacturing Ltd., and not Lakshmi Silk Manufacturing Co. Ltd;
- it is intended or likely to produce a misleading impression regarding the scope or scale of its activities which would be beyond the resources at its disposal:

- In case the key word used in the name proposed is the name of a person other than the name(s) of the promoters or their close blood relatives, No objection from such other (s) shall be attached with the application for name.

Too similar name - In case of too similar names, the resemblance between the names must be such as is likely to deceive. A name is likely to deceive where it suggests some connection or association with an existing company.

Examples

In **Ewing v. Buttercup Margarine Co. Ltd. [1917]**, the plaintiff who carried on business under the name of Butter Cup 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.

However, merely that few words are common may not render the name too identical and thus undesirable. Thus, in **Society of Motor Manufactures & Traders Limited v. Motor Manufactures & Traders Mutual Assurance Limited [1925]**, the plaintiff company brought an action to restrain the defendant company from using the said name. But, Lawrence, J., held "anyone who took the trouble to think about the matter, would see that the defendant company was an Insurance company and that the plaintiff society was a trade protection society and I 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".

Similarly, in **Asiatic Government Security Life Assurance Company Ltd. vs. New Asiatic Insurance Company Limited [1939]**, the Court held the two names were not too identical and therefore, did not restrain the respondents.

Thus, whether a name is too similar or not and therefore it shall be allowed or not is a question in each case.

Publication of name (Sec. 12)

Sub-section (*3*) of Section 12 provides 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 in the language in general use in the locality. 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]**. 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, if any;

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.

However, 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*).

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.

If a company does not paint or affix its name and the address of its registered office in the prescribed manner, If any default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees. [Section 12(8)]

6.5.2 The Registered Office Clause [Sec. 4(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 a registered office which establishes its domicile and is also the address at which the company's statutory books must normally be kept and to which notices and other communications can be sent. The notice of the exact situation (address) of the registered office shall be given to the Registrar of Companies, within 30 days from the date of incorporation (Section 12).

Verification of the Registered Office

The company must furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation by filing any of the prescribed documents.

6.5.3 The Objects Clause [Section 4(1) (c)]

The objects clause defines the objects of the company and indicates the sphere of its activities. As per Section 4 (1) (c), in this clause must be stated the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

A company cannot do anything beyond or outside its objects and any act done beyond that 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 an *ultra vires* act— ***Attorney General*** v. ***G.E. Rly. Co.***[1880]. Thus, a trading company has an implied power to borrow money and draw and accept bills of exchange.

The objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Act. *For example*, a public limited company cannot finance purchase of its own shares (Section 67 (2)).

6.5.4 The Liability Clause [Sec. 4(1)(d)]

This clause states the nature of liability of the members. **In the case of a limited liability company having share capital**, it must state that liability of members is limited to the amount unpaid on the shares. Thus, where a shareholder holding a 10-rupee share has paid Rs. 5 on it, he can be called upon to pay the balance of Rs. 5. But if he has paid the full value of Rs. 10, he cannot be required to pay anything more even if the company owes huge debts to its creditors.

In the case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets and costs, charges and expenses of winding up of the company.

In the case of unlimited liability company, whether having share capital or not, this clause shall state that the liability of its members is unlimited.

6.5.5 The Capital Clause [Sec. 4(1)(e)]

This clause must indicate the amount of capital with which the company is registered, and is known as Registered or Authorised or Nominal capital.

As per Sec. 4 (1) (e), in the case of a company having a share capital, the memorandum must state 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.

In the case of a public company having a share capital, a share may be either a Preference Share or an Equity share. Thus, a company's capital may be Preference share capital and Equity share capital. This clause shall state the number and value of shares into which the capital of the company is divided.

These shares are of a certain fixed value or amount. This fixed value is known as the "Par" or "nominal" value of a share. Thus, the nominal value of an equity share may be, say, Rs.10, and that of a preference share, say, Rs.100.

The effect of this clause is that the company cannot issue more shares than stated under this clause without altering the Memorandum as per Section 61 of the Companies Act, 2013.

6.5.6 The Association or Subscription Clause [Sec. 4 (1)(e)]

At the end of the Memorandum of every company there is an association or subscription clause in which the subscribers to the Memorandum of Association make the following declaration:

"We, the several persons, whose names and addresses 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 against our respective names."

In case of 'one person company', the declaration made shall be as follows:

"I, whose name and address is given below, am desirous of forming a company in pursuance of this memorandum of association and agree to take all the shares in the capital of the company."

According to Section 3 of the Act, the Memorandum shall be signed by at least seven subscribers in case of a public company, at least two subscribers in case of a private company and one subscriber where the company to be formed is one person company.

The statutory requirements regarding subscription of memorandum are:

a) the memorandum must be signed by each subscriber in the presence of at least one witness who must attest the signature;

b) each subscriber must take at least one share;

c) each subscriber must write opposite his name the number of share he takes [Section 4 (1) (e)]

6.6 DOCTRINE OF *ULTRA VIRES*

The term *'Ultra'* means' *beyond'* and the term *'Vires'* means the *'powers'*. Thus, ultra vires a company means *'beyond the powers of a company'*. You have learnt that the objects clause of the Memorandum states the objects of the company, therefore, any act which is beyond the stated purposes is ultra vires the company and, therefore, null and void. The company shall not be bound by such acts which are ultra vires the company. The purpose of the doctrine of ultra vires is to protect the interest of members, outsiders and creditors. They are:

i) The members of the company know the purposes for which their money can be used by the company.

ii) The third parties dealing with the company know the purposes for which the company has been brought into existence and, therefore, restrict their transactions with the company to those purposes only. Similarly, the creditors are assured that the assets of the company shall not be risked in unauthorized business.

Thus, in order to protect the interests of the shareholders and the third parties which enter into contracts with the company, the company's activities are confined to the objects given in the Memorandum of Association. It cannot do anything beyond the objects clause and if it does, it will be considered *ultra vires* (beyond capacity) and void *ab-initio*.

Ultra vires acts can be divided into the following three categories:

1) *Ultra vires* he Companies Act,

2) *Ultra vires* the Memorandum of Association, and

3) *Ultra vires* the Articles of Association.

1) ***Ultra vires* the Companies Act**: Any act done contrary to or in excess of the scope of Companies Act will be *ultra vires* the Act. Such an act shall be void and cannot be ratified even by a unanimous resolution of all the shareholders. A few examples of such acts are as follows:

   a) Payment of dividend out of capital (Sec. 123);

   b) Issue of bonus shares in lieu of dividend (Sec. 63);

   c) Issuance of unauthorized capital (Sec. 62);

   d) Reducing the share capital without complying with legal formalities (Sec. 66).

2) ***Ultra vires* the Memorandum of Association**: The Memorandum defines and confines the powers of company. The object of the company is determined by the Memorandum. A company cannot do anything which is beyond the purview of the objects clause. Any act done in contravention of the object clause shall be *ultra vires* the Memorandum and shall be void and it cannot be ratified even by an unanimous resolution of all the shareholders. The doctrine of ultra vires was first applied in the famous case of **Ashbury Railway carriage and Iron Co. v Riche**. In this case the company was incorporated to make, and sell, or lend on hire, railway carriages and wagons and to carry on the business of mechanical engineers

and general contractors. The directors of the company entered into a contract with Riche, a firm of railway contractor to finance construction of a railway line in Belgium. The contract was ratified by the company by passing a special resolution at a general meeting. Later, the contract was repudiated by the company on grounds of its being ultra vires and it was sued for breach of contract. The House of Lords held that the contract was ultra vires the Memorandum and therefore void. It could not be ratified by the shareholders, as the contract was *ultra vires* the object clause.

The doctrine of ultra vires has been recognized in India as well. The doctrine has been affirmed by the Supreme Court in **A.L. Mudaliar v. LIC of India.**

3) ***Ultra vires* the Articles of Association**: Acts which are ultra vires the articles of associations but are within the powers of the company are termed as *ultra vires* the articles. For example, payment of interest on 'advance calls' at a rate higher than allowed by the articles. Such act shall also be void, but the company in General Meeting may alter the articles by a special resolution and ratify unauthorised acts.

Effects of Ultra vires transactions:

1) **Void ab-initio**: An act which is *ultra vires* the company shall be null and void and it cannot be enforced against the company.

2) **No ratification** : An ultra vires the company transaction cannot be ratified even by the whole body of shareholders.

3) **Not Enforceable** : Not only outsiders can enforce *ultra vires* transactions against the company, the company can also not enforce such transactions against third parties.

4) **Injunction** : Whenever an ultra vires act has been or its about to be done, any member of the company can approach the Court and get an injunction restraining the company from proceeding with the ultra vires acts.

5) **Personal liability of Directors**: The directors of the company can be held personally liable for any loss caused by an ultra vires transaction.

From the above it should be clear to you that if an act is *ultra vires* the company, then such act shall be null and void. Thus, if a company borrows money beyond its limit, it is ultra vires and the lender has no right in respect of the loan against the company.

You should note that if an act is ultra vires the directors, but it is with in the powers of the company then such an act is not altogether void. It can be ratified by the shareholders in their general meeting and when it is so ratified, the company becomes liable for such acts. Now, if the company has power to borrow, but it restricts the authority of the directors to borrow upto a certain sum [Section 179 (4)], if the directors exceed their authority and borrow more than what they are authorized to borrow then the company may, if it wishes, ratify the directors' act, in which case the loan binds both the lender and the company as if it had been made with the company's authority in the first place.

Check Your Progress A

1. Mention the type of company against the Table in which its model form of Memorandum is given:

Table A

....

Table B

....

Table C

....

Table D

....

Table E

....

2. Fill in the blanks.

   i) Memorandum of Association is to be signed by at least ……..……… persons in the case of a public company and by ………..……….. persons in the case of a private company.

   ii) Every subscriber to the Memorandum has to take at least ……….. share.

   iii) The purpose of the Memorandum of Association is to protect the interest of …………….. as well as outsiders.

3. State whether the following statements are True or False.

   i) Memorandum of Association limits the area of operation of a company.

   ii) The signatures of subscribers to the memorandum need not be witnessed.

   iii) Every company is not required to prepare and file its own Memorandum of Association at the time of incorporation.

   iv) Any act done by a company beyond its objects clause is ultra vires.

   v) In the case of a company limited by shares, a member is liable to pay only the unpaid amount on his shares.

   vi) In the case of a company limited by guarantee, a member can be called upon to pay the 'guarantee amount' at any time during the life time of the company.

6.7 ALTERATION OF DIFFERENT CLAUSES IN THE MEMORANDUM

Section 13 provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provisions have been made in the Act. These provisions are explained herein below.

6.7.1 Change of Name

A) Change of name at the instance of the company: Section 13 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.

The company shall file with the Registrar—

a) the special resolution passed by the company; and

b) the approval of the Central Government.

When any change in the name of a company is made, as aforesaid, the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation in Form 2.27 with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

B) **Change of name on a direction from the Central Government:** If through inadvertence or otherwise, a company on its first registration or on its registration by a new name has been regis-tered with a name which, in the opinion of the Central Government, is identical with or too closely resembles the name of an existing company, the company may change its name within a period of *three months* from the issue of such direction by passing an ordinary resolution and by obtaining the approval of the Central Government in writing [Sec. 16].

Again, the company may change its name by following the aforesaid procedure, where an application has been made to the Central Government by a registered proprietor of a trade mark within three years of incorporation or registration or change of name of the company and, in the opinion of the Central Government, the name is identical with or too nearly resembles a registered trade mark of such proprietor under the Trade Marks Act, 1999. Where such a direction is made by the Central Government, the company shall change its name or new name, as the case may be, within a period of *six months* from the issue of such direction.

In eGMP Pharmaplan (P.) Ltd. vs. Regional Director, Ministry of Corporate Affairs, [2011], NNE Pharmaplan (P.) Ltd., filed a representation before Regional Director under section 22 (now Section 14) seeking a direction that petitioner-company incorporated on a later date with name eGMP Pharmaplan (P.) Ltd. should change its name. Regional Director concluded that use by petitioner of word "Pharmaplan" in its name would have a misleading effect in mind of general public and as such, it was a fit case for issue of direction under section 22(1)(b) [now Section 14] and directed petitioner to delete word 'Pharmaplan' from its existing name and change its name to some other name. The Delhi High Court held that since names of both companies structurally and phonetically too nearly resembled each other, Regional Director was right in directing petitioner to change its name.

As per Rule 29 of the Companies (Incorporation) Rule, 2014 framed by the Central Government, change of name shall not be allowed to a company which has defaulted in filing its Annual Returns or Financial Statements or any document due for filing with the Registrar or which has defaulted in repayment of matured deposits or debentures or interest on deposits or debentures.

You would have noted that the direction of the Central Government is required to be complied within a period of three or six months, as the case may be, from the date thereof.

If a company makes default in complying with any direction given under section 16 (*1*), the company shall be punishable with fine of one thousand rupees for every day during which the default continues and every officer who is in default shall be punishable with fine which shall not be less than five thousand rupees but which may extend to one lakh rupees [Section 16 (3)].

Where a company changes its name or obtains a new name under Section 16 (*1*), 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.

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 15 further requires that 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.

In case of any default in this regard will make the company and every officer who is in default liable to a penalty of one thousand rupees for every copy of the memorandum or articles issued without such alteration.

C) Effect of change of name

i) The change of name shall not affect any rights/obligations of the company or render the same defective in legal proceedings by or against it. Moreover, any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name.

ii) However, if any legal proceeding is commenced, after change of name, against the company, in its old name, it is a case of mere misdescription and not a case of proceeding against a person not in existence. It is not an incurable defect and can be amended to substitute the new name - **Pioneer Protective Glass Fibre (P.) Ltd. vs. Fibre Glass Pilkington Ltd. [1986]**.

iii) By change of name constitution of company does not change: In **Economic Investment Corporation Ltd. vs. CIT [1970]**, it was held that by change of name, the constitution of the company is not changed. The only thing that changes is its name; all the rights and obligations under the law of the old company pass to the new company. It is not similar to the reconstitution of a partnership, which in law means creation of a new legal entity altogether.

6.7.2 Change of Registered Office

This may include:

a. ***Change of registered office from one premises to another premises in the same city, town or village [Sec. 12]*** - A company can change its registered office from one place to another within the local limits of the city, town or village where it is situated, by passing a resolution of the Board of directors. However, the company should inform the Registrar the new address within 15 days of the change who shall record the same.

b. ***Change of Registered Office from one town or city or village to another town or city or village in the same State [Section 12]*** - In this case the following procedure is to be followed:

   i) ***Special resolution*** - A special resolution is required to be passed at a general meeting of the shareholders.

   ii) ***Confirmation of Regional Director*** - Confirmation of the Regional Director is to be obtained where the change is from jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies. The application to the Regional Director shall be made in Form INC-23. The Regional Director shall communicate the confirmation within a period of thirty days from the date of receipt of application to the company.

   As per Rule 28, the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

   iii) ***Copy of special resolution and confirmation by Regional Director to be filed with ROC*** - A copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days (Section 117). Copy of the confirmation by Regional Director shall be filed with the Registrar of Companies within 60 days of the date of confirmation. The Registrar is required to register the same and certify the registration within 30 days from the date of filing of such confirmation (Section 12).

The certificate issued by the Registrar shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.

If any default is made in complying with any of the aforesaid requirements, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

c. ***Change of Registered Office from one State to another State*** - Section 13 contains provisions with respect to the shift of the registered office from one State to another. You should note that shift of registered office from one premises to another within the same city/town/village or even from one city to another but within the same State does not involve alteration of memorandum. It's because, in the memorandum only the name of the State where registered office shall be located is mentioned. Shift of registered office from one State to another will involve alteration of memorandum and, therefore, requires a more elaborate procedure to be followed. Registered office of a company can be shifted from one State to another by:

   1. Passing special resolution;

   2. Settlement of the list of creditors including debenture holders;

   3. Obtaining the consent of the creditors and in case any creditor or creditors object, his debt or claim should be discharged or determined or secured to the satisfaction of the Central Government;

4. Obtaining confirmation from the Central Government.
5. Giving notice of the change of registered office in the manner prescribed to be given to registrar of companies within 30 days of the change.

Obtaining confirmation from the Central Government

For obtaining confirmation from the Central Government, Rule 30 of the Companies (Incorporation) Rules, 2014 provides that an application shall be filed with the Central Government in Form No. INC-23 along with the prescribed fee and specified documents.

The aforesaid information must, by way of an affidavit, be signed by the Company Secretary of the company, if any, and not less than two directors of the company, one of whom shall be a managing director.

Again, there shall also be attached to the application an affidavit from the directors of the company that no employee shall be retrenched as a consequence of shifting of the registered office from one State to another State.

There shall also be attached to the application a copy of the acknowledgment of service of a copy of the application with complete annexure to the Registrar and Chief Secretary of the State where the registered office is situated at the time of filing the application.

The company must also keep a duly authenticated copy of the list of creditors at the registered office.

Where any objection of any person whose interest is likely to be affected by the proposed application has been received by the applicant, it shall serve a copy thereof to the Central Government on or before the date of hearing.

Where no objection has been received from any of the parties, who have been duly served, the application may be put up for orders without hearing.

Order of Confirmation

Rule 30, read along with Section 13 (5) provides that before confirming the alteration, the Central Government shall ensure that, with respect to every creditor and debenture holder who, in the opinion of the Central government, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Central government, either his consent to the alteration has been obtained or his debt or claim has been discharged or has determined, or has been secured to the satisfaction of the Central Government.

The Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper.

You may note that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

Sub-section (5) of Section 13 provides that the Central Government shall dispose of the application under sub-section (*4*) within a period of sixty days.

Filing of order of the Central Government with the Registrar

Section 13 (7) read along with Rule 30 of **the Companies (Incorporation) Rules, 2014** requires a certified copy of the order of the Central Government approving the alteration to be filed by the company with the Registrar of each of the States within a period of 30 days, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

6.7.3 Change in Objects Clause

Alteration of objects may be divided into:

1. Alteration of objects by a company which has not issued a prospectus
2. Alteration of objects by a company which has issued a prospectus

1. **Alteration of objects by a company which has not issued a prospectus**

   A company which have not issued a prospectus may change its object by passing a special resolutions.

2. **Alteration of objects by a company which has issued a prospectus**

   Section 13 (*8*) read along with Rule 32 of **the Companies (Incorporation) Rules, 2014** provides that 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 through postal ballot is passed by the company. Requirement of passing of special resolution through postal ballet is not applicable where the number of members is upto 200. (companies management and administration rules 2014).

Besides, the notice in respect of the resolution for altering the objects shall contain the prescribed particulars including the unutilized amount out of the money so raised through prospectus, justification for the alteration/change in the objects, amount proposed to be utilized for the new objects.

6.7.4 Change in Liability Clause

The Companies Act, 2013 or the Rules made thereunder do not contain any provisions with respect to the alteration of liability clause. However, since the relationship between a member and the company is a contractual relationship, 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 of unlimited liability company, the liability may be made limited or reduced by re-registration of the company (Section 18). The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the registration of the unlimited company as a limited company [Sec. 18 (3)].

6.7.5 Change in Capital Clause

Section 61 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;
2. to consolidate and divide all or any of its share capital into shares of larger

amount than its existing shares e.g., 10 shares of Rs.10 each may be consolidated into one share of Rs.100 each;

3. to convert all or any of its fully paid-up shares into stock, and reconvert that 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 of paid and unpaid on each share must remain the same;

5. to 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 thus diminish the amount of its share capital by the amount of the shares so cancelled.

Check Your Progress B

1. Fill in the blanks.

   i) A company can shift its Registered Office to another State by passing a special resolution and with the permission of the …..........................………

   ii) The capital clause of Memorandum points out the…………….. capital of a company.

   iii) Capital clause can be altered by ……………..

   iv) Object clause of a company having issued prospectus and part of the funds so raised being unutilized can be altered ……… ……………………

2. Which of the following is correct:

   a) i) Memorandum of association is an unalterable charter.

      ii) Memorandum of association is an alterable charter.

      iii) Memorandum of association is not a charter.

   b) i) Authorised share capital of a company cannot be changed.

      ii) Authorised share capital of a company may be increased by passing an ordinary resolution.

      iii) Authorised share capital of a company may be increased by passing a special resolution.

      iv) Authorised share capital of a company may be increased by passing a special resolution and approval of the Central Government.

6.8 LET US SUM-UP

Memorandum of association of a company is a document of great importance. It defines as well as confines the powers of the company. Any act beyond the scope of the memorandum is ultra vires the company and thus unenforceable. Section 4 of the Companies Act, 2013 requires that the memorandum of a company must be drawn up in the form as given in Tables A, B, C, D & E in Schedule I, as may be applicable in the case of a company. Further, Section 4 requires the memorandum of a limited company to contain information about its name {with 'limited' or 'private limited' as the last word(s), as the case may be]; the name of the State in which registered office is to be situated; the objects with which the company is being registered; the liability being limited or unlimited; the amount of authorised share capital and its division into shares of fixed amounts. Memorandum of association has the following clauses.

Name Clause: Promoters are free to choose any suitable name for the company provided : (i) the last word/(s) is/are 'limited' or 'private limited', as the case may be (except in case of 'associations not for profit' if licensed by the Central Government); (ii) the name chosen is not undesirable. Central Government has framed certain rules in determining as to when a name may be considered undesirable.

Every company is required to paint or affix its name and address of its registered office outside of every office or place of business in a conspicuous position and in letters which are easily legible and in the language in general use in the locality.

Registered office clause: This clause states the name of the State in which the registered office of the company will be situated. Registered office of a company establishes its domicile.

The Objects Clause: In this clause must be stated the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

Any act beyond the objects stated in the memorandum is *ultra vires* the company and thus void.

Liability clause: This clause states the nature of liability of the members. In the case of a limited company, it must state that the liability of its members is limited by the amount remaining unpaid on the shares held by a member and in case of a guarantee company, by the amount guaranteed by him.

Association or subscription Clause: At the end of the memorandum of every company there is an association or subscription clause. Each subscriber must write opposite his name the number of shares he undertakes to subscribe for.

Alteration of Memorandum: The contents of a memorandum can be altered only in the manner and to the extent provided in the Act.

Name of a company can be changed by passing a special resolution and obtaining the approval of the Central Government.

Where a company has been registered by an undesirable name, the Central Government may direct it to alter its name. In such a case, the company may change its name by passing an ordinary resolution and then obtaining confirmation of the Central Government for the new name.

Registered office of a company may be shifted from one premises to another premises by passing a resolution of the Board of directors and intimating the change to ROC within 15 days thereof. But, where the registered office is proposed to be shifted from one city to another city within the same State, special resolution at a general meeting of shareholders must be passed. However, if shift of registered office from one city/town, etc. to another but within the same State results in change of jurisdiction of one ROC to the other, approval of the Regional Director shall also be necessary. Copy of the confirmation by

Regional Director shall be filed with the Registrar of Compa-nies within 60 days of the date of confirmation. The Registrar is required to register the same and certify the regis-tration within 30 days from the date of filing of such confirmation. But, shifting of registered office from one State to another State requires passing of special resolution of shareholders as well as the approval of Central Government.

Alteration of objects by a company which has not issued a prospectus, if Articles are silent, the company may at any time alter its objects by passing a Board of Directors' resolution. But, if company has raised money through issue of 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 through postal ballot is passed by the company.

Liability of a member cannot be increased unless the member agrees in writing. Alteration of capital clause may involve increase of authorised capital of the company, or sub-division or consolidation of shares or cancellation of shares not taken or agreed to be taken by any person. Any of these changes can be done, as per Section 61, by passing an ordinary resolution in general meeting of shareholders.

6.9 KEY WORDS

Memorandum of Association: It is a fundamental document containing conditions on the basis of which a company is incorporated.

Limited Liability: It denotes that the liability of the members is limited by the amount remaining unpaid on their shares. In the case of a guarantee company, this phrase denotes the maximum amount up to which a member of a company can be called upon to pay at the time of winding up.

Par Value: A company limited by shares has a share capital which is divided into shares of a certain fixed value or amount. This fixed value amount is known as "Par Value".

Registered Office: The Registered Office of a company determines its domicile. Also, this is the office to which notices are served and communications are sent to the company.

Ultra-Vires: Something which is beyond the powers of a company to do.

Unlimited Liability: The liability of the members of a company is termed as unlimited when their personal assets can be called to pay the liabilities of the company.

6.10 ANSWERS TO CHECK YOUR PROGRESS

A. 1.	Table A	A company limited by shares.
	Table B	A company limited by guarantee and not having a share capital.
	Table C	A company limited by guarantee and having a share capital.
	Table D	An unlimited company and not having share capital.
	Table E	An unlimited company and having share capital.

2. i) 7; 2 ; ii) One iii) Members

3. i) True; ii) False; iii) False; iv) True; v) True, vi) False

B 1. i) Central Government

ii) Authorised/Registered/Nominal

iii) Passing an ordinary resolution at a general body meeting.

iv) Passing a special resolution through postal ballot

2. a) (i); b) (ii)

6.11 TERMINAL QUESTIONS

1. What do you understand by Memorandum of Association?
2. What is the purpose of Memorandum of Association?
3. Enumerate the different clauses which are included in the Memorandum of Association.
4. Illustrate the Doctrine of *ultra vires* with suitable examples.
5. Describe the procedure for alteration of the objects clause of a company.
6. A company has its registered office in Delhi. The Board of Directors wants to shift its registered office from Delhi to Chandigarh, advise.
7. A Company was registered with name ‘Pyare Lal and Sons’ Pvt. Ltd. on Ist July, 2019 with registrar of companies in Delhi. Another company got registered with name ‘Pyaray Lal and Sons Pvt Ltd. at Jaipur with registrar of Company as 20th September, 2019. Discuss.
8. A Company has the business of manufacturing shirts for men. It wants to now add a new business of manufacturing “Trausers for men’. Its main object clause contains’ Manufacturing readymade garments for men’. Discuss the case.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 7 ARTICLES OF ASSOCIATION

Structure

7.0 Objectives

7.1 Introduction

7.2 Meaning and Purpose of Articles

7.3 Registration of Articles

7.4 Contents of Articles

7.5 Alteration of Articles

 7.5.1 Limitation on Power to Alter Articles

 7.5.2 Effect of Altered Articles

7.6 Relationship between Memorandum and Articles

7.7 Distinction between Memorandum and Articles

7.8 Binding Effect of Memorandum and Articles

7.9 Doctrine of Constructive Notice

7.10 Doctrine of Indoor Management

7.11 Let Us Sum Up

7.12 Key Words

7.13 Answers to Check Your Progress

7.14 Terminal Questions

7.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and purpose of articles of association;
- describe the contents of articles of association;
- explain the procedure for alteration of articles of association;
- know the limitations on the power of the company to alter articles of associations;
- explain the relationship of and distinction between articles of association and memorandum;
- explain the legal effects of the memorandum and articles; and
- understand the doctrines of constructive notice and indoor management.

7.1 INTRODUCTION

You have learnt in earlier units that a company is an incorporated body. Therefore, rules have to be framed for the management of its internal affairs and the conduct of its business. The relationship between the company and the members constituting it is to be defined. The rights and duties of members' vis-à-vis the company is to be described. All such rules and regulations are given in the articles of association. The Articles is the second important document which has to be filed with the Registrar of Companies.

The Companies Act, 2013, in Tables F, G, H, I and J in Schedule I has given model regulations for the management of respective companies that may be formed under the companies Act. As per the Companies Act, 2013, every company must have Articles of Association. However, a company has the freedom to adopt the applicable model Articles in whole or any of the regulations applicable to such company. In this unit, you will learn about the significance of the Articles and its contents. You will also note the distinction between the Memorandum and the Articles. The procedure of altering the Articles has also been explained. You will also study the legal effects of these documents. The doctrines of Constructive Notice and Indoor Management have been explained in detail.

7.2 MEANING AND PURPOSE OF ARTICLES

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.

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 in pursuance of any previous company law or of this Act", *i.e.*, the Act of 2013".

The Articles regulate the internal management of the company. They define the powers of its officers. They also establish 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. *Calcutta Stock Exchange Association Ltd.* (1971)]**.

Articles are like the partnership deed in a partnership. They set out provisions for the manner in which the company is to be administered. In particular, they provide for matters like the making of calls; forfeiture of shares; directors' qualifications; procedure for transfer and transmission of shares and debentures.

7.3 REGISTRATION OF ARTICLES

Documents to be filed for registration of a company include Articles of Association of the company. As per Section 5 of the Companies Act, 2013, the articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule 1 as may be applicable to such company. You may note that Table F contains model articles for a company limited by shares. Tables G, H, I and J contain model articles for a company limited by guarantee and having a share capital, a company limited by guarantee and not having a share capital, an unlimited company and having a share capital and an unlimited company but not having a share capital respectively.

A company may adopt all or any of the regulations contained in the model articles applicable to such company.

In case of any company, which is registered under 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.

With respect to companies registered under any previous law, the existing articles may continue unless the company decides to change the same as per the model articles contained in the respective applicable table, as aforesaid.

Signing of the Articles of Association

As per Rule 13 of the Companies (Incorporation) Rules, 2014, the Memorandum and Articles of Association of the company shall be signed in the following manner:-

- **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 at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any.

  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/their ID for their identification and satisfied myself of his/her/their identification particulars as filled in.

- **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. He shall also write against the name of the subscriber, the number of shares taken by him. 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.

- **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 in this behalf by a resolution of the board of directors of the body corporate.

- **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.

- **Where subscriber to the memorandum is a foreign national residing outside India,** memorandum and articles of association shall be signed in the manner prescribed in the rules.

7.4 CONTENTS OF ARTICLES

You have learnt that the Articles of Association of a company contains the rules and regulations for the internal management of the company. As per Section 5 of the Companies Act, 2013, the articles shall also contain such matters, as may be prescribed. However, company may include such additional matters in its articles as may be considered necessary for its management.

Provisions for Entrenchment

For the first time Companies Act, 2013 contains provisions relating to entrenchment from Articles. Sub-section (*3*) of Section 5 provides that the articles may contain provisions for entrenchment. What it means is that Articles may provide that certain provisions of the Articles will not be alterable merely by passing a special resolution; they will require a more elaborate prescribed procedure to be followed.

The provisions for entrenchment referred to above shall only 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.

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.

The Articles of Association of a company usually contain rules and regulations relating to the following matters:

i) The exclusion, wholly or in part, of the model articles as contained in respective Tables.

ii) Share capital- shares and their value and their division into equity and preference shares, if any.

iii) Rights of each class of shareholders and procedure for variation of their rights.

iv) Procedure relating to the allotment of shares, making of calls and forfeiture of shares.

v) Increase, alteration and reduction of share capital.

vi) Rules relating to transfer or transmission of shares and the procedure to be followed for the same.

vii) Lien of the company on shares allotted to the members for the amount unpaid in respect of such shares and the procedure in respect thereof.

viii) Appointment, remuneration, powers, duties etc. of the directors and officers of the company.

ix) Constitution and composition of Audit committee, Remuneration Committee, CSR Committee.

x) Procedure for conversion of shares into stock and vice versa.

xi) Notice of the meetings, voting rights of members, proxy, quorum, poll, etc.

xii) Audit of accounts, transfer of amount to reserves, declaration of dividend, etc.

xiii) Borrowing powers of the company and the mode of exercise of those powers.

xiv) Issue of share certificates including procedure for issue of duplicate shares.

xv) Winding up of the company.

The Articles of Association must be prepared carefully and it must contain rules in regard to all such matters which are required to be contained therein and which are necessary for the smooth functioning of the company.

But you must remember that the Articles must not contain anything which is against the provisions of the Companies Act or the Memorandum of Association. For example, Articles must not contain a rule permitting the payment of dividend out of capital, because according to Section 123, dividend can be paid only out of profits.

Regulations required in case of unlimited company, company limited by guarantee and private company limited by shares

Tables G, H, I and J appended to Schedule I require the Articles of Association of a guarantee company having share capital and an unlimited liability company having share capital to mention the number of members with which the company proposes to be registered and in case of a guarantee company not having share capital and an unlimited liability company not having share capital, the Articles of Association should also state that the subscribers to the memorandum and such other persons as the Board shall admit to membership shall be members of the company.

A private company having a share capital must provide in the articles, the three restrictions specified in sub-clauses (*i*), (*ii*) and (*iii*) of sub-section (68) of Section 2, *viz.*, (*i*) as to the right to transfer shares (*ii*) limit as to number of its members (*iii*) invitation to public to subscribe for any securites of the company. Any other private company (*i.e.*, not having share capital) must provide in its articles, restrictions as given under (*i*) and (*ii*) as mentioned above.

7.5 ALTERATION OF ARTICLES

Section 14 provides that subject to the provisions of the Act and to the conditions contained in its memorandum; a company may, by special resolution alter its articles including alterations having the effect of conversion of—

a) a private company into a public company; or

b) a public company into a private company.

Where 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, that is, the restrictions contained in Section 2 (68), the company shall, as from the date of such alteration, cease to be a private company.

In other words, a private company may convert itself into a public company by omitting the three restrictive clauses of Section 2 (68) [*Already discussed under definition of a private company*].

But, where alteration of the Articles shall have the effect of conversion of a public company into a private company, the same shall not take effect unless the approval of the Central Government has been obtained. In other words, if a public company wants to convert itself into a public company by introducing the three restrictive clauses of Section 2 (68), merely passing of special resolution will not be sufficient; it will have to obtain the approval of the Central Government also.

A copy of special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution as required by section 117. The right to alter articles just by passing special resolution is so important that a company cannot, in any manner, deprive itself of this power - **Walker vs. London Tramway Company [1879]**.

Sub-section (2) of Section 14 requires every alteration of the articles and a copy of the order of the Central Government approving the alteration, where applicable, 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 and the Registrar shall register the same.

Any alteration of the articles registered under sub-section (*2*) shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

7.5.1 Limitation on Power to Alter Articles

You have noted that Section 14 of the Companies Act, 2013 allows companies to alter the articles of association of a company by passing special resolution and where alteration is to have the effect of converting a public company into a private company; the company shall have to obtain the approval of the Central Government also besides passing special resolution. However, this right of the company to alter Articles is subject to certain limitation. These limitations include:

1. **Not to be inconsistent with Memorandum:** The alteration must not exceed the powers given by the memorandum or be in conflict with any provisions of the memorandum. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. **Not to be inconsistent with Companies Act or any other law:** The alteration must not be inconsistent with any provisions of the Companies Act or any other statute - for example, no public company can finance purchase of its own shares (Section 67) and if the articles of such a company are altered so as to have such a power then such power will be void.

   Similarly, where a resolution was passed expelling a member and authorising the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act [**Madhava Ramachandra Kamath vs. Canara Banking Corporation [1941]**].
3. **Not be inconsistent with any alteration made by the Tribunal:** Where under Section 242, the Tribunal makes an order with respect to any alteration in the memorandum or articles of a company, then the company shall not have the power to make any alteration which is inconsistent with its orders except with the approval of the Tribunal [Sec. 242 (5)].
4. **The altered articles must not include anything which is illegal or opposed to public policy or unlawful.**
5. *The alteration must be bona fide for the benefit of the company as a whole: It should not constitute a fraud on or oppress the minority.* The alteration will not, however, be bad merely because it inflicts hardship on an individual shareholder. In **Allen vs. Gold Reefs of West Africa Limited [1900]**, a company had a lien on all shares ‘not fully paid-up’ 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 by striking the words “fully paid up” and thus giving 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 that*, 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.

Again, in **Side Bottom vs. Kershaw Leese & Co. [1920]**, a company was empowered by an alteration in the articles, 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 being *bona fide* for the benefit of the company.

6. **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 14).***

7. **A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles**: In **British Murac Syndicate Ltd. vs. Alperton Rubber Co. [1915]**, an agreement provided that so long as the plaintiff syndicate should hold 5,000 shares in the defendant company, it should have the right of nominating two directors on the Board of the defendant company. A provision to the same effect was contained in 'Article 88' of the defendant company's articles. The plaintiff syndicate nominated two directors whom the defendant company refused to accept. An attempt was then made to cancel Article 88, but an injunction was granted to restrain it. The learned judge observed that the contract clearly involved, as one of its terms that Article 88 was not to be altered.

   However, where the damage is capable of being measured in terms of money, the company may alter its articles, subject to payment of damages for breach.

8. **Retrospective operation of Articles** - The amended regulation in the articles of association cannot operate retrospectively, but only from the date of amendment [**Pyare Lal Sharma vs. Managing Director, J & K Industries Ltd. (1989)**].

7.5.2 Effect of Altered Articles

Alteration binds members in the same way as original articles. The provision of Section 10 providing that the articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand after they have been altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles. ***Malleson* vs. *National Insurance & Guarantee Corpn.* [1894]**

Right of a shareholder to transfer his shares is always subject to provisions in articles of association as well as Section 14. A transferee, therefore, cannot have a better right than the transferor. The rights of a transferee until the transfer becomes effective, as against the company will again be subject to the provisions of the articles of association and the relevant provisions of the Act. The alteration affecting the articles of association in exercise of the said power cannot, therefore, be challenged by the transferee on the ground of being *mala fide* - **Mathrubumi Printing & Co. Ltd. v. Vardhaman Publishers Ltd. [1992]**.

7.6 RELATIONSHIP BETWEEN MEMORANDUM AND ARTICLES

The memorandum defines the company's objects and various powers it possesses; the articles determine how those objects shall be achieved and those powers exercised.

The articles of a company are subordinate and controlled by the memorandum of association which is the dominant instrument and contains the general constitution of the company. The memorandum is fundamental and can be altered only under certain circumstances provided by the Act. 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. 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 vs. Watson [1885]** - Articles going beyond the Memorandum are *ultra vires* - **Shyam Chand vs. Calcutta Stock Exchange [1947]**.

Subject to the rule that the memorandum prevails in the event of a conflict, the memorandum and the articles are contemporaneous documents, must be read together, and ambiguity or uncertainty in the one may be removed by reference to the other. Thus, where the memorandum was silent as to whether the company's shares were to be all of one class or might be of different classes, it was held that a power given by the articles to issue shares of different classes resolved the uncertainty and enabled the company to do so [**Re, South Durham Brewery Company (1885)**]. Where the memorandum of a trading company empowered to do all things incidental to achieving the object, it was held that provision in the articles empowering the company to lend money merely exemplifies the general words of the memorandum, and the company was, therefore, entitled to lend money to its employees [**Rainford vs. James Keith and Blackman Company Ltd. (1905)**]. Again, where the memorandum empowered the company to borrow on the security of its assets or credit and the articles provided that it might mortgage its uncalled capital, it was held that the articles merely made specific the general words of the memorandum so that the company could have power to mortgage its uncalled capital [**Re Pyle Works (No. 2) (1891)**].

The relationship between memorandum and articles has been aptly summed up by *Lord Cairns, L.C.* in **Ashbury Railway Carriage & Iron Co. Ltd. vs. Riche [1875]** as follows :

"The articles play a part subsidiary to a memorandum of association. They accept the memorandum of association as a charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of 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 actions of the company cannot go; inside that area, the shareholders may make such regulations for their own government as they think fit."

7.7 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between memorandum and articles may be noted as follows:

1. 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 the shareholders. The articles of association are the internal regulations of the company; they only regulate the relationship between company and the shareholders/members and amongst the members themselves.

2. Memorandum lays down the area beyond which the activities of the company cannot go. Articles provide for regulations inside that area. Thus, memorandum lays down the parameters for the articles.

3. Memorandum of association can be altered only under certain circumstances and in the manner provided in the Act. In most of the cases permission of the Central Government or Tribunal, is required, besides the approval of the shareholders in a general body meeting either by way of an ordinary resolution or special resolution. Generally, articles can be altered by the members by passing a special resolution only.

4. 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.

5. Acts done by a company beyond the scope of the memorandum are *ultra vires* and, thus, absolutely void. They cannot be ratified even by unanimous vote by all the shareholders. But the acts beyond the articles can be ratified by the shareholders provided the relevant provisions are not beyond the memorandum.

Check Your Progress A

1. Fill in the blanks.

   i) Articles of Associations are subsidiary to ………..……..

   ii) Articles of Association are the rules and regulations for the management of …………….. of the company.

2. State whether the following statements are True or False.

   i) Articles of Association regulate the relationship of the company with members.

   ii) Articles are the Charter of a company.

   iii) Every company is required to frame its own Articles of Association.

   iv) Articles of Association must be signed by subscribers to the Memorandum.

   v) Articles of a company can contain matters inconsistent with the provisions of the Companies Act, 2013.

   vi) Articles of Association are not required to be registered in case of a private company limited by shares.

7.8 BINDING EFFECT OF MEMORANDUM AND ARTICLES

Section 10 provides that the Memorandum and Articles, when registered, bind the company and its members to the same extent as if they had been signed by the company and by each member and contain covenants on its and his part to observe all the provisions of the Memorandum and of the 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, in relation to Articles, neither a company nor its members are bound to outsiders.

The discussion on legal effect of the Memorandum and Articles may be made under the following heads:

a) Members bound to the company;

b) Company bound to the members;

c) Members bound to members;

a) **Members Bound to the Company**

Each member must observe the provisions of the Memorandum and Articles. Every member is bound by whatever is contained in the Memorandum and Articles.

In **Borland's Trustee vs. Steel Bros. Co. Ltd. [1901]**, 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 market value. *Held,* that the trustee was bound by the articles, as a share was purchased by 'B' in terms of the articles.

Each member is not only bound by the covenants of memorandum and articles as originally framed but as altered from time to time in accordance with the provisions of the Companies Act.

b) **Company Bound to Members**

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* transaction. An individual member can make the company fulfil its obligation to him, such as to send the notice for the meetings, to allow him to cast his vote in the meeting.

In **Wood vs. Odessa Waterworks [1889]**, the directors proposed to pay dividend in kind by issuing debentures. The articles provided for payment of dividends. The Court held that payment means payment in cash and therefore the company could be compelled to pay dividend in terms of the Articles.

c) **Members Bound to Members**

The Articles bind the members *inter se, i.e.,* one to another as far as rights and duties arising out of 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 members *inter se* in relation to their rights as such members - **Ramakrishna Industries (P.) Ltd. vs. P.R. Ramakrishnan [1988]**.

After the articles are registered, they not only constitute a contract between the association or company on the one hand and its constituent members on the other, but they also constitute a contract between the members *inter se* - **Shiv Omkar Maheshwari vs. Bansidhar Jagannath [1957]**.

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 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)**].

However, Articles do not create an express contract among the members of the company. A member of a company has no right to bring a suit to enforce the Articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members *inter se* are regulated.

A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or *ultra vires* act. In **Jahangir R. Modi vs. Shamji Ladha [1866-67]**, the Bombay High Court held : "a shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have (by them) been employed in a transaction that they have no authority to enter into, without making the company a party to the suit".

Whether Company or Members Bound to Outsiders

The Memorandum or Articles do not confer any contractual rights upon outsiders against the company or its members, even though the name of the outsider is mentioned in the Articles. An out-sider (*i.e.*, a non-member) cannot rely on Articles of Association for his action against the company.

The articles of a company provided that 'E' should be a 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. His case 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 [**Eley vs. Positive Government Security Life Assurance Co. (1876)**].

Whether Directors are bound by whatever is contained in the Articles

The directors of a company derive their powers from the Articles and are subject to limitation, if any, applied on their powers by the Articles. If they contravene any provision of Articles, they render themselves liable to an action at the instance of the members. However, members may ratify the act of directors, if they so desire. But, if as a result of breach of duty, any loss has resulted to the company, the directors are liable to reimburse the company any loss so suffered.

7.9 DOCTRINE OF CONSTRUCTIVE NOTICE

Section 399 provides that the Memorandum and Articles when registered with Registrar of Companies 'become public documents' and then they can be inspected by any one by electronic means on payment of the prescribed fee. Again, Section 17 read along with **Rule 34** of **the Company (Incorporation) Rules, 2014** provides that a company shall on payment of the prescribed fee send a copy of each of the following documents to a member within seven days of the request being made by him-

1. the memorandum;
2. the articles, if any;
3. every agreement and every resolution referred to in sub-section (1) of section 117, if and so far as they have not been embodied in the memorandum and articles.

Failure to supply the copy (ies), as above, will make the company as well as every officer in default liable to a fine of Rs. 1,000 per day for each day of the default or Rs. 1,00,000, whichever is less.

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 of these documents it is presumed that he has an implied (constructive) notice of them. Where any charge or any property or assets of a Company or any of its undertaking is registered under Section 77, any person acquiring such property, asset or undertaking or part thereof any share or interest therein shall be deemed to have notice of the charge from the date of such registration (Section 80).

Example

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 will not have a right to claim under the bill.

7.10 DOCTRINE OF INDOOR MANAGEMENT

The rule of constructive notice proved too inconvenient for business transactions, particularly where the directors or other officers of the company were empowered under the articles to exercise certain powers subject only to certain prior approvals or sanctions of the shareholders. Whether those sanctions and approvals had actually been obtained or not could not be ascertained because the investors, vendors, creditors and other outsiders could not dare ask the directors in so many words about those sanctions having been obtained or to produce the relevant resolutions. Quite naturally, suppose if you desire to buy a 'bond' or 'debenture' issued by a company, you are not going to ask directors of the company to produce shareholders' resolution authorising them to issue such bonds before you subscribe the same. Likewise, if a director approaches you to buy certain goods worth, say, a few thousands of rupees, you will not ask him for a power of attorney or other relevant document authorising him to make those purchases on behalf of the company.

And if you do, may be, you will lose a good customer once for all. Since there are no means to ascertain whether necessary sanctions and approvals have been obtained before a certain officer exercises his powers which, as per articles, can only be exercised subject to certain approvals, those dealing with the company can assume that if the directors or other officers are entering into those transactions, they would have obtained the necessary sanctions. This is known as the 'doctrine of indoor management' and was first laid down in the case of **Royal British Bank vs. Turquand [1856]**.

The facts of **Turquand's** case were as follows:

The directors of a company were authorised by the articles to borrow on bonds such sums of money as authorised from time to time, by a resolution of the company in general meeting. 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.

You should note that the position would have been different if the sanction of general body of shareholders required was by way of special resolution. It's because all special resolutions are required to be registered with the ROC as per Section 117 and all those dealing with the company are deemed have knowledge of documents registered with ROC.

Thus, you would have observed from the foregoing discussion that the 'doctrine of constructive notice' throws a burden on people entering into contracts with a company by making a presumption that they would have read the company's memorandum and the articles even though they might not have actually read them. The 'doctrine of indoor management', on the other hand 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*, the persons dealing with the company are not bound to inquire into the regularity of internal proceedings.

Exceptions to the Doctrine of Indoor Management

The above noted 'doctrine of indoor management' is, however, subject to certain exceptions based on cases. 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 vs. Patent Ivory Co.**, the articles of a company empowered the directors to borrow up to 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. Therefore the company was liable to them for pounds 1000 only.

2. ***No knowledge of Articles*** - Again, 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. In **Rama Corporation vs. Proved Tin & General Investment Co. [1952]**, 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 people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. 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 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. Since there is no consent at all there is no transaction. 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 be the person gets 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 a nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management - **Ruben vs. Great Fingal Consolidated [1906]**.

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 **Al Underwood vs. Bank of Liverpool [1924]**, a person who was a sole director and principal shareholder of a company paid 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 **B. Anand Behari Lal vs. Dinshaw & Co. (Bankers) Ltd. [1942]**, 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.

5. **Others** - Doctrine is also not applicable where a pre-condition is required to be fulfilled before 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 vs. Arbuthnot [1917]**.

Check Your Progress B

1. Fill in the blanks.

   i) Memorandum and Articles, when registered, bind a company and its ……………..

   ii) Every person dealing with a company is presumed to have notice of the contents of ……..…………

   iii) Any one dealing with the company is ……..……….. to assume that whatever was required to be done in the internal management of the company has been done.

2. State whether the following statements are True or False.

   i) Articles may explain any ambiguity included in the Memorandum.

   ii) Memorandum and Articles are deemed to contain terms upon which shares are sold by the company.

   iii) Any one dealing with the company is not entitled to assume that whatever was required to be done as regards internal management of the company has been done.

   iv) Articles of Association regulate the relations of company with its members.

   v) A person who could discover irregularity while dealing with a company cannot claim benefit of the doctrine of indoor management.

3. State which of the alternatives is correct in the following cases:

   i) Table F contains a model form of

      a) Regulations for management of a company limited by shares.

      b) Memorandum of a company limited by shares.

      c) Memorandum and Articles of Association of a company limited by guarantee and not having a share capital.

   ii) If the Articles conflict with the Memorandum

      a) the Articles shall prevail.

      b) the Memorandum shall prevail.

      c) the directors will resolve the conflict.

      d) the court will resolve the conflict.

   iii) The Articles of a company may be altered by

      a) the directors.

      b) any official of the company.

      c) shareholders by passing an ordinary resolution.

      d) shareholders by passing a special resolution.

7.11 LET US SUM UP

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. Articles define the powers of its officers. They also establish a contract between the company and the members and between members *inter se*.

In relation to 'memorandum', 'articles' occupy a position subordinate to 'Memorandum'. It is the memorandum that prevails in the event of a conflict between the two.

Articles contain provisions relating to matters like share capital of the company; rights of various shareholders; share certificates; lien on shares; calls on shares; transfer of shares; transmission of shares; conversion of shares into stock and *vice versa;* general meetings and proceedings thereat; directors including first directors, their appointment, qualifications, powers and proceedings of Board of directors' meetings.

Tables F, G, H, I and J to Schedule I give the model form of articles for various types of companies. A company may straightway adopt relevant model Articles.

As per Rule 13 of the Companies (Incorporation) Rules, 2014, the 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 at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any.

Articles may be altered by passing a special resolution of the shareholders. This power is, however, subject to certain limitations, namely, alteration must not be inconsistent with the provisions of the Companies Act, or any other statute; it must not include anything illegal or opposed to public policy; must be *bona fide* in the interest of the company as a whole; must not have the effect of converting a public company into a private company unless approval of the Central Government has been obtained; should not result in breach of contract with third parties; the amendment should, generally, not be operative retrospectively. A valid alteration of articles binds members in the same way as original articles.

As per section 399, the memorandum and articles when registered with the Registrar become public documents and then they can be inspected by any one by electronic means on payment of the prescribed fee. Since this facility of inspection has been made available to all those who deal with the company, law presumes that they not only have knowledge of their contents but have also understood them. Thus, even if the party dealing with the company does not have actual notice of the contents of these documents, it is presumed that he has an implied notice of them. This is known as 'doctrine of constructive notice'.

However, the aforesaid rule of constructive notice has been held to be subject to the rule of indoor management. The 'rule of indoor management' was first laid down in the case of *Royal British Bank* v. *Turquand*. The 'rule of indoor management' offers protection to those dealing with the company through its officers who fail to follow the procedures prescribed under the articles before exercising those powers.

The persons dealing with the company are not bound to inquire into the regularity of internal proceedings.

However, the relief under 'indoor management' cannot be availed of by the directors who have the means of verifying the truth or those who did not read articles at all. Again, it is not available in case of forgery or even negligence.

7.12 KEY WORDS

Constructive Notice: Knowledge of the contents of documents on the part of those who are dealing with the company is presumed by law.

Inter se: Amongst themselves.

Public Document: Any document which is in possession of an officer of the government, and is open to inspection is known as a public document.

7.13 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) Memorandum of Association; ii) Internal Affairs

2. i) True; ii) False; iii) True; iv) True; v) False; vi) False

B 1. i) members ii) Memorandum and Articles of Association

iii) entitled

2. i) True, ii) True, iii) False, iv) True, v) True

3. i) a; ii) b; iii) d

7.14 TERMINAL QUESTIONS

1. What are Articles of Associations" How can they altered?
2. "The power of altering Articles of Association is wide, yet it is subject to a large number of limitations." Explain.
3. What are the usual contents of the Articles?
4. Explain the legal effect of the Articles of Association. How far they are binding on outsiders?
5. Explain briefly the relation between Memorandum and Articles of Association?
6. What is the distinction between a Memorandum and Articles of Association?
7. Explain the 'doctrine of indoor management'. Are there any exceptions to this doctrine"
8. Answer the following problems giving reasons:

   i) The authorised signatory of a company issued a share certificate in favour of X, which apparently complied with the company's articles as it was purported to be signed by two directors and the secretary and it had the company's common seal affixed to it. In fact, the secretary had forged the signatures of the directors and affixed the seal without any authority. Will the certificate be binding upon the company?

   ii) The plaintiffs contracted with a director of the defendant company and gave him a cheque under the contract. The director could have been authorised under the company's articles, but was not in fact so authorised. The plaintiffs had not seen the Articles. The director misappropriated the cheque and the plaintiffs sued the company. Is the company liable?

iii) Company 'A' lends money to Company 'B' on a mortgage of its assets and the procedure laid down in the articles was not complied with and the directors of the two companies were the same. Is the mortgage binding upon Company B?

iv) A limited Company is formed with its Articles stating that one Mr. Anil shall be the solicitor for the company, and that he shall not be removed except on the ground of misconduct. Can the company remove Mr. Anil from the position even though he is not guilty of misconduct?

v) A company, in which the directors hold majority of the shares, altered its Articles so as to give power to directors to require any shareholder, who competed with the company's busi-ness, to transfer his shares, at their full value, to any nominee of the directors. S had some shares in the company, and he was in competition with the company. Is S bound by the alteration?

Hints:

i) No; Forgery confers no protection, it is a nullity. Therefore, certificate is not binding on the company (*Refer to Ruben* v. *Great Final Consolidated Co. case*).

ii) No; the company is not liable. Once again, protection under indoor management cannot be claimed by those who have no knowledge of the Articles (*Refer to Rama Corporation* v. *Proved Tin and Investment Co. case*)

iii) No; the mortgage is not binding on company B. The directors had knowledge of the irregularity.

iv) Yes; the company can remove Mr. Anil because Articles of Association constitute no contract between the company and the outsiders (*Refer to Eley* v. *Positive Government Life Assurance Co. Ltd. case*).

v) Yes; S is bound by the alteration being in the interest of company as a whole (*Refer to the case of Side Bottom* v. *Kershaw Leese & Co.*).

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 8 PROSPECTUS

Structure

8.0 Objectives

8.1 Introduction

8.2 Meaning and Importance of Prospectus

8.3 Contents of a Prospectus

8.4 Statutory Requirements in Relation to a Prospectus

8.5 When Prospectus is not Required to be Issued

8.6 Prospectus by Implication/Deemed Prospectus

8.7 Shelf Prospectus and Red herring Prospectus

  8.7.1 Shelf Prospectus

  8.7.2 Red herring Prospectus

8.8 Minimum Subscription

8.9 Misstatement in a Prospectus and its Consequences

8.10 Golden Rule for Framing of Prospectus

8.11 Allotment of Shares in a Fictitious Name

8.12 Announcement Regarding Proposed Issue of Capital

8.13 Let Us Sum Up

8.14 Key Words

8.15 Answers to Check Your Progress

8.16 Terminal Questions

8.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and importance of prospectus;
- describe the contents of prospectus;
- explain the meanings of the deemed prospectus and shelf prospectus;
- understand the concept of minimum subscription;
- discuss the consequences of allotment of shares in fictitious name;
- describe the golden rule for framing of a prospectus; and
- explain the effects of misstatements in a prospectus and the remedies available.

8.1 INTRODUCTION

After incorporation of the company, the next step is to raise the necessary resources for carrying the business of the company. You have learnt that a private company is prohibited from inviting public to subscribe to its share capital. Thus, the need of inviting public to subscribe to the share capital arises only in the case of a public company. Even in case of a public company, if the directors are confident of arranging the required capital privately, they need not issue a prospectus. Generally, a public company raises its capital by issuing a prospectus. Besides, inviting the investors, the objective of issuing a prospectus is to inform them about the company's business, financial position, capital structure, future prospects, management, etc. In this unit, you will learn the meaning, need and importance of issuing a prospectus. You will also note contents of a prospectus, meaning of deemed prospectus and shelf prospectus. At the end, you will also know about the various remedies available to an aggrieved investor in case prospectus contains misstatement.

8.2 MEANING AND IMPORTANCE OF A PROSPECTUS

A prospectus, as per Section 2(70), means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities 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 conditions:

a) It invites subscription to, or purchase of, shares or debentures or any other security of a body corporate;

b) The aforesaid invitation is made to the public.

What constitutes an offer to the public? : As per Section 42 (4), an offer or invitation shall be deemed to be invitation to public, if it cannot be considered as private placement under sub-section (2) of Section 42. Explanation III to Section 42 (3) along with the rules framed thereunder provide that if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than 200 persons in a financial year, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public. Thus, we may say that if any company invites subscription or allots any security to 200 or more persons *in a financial year*, it will be said to have made a public offer. However, while counting the aforesaid figure of 200 persons, the following shall not be taken into account:

1. Qualified institutional buyers;

2. Employees, who are offered securities under a scheme of employees stock option as per provisions of section 62 (1) (b).

To be a prospectus, it must be 'issued to the public'. Single private communication does not amount to issue to the public [**Nash v. Lynde [1929]**]. In this case, several copies of a document marked "strictly confidential" and containing particulars of a proposed issue of shares, were sent by the managing director of a company to a co-director, who in turn sent a copy to a solicitor, who gave it to a client who, in turn, passed it on to a relation. Thus, a document was passed on privately through a small circle of friends of the directors. The House of Lords held that there had been no issue to the public.

Further, it may be noted that, as per the general law of contracts, an invitation shall not be an invitation to the public if it cannot be calculated to result, directly or indirectly, in the securities 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 is refused because he was not invited to make the offer. On the other hand, it will become an invitation to public where his (B's) offer shall also be considered.

Again, the offering of shares to kith and kin of a director is not an invitation to the public to buy shares - **Rattan Singh vs. Managing Director, Moga Transport Co. Ltd. [1959]**.

You must remember that a prospectus is not an offer by the company but it is only an invitation to offer. A company, by issuing a prospectus to the public, invites applications for the purchase of its shares, debentures or other securities. The persons who want to purchase shares in the company would fill up the share application form and submit the same along with the share application money. This act of applicants' amounts to making offers to the company to buy as many shares in the company as are mentioned in the share application form. The Board of directors of the company will then make the allotment of shares in response to those share application forms. This act of Board of directors amounts to acceptance of the offer of the applicant to purchase shares. Thus, a contract between the applicant and the company is made with all the contractual rights and obligations.

Section 33 reads "(1) No form of application for the purchase of any of the securities of a Company shall be issued unless such form is accompanied by an Abridged Prospectus. However, abridged prospectus need not accompany an application form, if it is shown that the application form was issued-

a) in connection with a *bona fide* invitation to a person to enter into a contract of underwriting agreement with respect to such securities; or

b) in relation to securities which were not offered to the public.

2) A copy of the prospectus shall, on request being made by any person before closing of the subscription list and the offer, be furnished to him.

3) If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default.

According to Section 2 (1) an 'abridged prospectus' means a memorandum containing such salient features of a prospectus as may be prescribed by Securities and Exchange Board by making regulations in this behalf.

Note: The word memorandum here means a note, report or detailed statement and not memorandum of association.

8.3 CONTENTS OF A PROSPECTUS

As per the requirement of Section 26 of the Companies Act, 2013, contents of a prospectus shall comprise of:

i) Information to be given in a Prospectus

ii) Reports to be set out in the Prospectus

iii) Declaration to be made

iv) Other matters

Information to be given in a Prospectus

Section 26(1) of the Companies Act, as amended by the Companies (Amendment) Act, 2017, requires a prospectus to be dated and signed and state such information as may be specified by Securities and Exchange Board of India in consultation with Central Government.

Declaration

There shall be included a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Other Matters

Prospectus shall also state such other matters and set out such other reports, as may be prescribed.

Statement of an Expert included in a Prospectus

A prospectus may contain a statement purporting to be made by an expert. The term "expert" includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power to issue a certificate in pursuance of any law. The reports from an expert must not be included in a prospectus unless:

i) such expert is a person who is not and has not been engaged or interested in the formation or promotion or management of the company,

ii) he gave his written consent to the issue of the prospectus and had not withdrawn the consent until the prospectus is delivered to the Registrar for registration,

iii) a statement that he has given and not withdrawn his consent thereto is included in the prospectus.

Exemptions

The aforesaid requirements of Section 26, that is, with respect to the contents do not apply to:

a) ***Rights Issue, i.e.,*** the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares in favour of any other person or not.

b) ***Shares/Debentures Uniform in all respects*****:** The provisions of Section 26 do not apply to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognized stock exchange.

Variation in terms of contract or objects in prospectus (Section 27)

If, at any time, the company wants to vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, it shall not be allowed to do so except by way of special resolution. The notice of the special resolution must clearly indicate the justification for such variation and the same should be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated.

Again, it may be noted that a company cannot use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

Exit Option

The Companies Act, 2013 has for the first time given an exit option to shareholders who do not agree to the proposal to vary the terms of contracts or objects referred to in the prospectus. The exit option shall be given 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.

Offer of sale of shares by certain members of company (Section 28)

You may note that, the Companies Act, 2013, for the first time, has incorporated provisions with respect to offer of sale of shares by certain members of company to be effected by the company on their behalf.

It provides that where certain members of a company (whether individuals or body corporate) propose, in consultation with the Board of Directors to offer whole or part of their holding of shares to the public, they shall collectively authorise the company to take all actions in respect of offer of sale for and on their behalf. They shall reimburse the company all expenses incurred by it on this matter.

Section 28, in this regard provides that any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of misstatements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

8.4 STATUTORY REQUIREMENTS IN RELATION TO A PROSPECTUS

1. ***Dating of Prospectus*** - As per section 26, a prospectus issued by or on behalf of a company or in relation to an intended company must be dated. The Section further provides that ***the date on the prospectus shall be deemed to be the date of the publication of the prospectus.***

2. ***Registration of Prospectus*** - Section 26 (1) requires the delivery of a copy of the prospectus to the Registrar on or before the date of its publication. The copy of the prospectus so delivered, should be signed by all the persons named there-in as director or proposed director or by his duly authorised attorney.

Every prospectus issued under sub-section (*1*) shall, on the face of it,—

a) state that a copy has been delivered for registration to the Registrar as required under sub-section (*4*); and

b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

The Registrar **shall not register a prospectus** unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

The aforesaid requirements apply to existing company or any intended company.

No prospectus shall be issued after ninety days from the date on which a copy of it was delivered to the Registrar.

Refusal to Register the Prospectus

Section 26 (7) provides that the Registrar shall not register a prospectus unless the requirements of Section 26 with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus. Thus, the Registrar will refuse to register a prospectus if—

a) It is not dated;

b) It does not contain matters, reports and declaration to be set out in it;

c) It contains statements or reports of experts engaged or interested in the formation or promotion or management of the company;

d) It includes a statement purported to be made by an expert without a statement that he has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration;

e) A copy delivered to the Registrar is not signed by every person who is named therein as a director or proposed director of the company or by his duly authorized attorney;

Penalty

If a prospectus is issued in contravention of the aforesaid provisions of Section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both [Section 26 (9)].

Prospectus in the form of Advertisement (Section 30)

Where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the objects, the liability of members and the amount of share capital of the company, and the names of the signatories to the memorandum and the number of shares subscribed for by them, and its capital structure.

8.5 WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED

Issue of a prospectus by a company is not compulsory in the following cases:

1. A private company is not required to issue a prospectus.
2. Even a public company need not issue a prospectus if the promoters or directors feel that they can mobilize resources through personal relationships and contacts, and, therefore, the shares or debentures are not offered to the public.
3. Where the shares or the debentures are offered to existing holders of shares or debentures by way of right (*i.e.,* rights issue) with or without the right of renunciation in favour of other person [Section 26 (2) (a)].
5. Where the issue relates to shares or debentures which are, or to be, uniform in all respects with shares or debentures previously issued and dealt in and quoted on a recognised stock exchange [Section 26(2) (b)].

Check Your Progress A

1. Choose the correct alternative(s):

   i) Registrar of Companies shall refuse to register a prospectus:
      a) if it is not dated.
      b) contains statement of an expert who has not signed it.
      c) contains information which is six months old.
      d) in all the aforesaid cases.

   ii) A prospectus issued in the form of Advertisement must state:
      a) the objects for which the company has been formed.
      b) the liability of members.
      c) the amount of share capital of the company.
      d) its capital structure.
      e) All of the above

   iii) The date of issue of the prospectus is :
      a) The date appearing on the prospectus
      b) The date when the prospectus is actually published
      c) The date of registration of the prospectus with the Registrar of companies.

   iv) A public company need not issue a prospectus:
      a) In case of rights issue of shares or debentures.
      b) Shares or debentures being offered are uniform in all respects with shares or debentures previously issued and dealt in and quoted on a recognized stock exchange.
      c) Where invitation is made by way of advertisement.
      d) Only in (a) and (b) above
      e) In (a), (b), and (c) above

8.6 PROSPECTUS BY IMPLICATION/DEEMED PROSPECTUS

In general, the provisions of the Companies Act relating to prospectus are restricted to cases where the invitation is made by or on behalf of a company for subscription of its shares or debentures. As such it was possible at one time for a company to avoid the statutory provisions relating to prospectus by allotting shares or debentures to the public through the medium of Issue Houses. The shares or debentures will be allotted to these Issue Houses which will in turn invite subscription from the public through their own offer documents. Thus, the company could indirectly raise subscriptions from the members of the public without issuing an offer document or prospectus.

Section 25 covers documents issued by the Issue Houses. Accordingly, such an offer document is treated as a prospectus issued by the company. Section 25 has been essentially designed to check the by-passing of the provisions of Section 26 (Section 26 requires certain information to be disclosed and certain reports to be set out in the prospectus) by making an offer of sale of shares or debentures through the medium of Issue Houses.

Section 25(1) provides that where a company allots or agrees to allot any shares or debentures with a view to these being offered for sale to the public, any document by which the offer of sale to the public is made, shall for all purposes be deemed to be a prospectus issued by the company.

Further, sub-section (2) of Section 25 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 six 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.

Additional requirements relating to deemed prospectus

In respect of a document deemed as a prospectus, Section 25(3) requires that it must contain certain information in addition to the information required to be stated in a prospectus under Section 26. Additional information requirements are as under:

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. Section 26, dealing with registration of prospectus applies to the deemed prospectus in terms of Section 25(3) (ii) and accordingly it renders the persons making the offer of sale to the public as deemed directors of the company.

Where the person making the offer is a company the document (*i.e.*, deemed prospectus) must be signed by at least two directors.

8.7 SHELF PROSPECTUS AND RED HERRING PROSPECTUS

8.7.1 Shelf Prospectus (Section 31)

"Shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus- Explanation to Section 31.

Sub section (1) of Section 31 provides that a 'Shelf prospectus' may be issued by any class or classes of companies as the Securities and Exchange Board (SEBI) may provide by regulations in this behalf. Raising finance from the public by means of various securities is a time consuming process. Every time any such issue comes, a fresh prospectus is required to be filed. Although it is a repetitive matter, the procedural aspects take a lot of time. In order to minimise the burden on such institutions, 'shelf prospectus' has been introduced. The validity period of a 'shelf prospectus' cannot exceed one year from the date of opening of the first offering of securities under that prospectus. For subsequent offerings, information memorandum updating the information under the various heads will have to be filed and entire set comprising of shelf prospectus and the information memorandum shall constitute the prospectus and have to be circulated to the general public. *The provisions of Section 31, in this regard, are as follows:*

i) A shelf prospectus may be issued by any class or classes of companies as the Securities and Exchange Board of India (SEBI) may provide by regulations in this behalf.

ii) A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within the period of its validity which cannot be more than one year.

iii) A company filing a shelf prospectus shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within such time as may be prescribed, prior to making of a second or subsequent offer of securities under the shelf prospectus.

iv) An Information Memorandum shall be issued to the public alongwith shelf prospectus filed at the stage of the first offer of securities. Information memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Note: The word memorandum here means a report, or detailed note or summary and not Memorandum of Association.

8.7.2 Red herring Prospectus [Section 32]

Section 32 of the Companies Act, 2013 contains the following provisions with respect to 'red herring prospectus':

1. A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.

   "Red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

2. A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

3. The red-herring prospectus shall carry same obligation as are applicable in the case of a prospectus.

4. Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

5. Upon the closing of the offer of securities, the prospectus stating therein:

   a) the total capital raised, whether by way of debt or share capital,

   b) the closing price of the securities, and

   c) any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board of India.

8.8 MINIMUM SUBSCRIPTION

No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument. (Section 39).

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

As per Rule 11 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 the application money shall be repaid within a period of 15 days from the closure of the issue. In case of failure to repay, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen per cent per annum.

The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

In case of company's failure to return the amount, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less [Section 39(5)].

8.9 MISSTATEMENT IN A PROSPECTUS AND ITS CONSEQUENCES

The prospective shareholders are entitled to true and faithful disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material facts.

What is an Untrue Statement/Misstatement?

According to section 34(1) of the Act, a statement included in a prospectus shall be deemed to be untrue:

a) if the statement is misleading in the form or context in which it is included; or

b) where any inclusion or omission from a prospectus of any matter is likely to mislead.

Thus, in regard to considering a prospectus as fraudulent, it is not necessary that there should be false representation in it; even if every word included in the prospectus is true, the suppression of material facts may render it fraudulent. To judge its effect, it should be read as a whole.

In **Rex v. Kylsant** [1932], all the statements included in the prospectus issued by the company 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.

A mere silence cannot be a sufficient foundation for setting aside the allotment of shares. The withholding of facts should be such that if not stated it makes that which is stated absolutely false. In **Peek v. Gurney** [1873], the prospectus issued did not mention about certain liabilities. This created a false impression about the company being very prosperous. The prospectus was held to be untrue.

Liability and Defences

An allottee of shares, who had applied for shares, on the faith of a prospectus (i) containing untrue statement; or (ii) including or omitting material facts which have the effect of what is stated as false has remedies against the company, its promoters and directors and experts.

It should be noted carefully that the right to claim compensation for any loss or damage is available only to a person who has 'subscribed' for shares, debentures or any other security on the faith of the prospectus containing untrue statements. Thus, a subsequent buyer of shares in the open market has no remedy against the company or the directors or promoters. If there is any misrepresentation of a material fact in a prospectus, there may arise (i) civil liability, and (ii) criminal liability.

Civil Liability

Section 35 (1) provides that where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

a) is a director of the company at the time of the issue of the prospectus;

b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

c) is a promoter of the company;

d) has authorised the issue of the prospectus; and

e) is an expert referred to in sub-section (*5*) of section 26,

shall, besides punishment under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

You should note that Section 36 provides for Punishment for fraudulently inducing persons to invest money. We shall discuss the provisions of Section 36 a little later.

Defences available to avoid Civil Liability

No person shall be liable under Section 35 (*1*), if he proves—

a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, or

b) that it was issued without his authority or consent; or

c) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

d) that with respect to every misleading statement purported to have been made by an expert or copy or extract from a report or valuation, he had reasonable ground to believe and did up to the time of issue of prospectus believe that person was competent to make it and had no knowledge before allotment thereunder.

However, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (*1*) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus (Section 35 (3)).

Criminal Liability

According to Section 34, where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Defences available to avoid Criminal Liability

The aforesaid criminal liability will not be attracted if the person proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

Punishment for fraudulently inducing persons to invest money

Section 36 provides that any person who,

i) either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or

ii) deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into specified agreements, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Agreements covered under Section 36 include:

a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or

b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution.

Action by Affected Persons/Class Action Suit (Section 37)

A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Thus, Section 37, not only provides for individual action but also for class action.

8.10 GOLDEN RULE FOR FRAMING OF PROSPECTUS

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersely 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 representations contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the 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 per cent 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 profits. *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 vs. Twisa].**

Thus, the persons issuing the prospectus must not only include in the prospectus all the relevant particulars specified in Section 26 of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

8.11 ALLOTMENT OF SHARES IN FICTITIOUS NAMES PROHIBITED

Section 38 provides that any person who—

a) makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

b) makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

c) otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

The aforesaid penal provisions must be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

Further, where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person (Subsection (3)).

The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

8.12 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 penal provisions under Sections 34 and 35 for publishing an incomplete prospectus.

Section 30, in this regard, provides that where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein:

i) the objects as stated in the Memorandum;

ii) the liability of members;

iii) the amount of authorized share capital of the company;

iv) the names of the signatories to the memorandum and the number of shares subscribed for by them; and

v) the capital structure of the company.

Check Your Progress B

1. Fill in the blanks.

   i) A company should not issue a prospectus to the public unless a copy thereof has been delivered to the ………………..

ii) Shelf Prospectus remains valid up to……………

iii) A prospectus containing statement by experts, must contain ………………………………..

iv) A prospectus must be issued within ……………… of its registration.

2. State whether the following statements are True or False.

i) A public company may allot shares without issuing a prospectus.

ii) A document is not a prospectus unless it is an invitation to the public to subscribe for shares in, or debentures of, or any other security with a body corporate.

iii) A prospectus must be dated.

iv) A public company issuing shares among friends and relatives need not issue a prospectus.

v) A person can avoid the contract to purchase shares in the company even if he has purchased shares in the open market and has not gone through the prospectus containing untrue statements.

vi) An allottee of shares can retain the shares and can sue the company for damages in case he finds that the prospectus contained untrue statements.

vii) A director can avoid criminal liability for misstatements in the prospectus if proves that he had reasonable ground to believe that the statement alleged to be untrue is true.

viii) Where a prospectus contains untrue statements, the persons who authorized its issue are punishable with fine upto Rs.50,000.

ix) Red herring prospectus is a prospectus filed with RoC after the filing of the Prospectus.

8.13 LET US SUM UP

Unlike a private company which arranges its share capital primarily, from friends and relatives, a public company normally invites public to subscribe to its share capital. In such a case the public company issues a prospectus inviting subscription. In fact, before the prospectus is issued, the company is required to take certain steps which include the appointment of bankers, auditors, underwriters, brokers, making arrangements for listing of shares on stock exchanges, drafting the prospectus, etc.

Thereafter, the Board of directors has to decide about the time of issue of prospectus. For this purpose, the Board considers the condition of the capital market, the investors' mood, fiscal and monetary policies of the Government and the state of business conditions.

Prospectus means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

As to what constitutes an offer to the public, Section 42 (4) states that an offer or invitation shall be deemed to be invitation to public, if it cannot be considered as private placement. Explanation III to Section 42 (3) along with the rules framed thereunder provide that if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than 200 persons in a financial year, the same shall be deemed to be an offer to the public.

Contents of a prospectus: As per the requirement of Section 26 of the Companies Act, 2013, contents of a prospectus shall comprise of:

i) Information to be given in a Prospectus

ii) Reports to be set out in the Prospectus

iii) Declaration to be made

iv) Other matters

Although most of the public companies do issue a prospectus to meet their financial requirements, the issue of a prospectus by a company is not compulsory. In the following cases, a company is not required to issue a prospectus:

1. In the case of a public company where the promoters or directors propose to mobilise resources through personal relationships and contacts and, therefore, do not propose to approach public for subscription.
2. Where the shares or debentures are offered to existing holders of shares or debentures by way of right.
3. Where the issue relates to shares or debentures which are uniform in all respects with shares or debentures previously issued and dealt in and quoted on a recognised stock exchange.
4. Where invitation is made by way of advertisement.

If, at any time, the company wants to vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, it shall not be allowed to do so except by way of special resolution. Besides, the company must give exit option to those shareholders who do not approve of the variations.

As per section 26, a prospectus issued by or on behalf of a company or in relation to an intended company must be dated. The Section further provides that ***the date on the prospectus shall be deemed to be the date of the publication of the prospectus.***

Further, Section 26 requires the delivery of a copy of the prospectus to the Registrar on or before the date of its publication.

The Registrar **shall not register a prospectus** unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

No prospectus shall be issued after ninety days from the date on which a copy of it was delivered to the Registrar.

Deemed prospectus: In order to check the by-passing of the provisions relating to prospectus, section 25 declares that all documents containing offer of shares or debentures for sale shall be included within the definition of the term prospectus. Therefore, offer of shares or debentures through the medium of

Issue Houses shall require the provisions relating to prospectus to be duly complied with if certain conditions are satisfied.

Besides, any company proposing a public issue may issue a red-herring prospectus before it issues prospectus. A 'red-herring prospectus' is a prospectus which does not have complete particulars on the price of securities offered and quantum of securities offered.

Misstatement in a prospectus: In order to ensure that the prospective investors are not subjected to frauds by making certain positive misrepresentation in the prospectus or by deliberately omitting certain material information, certain remedies have been provided to the aggrieved parties who may subscribe on the faith of any misrepresentation or omissions calculated to deceive. The remedies provide for the right to rescind, a claim for damages and also prosecution of the company and the guilty officers in terms of imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Prohibition of allotment of shares in fictitious name: Section 38 prohibits making of an application for acquiring shares of a company under a fictitious name. The section makes the act punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and the person guilty of such fraud shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

8.14 KEY WORDS

Minimum Subscription: It is an amount so mentioned in the prospectus and, as per SEBI Regulations, 2009, can in no case be less than 90 % of the Issue. In the event of company's failure to raise minimum subscription, the entire application money has to be refunded back.

Prospectus: It is a document issued by a company inviting members of the public to subscribe to its share capital.

Abridged Prospectus: It means a memorandum containing such salient features of a prospectus as may be prescribed by SEBI

Shelf Prospectus: A company which proposes to make more than one public issue of securities in a period of one year, may file 'shelf prospectus' which will remain valid up to one year. Such a company need not issue a prospectus every time it offers securities to public; it shall only need to file an 'information memorandum' with respect to changes in the financial position, new charges created, etc.

Red-Herring Prospectus: It is a prospectus which does not have complete particulars on the price of securities offered and quantum of securities offered.

Deemed Prospectus: The document that offers shares or debentures of a company through the medium of Issues Houses.

Issues House: An investment banking firm whose business is to underwrite share or debenture issue and offer the securities to the public.

Information Memorandum: It is issued along with self prospectus and contains all material facts relating to new charge created, changes in financial position between various offers of securities and other changes as may be prescribed.

8.15 ANSWERS TO CHECK YOUR PROGRESS

A) 1. i) (d); ii) (e); iii) (a); iv) (d)

B) i) Registrar of Companies; ii) one year; iii) a statement about the consent of the expert; iv) 90 days.

2. i) True; ii) True; iii) True; iv) True; v) False; vi) True; vii) True; viii) False; ix) False.

8.16 TERMINAL QUESTIONS

1. Explain the provisions of the Companies Act, 2013, with regard to the registration of prospectus of a public company going for public issue of equity shares. What are the documents required to be submitted by the company, to the Registrar of Companies for the above purpose?'
2. When and by whom can the allotment of shares be rescinded on the ground of a false and misleading prospectus under the Companies Act, 2013?
3. When is a company not required to issue prospectus in connection with issue of shares or debentures? When can the invitation for offer to subscribe for shares be treated as not having been made to the public?
4. Who is an 'Expert'? Explain his liability, relating to publication of prospectus, for any misstatement in the report given by him?
5. State the liability of the company and the directors with respect to misstatements included in a prospectus. When a director of a company is not liable to an aggrieved party for the issue of a prospectus containing a 'misstatement'?
6. Write a note on:
   i) 'Shelf Prospectus'.
   ii) Red herring Prospectus.
7. What is a 'Deemed Prospectus'? State the provisions of the Companies Act, 2013 with respect to 'Deemed Prospectus'.
8. Answer the following problems giving reasons:
   i) X Co. Ltd., intended to buy a rubber estate in Peru. Its prospectus contained extracts from an experts report giving the number of rubber trees in the estate. The report was inaccurate. Will any shareholder buying the shares of the company on the basis of the above representation have any remedy against the company? Can the persons authorising the issue of the prospectus escape from their liability?
   ii) A prospectus issued by a company contained a promise of subscription of a substantial amount by some persons so as to induce the public to subscribe. The plaintiff who was allotted 10 shares alleged material misrepresentation. Decide?
   iii) A purchased from B 1000 shares of a company on the basis of

prospectus containing wrong statement. What remedies are avail-able to A against the company?

iv) A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars. Decide.

Hints:

i) The allottee shall have the right to claim damages from the company. Persons authorising the issue of prospectus shall not be liable since they made the statement on the basis of report of an expert. However, expert can be proceeded against.

ii) The allottee shall be entitled to return back shares and claim refund of price as well as damages. Company as well as persons responsible for issue of prospectus can be charged with criminal liability.

iii) A shall have no remedy against the company since shares were not purchased from the company.

iv) Yes, the allottee will succeed. *See Rex* v. *Kylsant case*.

> **Note:** These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 9 SHARE AND LOAN CAPITAL

Structure

9.0 Objectives

9.1 Introduction

9.2 Meaning and Types of Share Capital

9.3 Meaning and Nature of a Share

- 9.3.1 Meaning of a Share
- 9.3.2 Nature of a Share
- 9.3.3 Types of Shares

9.4 Meaning of Stock

9.5 Meaning and Types of Debentures

- 9.5.1 Meaning and Characteristics
- 9.5.2 Characteristics Features of a Debenture
- 9.5.3 Types of Debentures

9.6 Difference between a Share and a Debenture

9.7 Public Deposits

- 9.7.1 Meaning of Deposit
- 9.7.2 Deposit and Loan
- 9.7.3 Deposit and Debenture

9.8 Global Depository Receipts

9.9 Let Us Sum Up

9.10 Key Words

9.11 Answers to Check Your Progress

9.12 Terminal Questions

9.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and types of shares;
- describe the types of capital;
- distinguish between share and stock;
- explain the meaning of debenture and classify them;
- distinguish between share and debenture;
- explain what is a deposit and loan;
- list the rules regarding acceptance of deposits by non-banking, non-finance companies; and
- discuss about the global depository receipts.

9.1 INTRODUCTION

You have learnt that a public company may raise the necessary funds by issuing shares and debentures and by accepting deposits from the public. In this unit, you will learn about the meaning of share and share capital, various types of shares, meaning and types of debentures and meaning of loan, difference between deposit and loan, the rules relating to deposits; and also learn about the global depository receipts.

9.2 MEANING AND TYPES OF SHARE CAPITAL

You know that to carry on any business, some money is needed, usually called 'capital'. In the case of a company where large amount of money is required, it is raised by issue of shares. The amount so raised is called the 'share capital' of the company.

A company having share capital should state its amount of share capital in the Memorandum of Association. The capital clause of the Memorandum of Association states the amount of capital that the company may raise during its lifetime unless it is increased. It's called authorized capital or nominal capital. The authorized capital is divided into specified number of shares of a fixed amount. For example, the authorized share capital of a company may be divided into shares of Rs.10 each. The persons contributing towards the share capital are known as 'shareholders'. **You should note that the money borrowed by the company by issuing debentures, is not part of the share capital of the company.** It is in the form of a long-term loan to the company.

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

1) **Nominal or Authorised Capital:** It refers to the amount stated in the Memorandum of Association as the capital of the company with which it is to be registered. This is the maximum amount of capital which a company is authorised to raise by issuing the shares. This is also known as 'registered capital', as this is the amount of capital with which the company is registered. This amount is divided into shares of a fixed amount. It can be increased by adopting the prescribed legal procedure.

2) **Issued Capital:** It is that part of the authorised capital which is issued to the public for subscription. It is not necessary for a company to issue all the nominal capital in the beginning itself. In fact, the term 'issued capital' means that part of the share capital which has been actually issued or offered by the company. The balance of nominal capital remaining to be issued is called 'unissued capital'.

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

   A company cannot accept for subscription an amount greater than the issued amount. Where the shares issued for subscription are wholly subscribed, issued capital will be the same as the subscribed capital.

4) **Called-up Capital:** It is that part of nominal value of issued capital which has been called-up or demanded on the shares by the company. Many times, a company does not collect the full amount on shares it has allotted. It collects it in installments known as application money, allotment money, first call, second call and so on. The amount of installments which have been demanded for the time being are termed as 'called-up capital' and the amount not yet demanded is termed as 'uncalled capital' and the shareholders continue to be liable to pay this amount as and when called.

5) **Paid-up Capital:** It is that part of the called-up capital which has actually been received from the shareholders. For example, a company has called-up Rs.5 lakhs, but it has actually received Rs.4,90,000 then Rs.4,90,000 is the paid-up capital of the company. The amount not paid in respect of allotment and calls made is known as 'calls in arrears'. In the above example, Rs.10,000 is the amount of calls in arrears. In case there are no calls in arrears, the paid-up capital will be the same as the called-up capital.

9.3 MEANING AND NATURE OF A SHARE

9.3.1 Meaning of a Share

The capital of a company is divided into a number of indivisible units of a fixed amount. These units are known as 'shares'. According to Section 2(84) of the Companies Act, 2013, "A share is a share in the share capital of a company and includes stock."

The Supreme Court of India in the **Commissioner of Income-tax v. Standard Vacuum Oil Co. [1966]** observed "By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company".

In another case, Supreme Court defined a share as "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound-up **[Bucha F. Guzdar v. Commissioner of Income-tax, Bombay]**.

In short, a 'share' does not merely represent an interest of a shareholder in a company; it carries with it certain rights and liabilities while the company is a going concern or while the company is being wound-up. It thus represents a 'bundle of rights and obligations.

9.3.2 Nature of a Share

A 'share' is not a sum of money but is the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual 'covenants' entered by all the shareholders inter se **[Borland's Trustees v. Steel Bros. & Co. Ltd. [1901].**

A share is a chose-in-action. A chose-in-action implies the existence of some person entitled to the rights, which are rights in action as distinct from rights in possession, and until the share is issued no such person exists.

In India, a share is regarded as 'goods'. Section 2(7) of the Sale of Goods

Act, 1930 defines ‘goods’ to mean any kind of movable property other than actionable claims and money and includes stock and shares. However, Section 44 of the Companies Act, 2013 while recognizing shares as movable property, suggests that they shall be transferable only in the manner provided by the articles of the company.

In **Vishwanathan v. East India Distilleries [1957]**, it was observed:

“A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. Such commodities are not brought into existence by legislation, but a share in a company belongs to a totally different category of property. It is incorporeal in nature, and it consists merely of a bundle of rights and obligations.”

Again, in **Shree Gopal Paper Mills Ltd. v. CIT [1967]** the learned Judge observed that the share when it becomes associated with a member becomes a movable property. It is, however, not a movable property whose transfer is solely regulated by the Sale of Goods Act. Its transfer is also governed by the Companies Act and/or Articles of the Company… Each share again bears a distinguishing number. It is, however, not a tangible property for it is not the share certificate; it only consists of a bundle of rights and obligations. Also, a share is not a negotiable instrument.

9.3.3 Types of Shares

As per the Companies Act, 2013, only two kinds of shares can be issued by a company. Section 43 of the Act provides that the share capital of a company limited by shares shall be of two kinds only, namely :

a) **Equity share**

   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.**

a) **Equity Shares [Section 43)]**

The equity shares are those shares which are not preference shares. In other words, shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital are known as equity shares. After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable net profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available. The rate of dividend is recommended by the Board of directors of the company and declared by shareholders in the annual general meeting.

Every member of a company limited by shares and holding equity share capital therein, shall have:

a) a right to vote on every resolution placed before the company; and

b) his voting rights, on a poll, shall be in proportion to his share in the paid-up equity share capital of the company. As compared to this, the holders of preference shares can vote only on such resolutions which directly affect the rights attached to the preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital. However, if the preference dividend is not paid for two years or more, the preference shareholders shall also get voting right on every resolution placed before the company (Section 47).

Voting rights of a preference shareholder, on a poll, shall be in proportion to his share in the paid-up preference share capital of the company.

Rules for Issue of Equity shares with differential rights as to dividend, voting or otherwise

With respect to issue of shares with differential voting rights, the Department of Company Affairs has notified the Companies (Share Capital and Debentures) Rules, 2014. As per Rule 4 of these rules, no company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with, inter alia, the following conditions:

a) the articles of association of the company authorizes the issue of shares with differential rights;

b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders:

   Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot ;

c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

d) the company has consistent track record of distributable profits for the last three years;

e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

   A company may, however, issue equity shares with differential voting right upon the expiry of five years from the end of financial year in which such default was made good (MCA notification No GSR 704(E) dated 19.7.2016.

h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies are being regulated by sectoral regulators;

i) the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.

b) **Preference Shares**

Preference Shares or Preference Share Capital means that part of the share capital of the company which fulfils both the following requirements:

1) During the life of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (say, one lac rupees) payable to preference shareholders before anything else is paid to the equity shareholders. Alternatively, the amount payable as preferential dividend may be calculated at a fixed rate, e.g., 10% of the nominal value of each share.

2) On the winding-up of the company it must carry a preferential right to be paid, i.e., amount paid up on preference shares must be paid back before anything is paid to the equity shareholders.

Rules relating to issue and redemption of preference shares

Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014, inter alia, provide:

1. **A** company having a share capital may issue preference shares only if so authorized by its articles.
2. A special resolution in the general meeting of the company must have been passed authorizing the issue.
3. The company, at the time of such issue of preference shares, must not have any subsisting default in the redemption of preference shares issued earlier or in payment of dividend due on any preference shares.
4. The Register of Members maintained under section 88 must contain the particulars in respect of such preference shareholder(s).
5. A company intending to list its preference shares on a recognized stock exchange shall issue such shares in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.
6. A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. The preference shares may be redeemed:

   a) at a fixed time or on the happening of a particular event;

   b) any time at the company's option; or

   c) any time at the shareholder's option.

Types of Preference Shares

a. **Participating and non-participating shares** - Participating preference shares are those shares which are entitled to a fixed preferential dividend and, in addition, carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders. For example, after 20% dividend has been paid to equity shareholders, the preference shareholders may share the surplus profits equally with equity shareholders. Again, in the event of winding-up, if after paying back both the preference and equity shareholders, there is still any surplus left, then the participating preference shareholders get additional share in the surplus assets of the company. Non participating share holders have no right in surplus profits or assets. If articles are silent all preference shares are considered as non-participating.

b. **Cumulative and non-cumulative shares** - With regard to the payment of dividends, preference shares may be cumulative or non-cumulative. A cumulative preference share confers a right on its holder to claim fixed dividend of the past and the current year(s) out of future profits. The fixed dividend keeps on accumulating until it is fully paid. The non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividends out of the profits of each year. If no profits are available in any year, the shareholders get nothing, nor can they claim unpaid dividend in any subsequent year.

   Preference shares are cumulative unless expressly stated to be non-cumulative. Dividends on preference shares, like equity shares, can be paid only out of profits.

c. **Redeemable and Irredeemable Preference shares –** As per Section 55 of the Companies Act, 2013:

   1. No company limited by shares can issue any preference shares which are irredeemable.

   2. A company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue.

      However, a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

      Rule 10 of the Companies (Share Capital and Debentures) Rules, 2014, in this regard, provides that a company engaged in the setting up of infrastructure projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum 10% of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

   3. Where a company is not in a position to redeem any preferences shares or to pay dividend, if any, on such shares in accordance with the terms of issue, it may with the consent of the holders of three-fourths in value of such preference shares and with the approval of

the Tribunal, on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

However, the Tribunal shall, while giving the approval, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

It may be further noted that notice of redemption of preference shares must be sent to the Registrar under Section 64 of the Act within 30 days.

Conditions for issue of Redeemable Preference Shares

a) No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

b) no such shares shall be redeemed unless they are fully paid;

c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account;

d) the capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

e) the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

f) the issue of further redeemable preference shares or the redemption of preference shares shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

As noted before, Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. The preference shares may be redeemed:

a) at a fixed time or on the happening of a particular event;

b) any time at the company's option; or

c) any time at the shareholder's option.

Difference between Preference Share and Equity Share

1) Preference shares are entitled to a fixed rate/amount of dividend. The rate of dividend on equity shares depends upon the amount of net profit available after payment of dividend to preference share-holders and the fund requirements of the company for future expansion, etc.

2) Dividend on the preference shares is paid in preference to the equity shares. In other words, the dividend on equity shares is paid only after the preference dividend has been paid.

3) The preference shares have preference in relation to equity shares with regard to the repayment of capital on winding-up.

4) If the preference shares are cumulative, the dividend not paid in any year is accumulated and until such arrears of dividend are paid, equity shareholders are not paid any dividend.

5) Redeemable preference shares are redeemed by the company on expiry of the stipulated period, but equity shares cannot be redeemed.

6) The voting rights of preference shareholders are restricted. An equity shareholder can vote on all matters affecting the company but a preference shareholder can vote only when his special rights as a preference shareholder are being varied or on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital or where preference shares dividend is in arrears for at least two years.

7) A company may issue rights shares to the company's existing equity shareholders whereas it is not so allowed in case of preference shares (Section 62).

Sweat Equity Shares

"Sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called (Section 2(88)).

As per Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014, 'employee' means a permanent employee of the company who has been working in India or outside India, for at least last one year. Further, it includes an employee, as aforesaid, of a subsidiary, in India or outside India, or of a holding company of the company.

A director of the company includes a whole time director as well as other directors of the company as well as its subsidiary or holding company, in India or outside India

A company can issue sweat equity shares only of a class of shares already issued.

Besides, for issue of sweat equity shares, Section 54, inter alia, requires to ensure that:

1) The issue is authorized by a special resolution passed by the company. The special resolution must specify the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued. As per Rule 8, the special resolution authorizing the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

   In case of a listed company, the sweat equity shares are issued in accordance with the SEBI regulations made in this behalf and in case of an unlisted company, the sweat equity shares are issued in accordance with such rules as may be prescribed.

2) Rule 8 provides that a company shall not issue sweat equity shares for more than 15% of the existing paid-up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. In no case the issuance of sweat equity shares in the company can exceed 25% of the paid-up equity capital of the company at any time.

3) Sweat equity shares issued to directors or employees shall be locked in/ non transferable for a period of three years from the date of allotment. The fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

4) The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

5) The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.

6) The rights, limitations, restrictions applicable to the sweat equity shares shall be the same as applicable to equity shares.

9.4 MEANING OF STOCK

Stock is the aggregate consolidated holdings of the share capital of a person. In simple words, it means a number of shares put together in a bundle. The stock is expressed in terms of money and not as so many shares. Stock can be split into fractions of any amount without regard to the original face value of the share. The main advantage of stock is that the shareholder can transfer any portion of it as he likes.

You have learnt that as per Section 2(84) of the Act a share includes stock. Thus, a company, if authorised by its articles, can convert its fully paid-up shares into stock by passing an ordinary resolution (Section 61). From this, it should be clear to you that a company cannot make an original issue of the stock. When the shares are converted into stock, the company must give a notice to the Registrar of such conversion within thirty days of doing so (Section 64). On conversion of shares into stock, the register of members must show the amount of stock held by each member instead of the number of shares. For example, a member may be holding one thousand equity shares of Rs.10 each, fully paid-up. When these shares are converted into stock, he becomes the stockholder owning Rs.10,000 worth of stock.

Conversion of shares into stock does not alter the relationship between the holder and the company, the stockholder still remains a member. The holders of stock shall have the same rights as regards dividends, voting at meetings of the company as if they held the shares from which the stock arose. The stock is also transferable like shares. You should note that stock can also be reconverted into fully paid-up shares by an ordinary resolution (Section 61).

Distinction between shares and stock

In this section, you have learnt that stock possesses all the features of a share, but there are many points of difference between the two. These are as follows:

	Share	Stock
1.	A share has a nominal value	1. A stock has no nominal value.
2.	A share has a distinctive number which distinguishes it from other shares.	2. A stock bears no such number.
3.	Originally shares can only be issued.	3. A company cannot make an original issue of stock. Stock can be issued by an existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid up.	4. 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.	5. A stock may be transferred in any fractions
6.	All the shares of a class are of equal denomination.	6. Stock may be of different denominations.

Check Your Progress A

1. What is the meaning of share capital of a company?

   ....

   ....

   ....

2. What is the difference between called-up capital and paid-up capital ?

   ....

   ....

   ....

3. Which of the following statements is correct ?

   i) The subscribed capital of a company is:

      a) never more than the issued capital.

      b) never less than the issued capital.

      c) always equal to the issued capital.

   ii) A company may convert all or any of its fully paid up shares into stock:

      a) by passing a special resolution.

      b) by passing an ordinary resolution.

      c) with the approval of the Tribunal.

4. State whether the following statements are True or False.

   i) Shares and stock can be directly issued to the public.

   ii) Only a public company can convert its shares into stock by passing an ordinary resolution.

   iii) Equity shareholders have a right to receive dividend at a fixed rate.

   iv) Preference shareholders have generally, no voting rights.

   v) A company cannot issue irredeemable preference shares.

   vi) Redeemable preference shares cannot be redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption.

9.5 MEANING AND TYPES OF DEBENTURES

9.5.1 Meaning and Definition

When company needs Funds for its project or for the extension and development purpose without increasing its share capital, it borrows from the public. The most common form of raising loan from the public is by issue of debentures.

Section 2(30) of the Companies Act, 2013 defines the term debenture as follows:

"Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not."

If we go by the aforesaid definition of 'debenture', bills of exchange or other negotiable instruments, deeds of covenant and many other documents in which a company stipulates to pay a sum of money will also qualify to be called as debentures.

9.5.2 Characteristic Features of a Debenture

The characteristic features of a debenture are as follows:

1. It is a movable property (Section 44).
2. It is issued by the company and is in the form of a certificate of indebtedness.
3. It usually specifies the date of redemption. It also provides for the re-payment of principal and interest at specified date or dates.
4. It generally creates a charge on the undertaking or undertakings of the company.

Usually the words 'pari passu' appear in the terms and conditions of debentures. This means that all the debentures of a particular class will receive the money proportionately in case the company is unable to discharge the whole obligation. In the absence of this clause the debenture-holders would rank in accordance with the rank of the issue and if issued on the same date then in the order of time when they were issued (which may be known by the serial number of the debenture).

9.5.3 Types of Debentures

Debentures may be of the following kinds:

1. **Bearer Debentures** - Bearer debentures are negotiable instruments, transferable by delivery. According to Perrins and Jeffreys, "By making debentures payable to bearer they are invested with the character of a negotiable instrument, so as to :

   a) make them transferable free from equities;

   b) render the delivery of a debenture and any interest coupon a good discharge to the company;

   c) enable the bearer to sue the company in his own name, if necessary;

   d) ensure a good title to any person who acquires the debenture bona fide for valuable consideration, notwithstanding any defect in the title of the person from whom he acquires it."

   The interest on 'bearer debentures' is paid by means of attached coupons. On maturity, the principal sum is paid to the bearer.

2. **Registered Debentures** - These are debentures which are payable to the registered holders, i.e., persons whose names appear in the Register of debenture-holders. Such debentures are transferable in the same way as shares or in accordance with the conditions endorsed on their back. The debenture itself consists of two parts:

   a) The covenants by the company to pay the principal and interest, and

   b) The endorsed conditions, e.g., the term of the loan.

   The endorsed conditions vary, but they normally contain a provision that the debenture is one of a series all ranking pari passu.

3. **Perpetual or Irredeemable Debentures** - A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is called a perpetual or irredeemable debenture. Though irredeemable debentures were allowed under Section 120 of the Companies Act, 1956, no corresponding provision has been made under the Act of 2013. Thus, no fresh irredeemable debentures may be issued by the companies.

4. **Redeemable Debentures** - Redeemable debentures are issued for a specified period of time. On the expiry of that specified time the company has the right to pay back the debenture-holders and have its properties released from the mortgage or charge. As per Companies Act, 2013 only redeemable debentures can be issued.

   Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, inter alia, provides that no company shall issue secured debentures unless it complies with the following conditions:

   a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue. However, a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;

   b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;

c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and

d) security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

   i) any specific movable property of the company (not being in the nature of pledge), and/or

   ii) any specific immovable property wherever situate, or any interest therein.

e) No person shall be appointed as a debenture trustee, if he-

   i) beneficially holds shares in the company;

   ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

   iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

   iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

   v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

   vi) has any pecuniary (monetary) relationship with the company amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

   vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

f) The trust deed, as aforesaid, shall be executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.

g) The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions prescribed under the Rules.

5. **Secured and Naked Debentures** - Normally, debentures are secured by a mortgage or a charge on the company's assets. However, debentures may be issued without any charge on the assets of the company. Such debentures are called 'Naked or unsecured debentures'. They are mere acknowledgements of a debt due from the company, creating no rights beyond those of ordinary unsecured creditors. Unsecured debentures are treated as deposits and should, therefore, conform to requirements applicable to public deposits accepted by a company.

6. **Convertible Debentures** - A company may also issue convertible debentures, either wholly or partly. In case of convertible debentures, an option is given to the debenture-holders to convert them into equity or preference shares at stated rates of exchange, after a certain period. Section 71 requires the company to pass a special resolution for issue of convertible debentures whether wholly or partly. Such debentures once converted into shares cannot be reconverted into debentures.

9.6 DIFFERENCE BETWEEN A SHARE AND A DEBENTURE

The points of distinction between 'share' and 'debenture' may be noted as follows:

1. A holder of a share is a member of the company. A debenture-holder, on the other hand, is a lender to the company.
2. A shareholder has a right to vote. A debenture-holder does not enjoy such a right. Sub-section (2) of Section 71 of the Companies Act, 2013 declares that no company shall issue any debentures carrying voting rights.
3. Income on shares depends on the profits. Shareholders are entitled to get dividend only out of profits. Debenture holders are entitled to a fixed rate of interest which the company must pay irrespective of profits, i.e., profits or no profits.
4. Shareholders cannot be paid back (except in case of redeemable preference shares) until its winding-up. Debenture holders may be paid back on the expiry of the specified time.
5. In the event of winding-up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture holders, normally, being secured lenders, have prior claim for repayment.
6. Dividend on shares is not a charge against profit. Interest on debentures, on the other hand, is a charge against the profits and is deducted from revenues for the purpose of calculating tax liability.

9.7 PUBLIC DEPOSITS

You have learnt about the two main sources of raising funds by a Company i.e. shares and debentures. Public deposit is another important source of meeting short term capital requirements.

9.7.1 Meaning of Deposit

Section 2 (31) of the Companies Act, 2013 defines the term 'deposit' as follows:

"Deposit" includes any receipt of money by way of deposit or loan or in any other form by a company. However, as per **the Companies (Acceptance of Deposits) Rules, 2014**, **"Deposit" does not include-**

i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government;

ii) any amount received from the notified foreign Governments and foreign/ international banks and multilateral financial institutions;

iii) any amount received as a loan or facility from any banking company or from a banking institution notified by the Central Government or from a co-operative bank;

iv) any amount received as a loan or financial assistance from the notified public financial institutions, regional financial institutions, insurance Companies, scheduled Banks.

v) any amount received against issue of commercial paper or any other instrument issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

vi) any amount received by a company from any other company;

vii) any share application money or advance towards allotment of securities pending allotment;

However, if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company; except when a director has given money out of funds acquired by him by borrowing or accepting loans or deposits from others.

ix) any amount raised by the issue of secured bonds or debentures provided that the amount of such bonds or debentures does not exceed the market value of such assets as assessed by a registered valuer;

any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognized stock exchange.

x) any amount received from an employee not exceeding his annual salary, under a contract of employment with the company in the nature of non-interest bearing security deposit;

xi) any non-interest bearing amount received or held in trust;

xii) any amount received in the course of or for the purposes of the business of the company:

a) as an advance for the supply of goods or provision of services provided that such advance is appropriated against supply of goods or provision of services within a period of 365 days from acceptance of such advance;

b) as advance received under an agreement for sale of property provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement;

c) as security deposit for the performance of the contract for supply of goods or provision of services;

d) as advance received under long term projects or for supply of capital goods.

e) as an advance towards consideration for providing future services in the form of warranty or maintenance contract as per written contract or arrangement, if the period for providing such services does not exceed the prevalent as per common business practices or five years, from the date of acceptance of such service whichever is less;

f) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

g) as an advance of subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of certain conditions.

xiv) any amount accepted by a Nidhi company in accordance with the prescribed rules;

xv) any amount received by way of subscription in respect of chit under the Chit Fund Act, 1982;

xvi) any amount received by the company under collective investment scheme in compliance with the SEBI regulations.

xvii) any amount of Rs. 25 lakh or more received by a start-up company (i.e. a private company incorporated under Companies Act) by way of a note convertible into equity shares or repayable within a period of five years from the date of issue, in a single tranche, from a person;

xviii) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds, Mutual Funds registered with SEBI, Infra structure Investment Trusts and Real Estate Investment Trusts.

9.7.2 Deposit and Loan

As per Section 2 (31) of the Companies Act, 2013 as well as the Companies (Acceptance of Deposits) Rules, 2014, referred to above, the expression 'deposit' includes 'loan' i.e, any amount borrowed by a company. However, there had been a number of judicial decisions in the past bringing out distinction between a loan and a deposit. In **Abdul Hamid Sahib v. Rahmat Bi** AIR 1965 Mad. 417, it was observed that in a sense, deposit is also a loan with the difference that a loan is repayable the minute it is incurred. In the case of deposits, repayment will depend on the maturity date fixed therein or the terms of agreement relating to the demand on the making of which the deposit becomes payable. In other words, unlike a loan which may become repayable instantly or on notice, there is no immediate obligation to repay in the case of deposits. It is repayable only on the basis provided in the Companies (Acceptance of Deposits) Rules, 2014.

In another case, the Supreme Court observed that the terms 'deposit' and 'loan' are not synonymous and whether a transaction is a deposit or a loan does not merely depend on the terms of documents, but has to be judged from the intention of the parties - **Annamalai v. Veerappa AIR 1956 SC 12.** Even the Limitation Act, 1963 provides for different periods of limitation for loan and deposit. In the case of a loan the period of limitation commences from the date when the loan is made, whereas in the case of deposits, it commences from the date when the demand is made.

9.7.3 Deposit and Debenture

According to section 2(30) of the Companies Act, 2013, debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. A debenture is thus a document which either creates or acknowledges a debt. A debenture may be secured or unsecured. **Where the debenture is unsecured, it will squarely fall within the definition of deposit.** It is only the debentures which satisfy the conditions stipulated in Rule 2 (1) (c) (ix) of the Companies (Acceptance of Deposits) Rules, 2014 (discussed earlier), which are excluded from the definition of deposits.

9.8 GLOBAL DEPOSITORY RECEIPTS

Global Depository Receipts (GDR) is an instrument in which a company located in a country issues one or more of its shares or convertible debentures/bonds outside the domestic country. A company can raise foreign currency funds by issuing equity shares.

As per Section 2 (44) of the Companies Act (2013) “Global Depository Receipt (GDR) means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company (in India) making an issue of such depository receipts”. Similarly, as per Section 2 (48) Indian Depository Receipt means “only instrument in the form of depository receipt created by a domestic depository in India and authorized by a company incorporated outside India making an issue of such depository receipts”.

The main reason why Indian companies issue the depository receipts is that they are prohibited from issuing rupee denominated securities which can be listed on foreign stock exchanges. Apart from this raising funds through depository receipt, result in diversifying of investor base, enhanced visibility, global presence, increased liquidity, better disclosures and other associated benefits.

Section 41 read along with Companies (Issue of Global depository Receipts) Rules 2014 allows a company which is eligible to do so in terms of scheme and relevant provisions of Foreign Exchange Management Rules and Regulation to issue depository receipts in any foreign country. The depository receipts can be issued by way of public offering or private placement or in any of other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

Condition for issue of GDRs, interalia include passing of a resolution by the Board as well as special resolution at a general meeting; the GDRs shall be issued by an overseas bank appointed by the Company and the underlying shares shall be kept in the custody of a domestic custodian bank; the company shall appoint a merchant banker or a practicing chartered accountant, practicing cost accountant practicing company secretary to oversee all the compliances relating to issue of depository receipts and take the compliance relating to issue of depositary receipts and take the compliance report from them. The provisions of the Act and any rules issued there under in so far as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

The issuance of depository receipts (ADR/GDR) in India are governed by Reserve Bank of India the Depository Receipts Scheme 2014. Some of the main features of the scheme are as follows :

1. No prior approval of the Finance Ministry is required to issue depository receipts, however, if the provisions of Foreign Exchange Management Act, 1999 are attracted on issuance and transfer of permissible securities constituting the underlying for DRs to a non-resident outside India, then the approval, if any, required under the Act would be required.

2. **Eligibility Criteria :** As per 2014 Scheme, any Indian company whether listed or unlisted, private or public or any other issuer or person holding permissible securities is eligible to issue or transfer (as the case may be) such securities to a foreign depository for issuance of depository receipts. Persons or companies debarred from accessing the capital market cannot issue or transfer securities for issuance of depository receipts.

   The depository receipts can be issued by a regulated entity having the legal capacity to issue DRs and operating in permissible jurisdiction.

3. **Kind of Issue of DRs :** There are two kinds of issue of depository receipts. The sponsored issue and the unsponsored issue. In an sponsored ADR programme, the company sponsors an ADR/GDR against the existing shares held by the existing shareholders. The price at which these shares would be converted to ADR/GDR is arrived by the lead book running managers. In sponsored ADR/GDR progrmame the company/issuer is a party to the deposit agreement and only one such ADR/GDR progrmame can exist at a time. In case of unsponsored issue the issuer is not a party to the deposit agreement and multiple programmes can run simultaneously. The unsponsored DRs can be issued on the back of listed permissible securities only if two conditions are fulfilled viz :

   i) DRs are listed on International Exchange

   ii) DRs give the holder the right to issue voting instructions

4. **Permissible Security:** The DRs can be issued on back of any permissible securities issued by government, companies, mutual funds etc. The permissible securities are required to be in dematerialized form before they can be used for issuance of depository receipts.

5. **End Use Restrictions:** Scheme 2014 puts no restriction on the end use of proceeds from the issue of DRs however restrictions as applicable under FEMA (1990) are still applicable.

Global Depository Receipt/American Depository Receipt and Indian Depository Receipt are identical from legal, operational technical and administrative point of view. The only difference is that GDR, ADR and IDR are issued in global, American and Indian Financial markets respectively.

9.9 LET US SUM-UP

Money raised through issue of shares is called share capital. The amount of capital stated in the Memorandum of Association of the company is called 'Nominal Capital' or Authorised Capital. Whole of the authorized capital need not be offered for subscription. The amount offered to the public for subscription is called the 'Offered Capital' or Issued Capital'. That part of the Issued Capital which is actually subscribed is called the 'Subscribed Capital'. The entire subscribed capital need not be called up by the company. The portion of the subscribed capital for which calls have been made is called as the "called up Capital'.

"A share is a share in the share capital of a company and includes stock." However, Supreme Court has accorded a much wider meaning to the term 'share'. It observed "By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company".

In another case, Supreme Court defined a share as "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound-up".

A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. It's, however, not a negotiable instrument.

Only two kinds of shares can be issued by a company, namely, equity and preference shares. Equity shares may be with voting rights or with differential rights as to dividend, voting or otherwise.

Preference shares carry a right of dividend either of a fixed amount or at a fixed rate and in case of winding up, it also carries a right to be paid back the capital before anything is paid to the equity shareholders. A company may issue redeemable preference shares which are participating or non-participating, cumulative or non cumulative. Under Companies Act, 2013, a company cannot issue irredeemable preference shares.

A company may issue "Sweat equity shares" to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions. A company can issue sweat equity shares only of a class of shares already issued and after passing a special resolution. Further, the issue of sweat equity shares in the company cannot exceed 25% of the paid up equity capital of the company at any time.

Stock is the aggregate consolidated holdings of the share capital of a person. In simple words, it means a number of shares put together in a bundle. The stock is expressed in terms of money and not as so many shares.

A company, if authorised by its articles, can, by passing an ordinary resolution, convert its fully paid-up shares into stock and vice versa.

Debenture is an instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. It includes 'bond' and 'debenture stock'.

Different types of debentures may be issued by a company including bearer debentures, registered debentures, naked debentures, convertible debentures or redeemable debentures. Companies Act, 2013, however, disallows a company to issue irredeemable debentures.

"Deposit" includes any receipt of money by way of deposit or loan or in any other form by a company. It, however, does not include amounts so notified under the Companies (Acceptance of Deposits) Rules, 2014.

Global Depository Receipt is an instrument in which a company located in a country issues one or more of its shares/convertible debentures/bonds outside the domestic country. A company can raise foreign currency funds by issuing equity shares. The issuance of depository Receipts in India are governed by Reserve Bank of India's depository Receipt scheme 2014.

9.10 KEY WORDS

Share : A unit into which the capital of the company is divided.

Issued Capital : The amount of capital that is issued by a company to public.

Preference Shares : Shares which carry preferential rights with reference to dividend and the repayment of capital in the event of winding up of the company.

Stock : Aggregate of fully paid-up shares of a member.

Reserve Capital : That part of uncalled capital which can be called up only in the event of winding up of the company.

Debentures : A document acknowledging a debt by a company.

Bearer Debentures : Debentures which are transferable by delivery only.

Naked Debentures : Debentures which are not secured by any mortgage of asset.

Secured Debentures : Debentures which are secured by the mortgage of some assets of the company.

Convertible Debentures : Debentures that are fully or partly convertible into equity shares of the company.

Redeemable Debentures : Debentures which are repayable after the stipulated period.

Sweat Equity Shares : Equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called

Deposit : Any deposit of money with, and includes any amount borrowed by a company.

Global Depository Receipt: An instrument by which a company raises capital in foreign country through depository.

9.11 ANSWERS TO CHECK YOUR PROGRESS

A. 1. i) a) ii) b)

2. i) False, ii) False, iii) False, iv) True, v) True, vi) False,

9.12 TERMINAL QUESTIONS

1. Define the term 'share'. What is the nature of a share? Is share a negotiable instrument?

2. What are the different types of shares which a company can issue?
3. Distinguish between 'equity shares' and 'preference shares'.
4. Write a note on 'Equity shares with differential rights as to dividend, voting or otherwise'. Can a company issue non voting shares?
5. State the rules subject to which preference shares may be issued and redeemed.
6. What are the different kinds of preference shares that a company may issue? Can a company issue irredeemable preference shares?
7. What is a debenture? What are the characteristic features of a debenture?
8. What are the different kinds of debentures that may be issued by a company?
9. Distinguish between a 'Share' and a "Debenture'.
10. Define the term 'Deposit'. State as to what is not a deposit as per the Companies (Acceptance of Deposits) Rules, 2014.
11. Distinguish between:
    (a) Deposit and Loan
    (b) Deposit and Debenture
12. What are sweat equity shares ? what are the conditions for issuing the sweat equity shares.
13. What are Global Depository Receipts? Discuss the main features of Reserve Bank of India's Depository Receipts Scheme 2014 for their issuance.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 10 ISSUE AND ALLOTMENT OF SHARES

Structure

10.0 Objectives

10.1 Introduction

10.2 Issue of Shares at Par

10.3 Private Placement of Shares

10.4 Public Issue of Shares

- 10.4.1 Initial Public Offer
- 10.4.2 Further Public Offer

10.5 Rights Shares

10.6 Bonus Shares

10.7 Distinction between Rights Shares and Bonus Shares

10.8 Issue of Shares at a Discount

10.9 Issue of Shares at a Premium

10.10 Allotment of Shares

- 10.10.1 Notice of Allotment
- 10.10.2 Rules Regarding Allotment of Shares
- 10.10.3 Procedure of Allotment
- 10.10.4 Return as to Allotment

10.11 Share Certificate

- 10.11.1 Issue of Share Certificates
- 10.11.2 Effects of Share Certificate
- 10.11.3 Duplicate Share Certificate

10.12 Calls on Shares

- 10.12.1 Essentials of a Valid Call
- 10.12.2 Payment of Calls Otherwise than in Cash
- 10.12.3 Payment of Calls in Advance
- 10.12.4 Interest on Calls due but not Paid

10.13 Forfeiture of Shares

10.14 Re-issue of Forfeited Shares

10.15 Surrender of Shares

10.16 Buy back of Shares

- 10.16.1 Sources of Buy-Back

10.16.2 Conditions for Buy-Back

10.16.3 Prohibition for Buy-Back in Certain Circumstances

10.16.4 Financial Assistance for Purchase of its Own Shares

10.17 Book Building

10.18 Let Us Sum Up

10.19 Key Words

10.20 Answers to Check Your Progress

10.21 Terminal Questions

10.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the issue of shares at par;
- explain the meaning and rules relating to private placement of shares;
- explain the meaning and rules relating to rights shares and bonus shares;
- distinguish between rights shares and bonus shares;
- discuss initial public offering and further public offering;
- list the circumstances under which the shares can be issued at a discount and at a premium;
- explain the meaning of allotment of shares;
- describe the rules relating to allotment of shares;
- explain the meaning of a share certificate;
- explain the essentials of a valid call;
- describe the circumstances under which the shares can be forfeited and reissued;
- explain the rules for the surrender of shares and buy back of shares; and
- describe book building process.

10.1 INTRODUCTION

In Unit 9 you learnt about the various kinds of shares and debentures that can be issued by a company. The Companies Act 2013 has laid down detailed procedure for the issue and allotment of shares which a company has to follow. In this unit, you will learn about issue of shares at par, private placement of shares, public issue of shares, initial public offer and further public offer, rights shares and bonus shares You will also learn about that procedure including the detailed rules relating to the allotment of shares. In addition, you will study the rules relating to the issue of shares at a premium or at a discount, and the procedure for the forfeiture and reissue of forfeited shares and surrender of shares, buy back of shares and book building.

10.2 ISSUE OF SHARES AT PAR

A company may issue shares at their face value or at a price other than the face value. When shares are issued at a price equal to their face value, it is termed as shares issued at par. It means when the issue price is equal to the face value it is called the issue of shares at par.

The term is not defined in the Act. The company may sell share less or more than par value, called sale of share of a discount or premium respectively.

Shares may be issued by a company by (a) public offer (b) rights issue / bonus issue and (c) private placement. Public offer may be (1) initial public offer (IPO) or (2) further public offer (FPO). They are discussed in this unit.

10.3 PRIVATE PLACEMENT OF SHARES

A company may make a private placement of securities. As per explanation 1 to Section 42 (3) private placement means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application which satisfies the conditions specified in this section.

Conditions

a) i) A private placement is to be made only to a select group of persons who have been identified by the Board, whose number shall not exceed fifty or such higher number as may be prescribed (presently, 200) (excluding the qualified institutional buyers and employees of the company being offered securities under the scheme of employees stock option in a financial year subject to such conditions as may be prescribed).

Qualified institutional buyer means the qualified institutional buyer as defined in the Securities and Exchange Board of India (issue of capital and disclosure requirement) Regulations 2009.

ii) Private placement shall be made through private placement offer and application in the prescribed form. However, the private placement offer and application shall not carry any right of renunciation.

In Mrs. Proddaturi Malathi vs. SRP Logistics (P) Ltd [2018] 96 taxmann.com 565 (NCL-AT), respondent directors increased share capital of company and further allotted shares of company to R2-director and to outsider at par by preferential allotment/private placement without following necessary procedure, said increase in share capital and subsequent allotment of shares was held to be invalid and thus same was to be set aside.

b) Every identified person willing to subscribe to private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking financial channel and not by cash.

Provided that a company shall not utilise money raised through private placement unless the allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (8).

c) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

d) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to replay the application money within the aforesaid period, it shall be liable to replay that money with interest at the rate of twelve percent per annum from the expiry of the sixteeth day.

   Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilized for any purpose other than

   a) for adjustment against allotment of securities; or

   b) for the repayment of monies where the company is unable to allot securities.

e) No company issuing securities under this section shall release any public advertisement or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

f) A company making any allotment of securities under this section shall file with the Registrar a return of allotment within fifteen days from the date of the allotment in such a manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Penalty

i) If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty five lakh rupees.

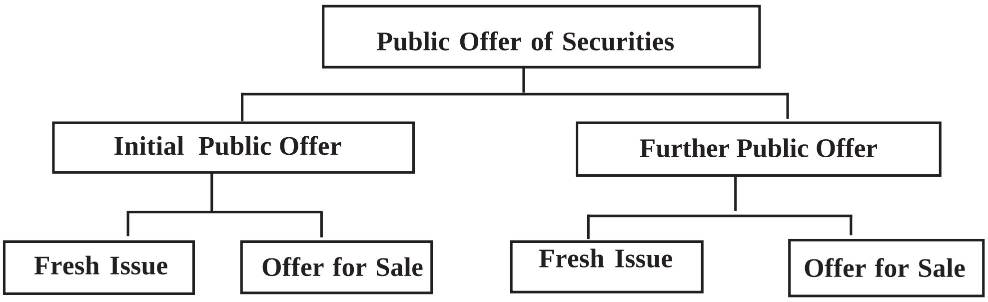
ii) Subject to sub-section (ii), if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or rupees two crores, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

10.4 PUBLIC ISSUE OF SHARES

The word "issue" here obviously means issued to public which further means issued generally and not merely to a set of selected persons. Issued generally in relation to prospectus means issued to persons irrespective of their being existing members or debenture holders of the body corporate to which prospectus relates. So word public shall include any section of public.

Issues can be classified as a public offer, rights or bonus issue and private placement. Public offer may be (a) initial public offer (IPO) (b) further public offer (FPO). Both of them may be a fresh issue or offer for sale. It should be in a dematerialised form. Certain members of the company, in consultation with the Board can offer sale of shares to the public.

10.4.1 Initial Public Offer



A public company limited by share may issue securities to public through prospectus called public offer. The word "securities" is a wider term and includes share and other instruments. A public company may issue securities by a public offer or rights/bonus issue or private placement. Public offer has been defined by explanation to Section 23 "public offer includes initial public offer or further public offer of securities to the public by a company or an offer for sale of securities to the public by existing shareholder, through issue of prospectus".

When company makes either a fresh issue of securities or offer its existing securities for sale or both for the first time to public, its called initial public offer (IPO), whereas after the first issue, whenever a company makes either a fresh issue of securities to public or an offer for sale to public, its called further public offer (FPO).

SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 with respect to public issue of equity shares or any other security convertible into equity shares.

Initial Public Offer (IPO)

1) **Entities not eligible to make an initial public offer**

1) An issuer shall not be eligible to make an initial public offer

   a) if the issuer, any of its promoter, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board (SEBI).

   b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

   c) if the issuer or any of its promoters or directors is a wilful defaulter.

   d) if any of its promoters or directors is a fugitive economic offender.

   The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

2) An issuer shall not be eligible to make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer.

However, the provisions of this sub-regulation shall not apply to:

a) Outstanding options granted to employees, whether currently an employee or not, pursuant to an employee stock option scheme in compliance with the Companies Act, 2013;

b) Fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) or the prospectus (in case of fixed issues), as the case may be.

(B) Eligibility requirements for an initial public offer

(1) An issuer shall be eligible to make an initial public offer only if:

a) it has net tangible assets of at least three crore rupees, calculated on a restated and consolidated basis, in each of the preceding three full years of (of twelve months each), of which not more than fifty per cent are held in monetary assets.

If more than fifty percent of the net tangible assets are held in monetary assets, the issuer should have utilized or made firm commitments to utilize such excess monetary assets in its business or project.

Further, the limit of fifty per cent on monetary assets shall not be applicable in case the initial public offer is made entirely through an offer for sale.

b) it has an average operating profit of at least fifteen crore rupees, calculated on a restated and consolidated basis, during the preceding three years (of twelve months each), with operating profit in each of these preceding three years;

c) it has a networth of at least one crore rupee in each of the proceeding three full years (of twelve months each), calculated on a restated and consolidated basis;

d) if it has changed its name within the last one year, at least fifty percent of the revenue, calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by its new name.

2) An issuer not satisfying the condition stipulated in sub-regulation (1) shall be eligible to make an initial public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer to qualified institutional buyers and to refund the full subscription money if it fails to do so.

C) General Conditions

1) An issuer making an initial public offer shall ensure that:

a) it has make an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange.

b) it has entered into an agreement with a depository for dematerialization of the specified securities already issued and proposed to be issued.

c) all its specified securities held by the promoters are in dematerialized form prior to filing of an offer document.

d) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited.

e) it has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for a specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through identifiable internal accruals.

2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed twenty five per cent of the amount being raised by the issuer.

10.4.2 Further Public Offer

Eligibility Requirements

Entities not eligible to make a further public offer.

An issuer shall not be eligible to make a further public offer:

a) If the issuer, any of its promoters, promoter group or directors, selling shareholders are debarred from accessing the capital market by the Board.

b) If any of the promoter or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

c) If the issuer or any of its promoters or directors is a wilful defaulter.

d) If any of its promoters or directors is fugitive economic offender.

The restrictions under (a) and (b) above shall not apply to persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarrment is already over as on the date of filing of the draft offer document with the board.

Eligibility requirement for further public offer

1) An issuer may make a further public offer, if it has changed its name within the last year, at least fifty per cent of the revenue for the preceding one full year has been earned by it from the activity indicated by its new name.

2) An issuer not satisfying the condition stipulated in sub-regulation (1) may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

General Conditions

1) An issuer making a further public offer shall ensure that:

   a) It has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of schedule XIX of SBI Regulations, 2018;

   b) It has entered into an agreement with a depository for dematerialisation of specified securities already issued and proposed to be issued;

   c) All its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

   d) It has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

2) The amount for general corporate purposes as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed twenty five per cent of the amount being raised by the issuer.

10.5 RIGHTS SHARES

When a company, having share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to the existing share holders under Section [62(1) (a)]. It is called "Rights Issue". If such shares are offered to employees, it is called "Employees Stock Option" under Section [62 (1) (b)]. Such shares can be offered other than existing share holders or employees, on preferential basis.

Section 62 (1) reads "where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered –

a) to persons who, at the date of offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to following conditions namely –

   i) the offer shall be made by **notice** specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of offer within which the offer, if not accepted, shall be deemed to have been declined.

   ii) unless the articles of the company otherwise provide, the existing shareholder shall have a right to renounce the shares offered to him in favour any other person who need not be a member of the company.

   iii) after the expiry of the time specified in the notice or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the share offered, "the Board of Directors may dispose off them in such a manner which is not disadvantageous to the shareholders and the company".

10.6 BONUS SHARES

As per section 63, a company may issue fully paid-up shares to its members, in any manner whatsoever, out of :

i) its free reserves;

ii) the securities premium account;

iii) the capital redemption reserve account;

provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless–

a) it is authorised by its articles;

b) it has, on the recommendations of the Board, been authorised in the general meeting of the company;

c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

d) it has not been defaulted in respect of the repayment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

The Bonus Shares shall not be issued in lieu of Dividend.

Bonus shares are not taxable in the hands of shareholders. Paid-up share capital increases with issue of bonus shares.

According to Rule 14 of Companies (share capital and debentures) Rules 2014, once the Board has recommended a bonus issue, it can not be withdrawn afterwards.

10.7 DISTINCTION BETWEEN RIGHTS SHARES AND BONUS SHARES

Rights Shares	Bonus Shares
1. They are issued when a company having share capital proposes to increase its subscribed capital by further issue of shares.	1. They are issued when a company decides to capitalise its free reserves, securities premium account or capital redemption reserve account.
2. It only confer a privilege on the existing shareholders to have a claim on the shares offered after the first public issue.	2. They are issued to the existing members free of charge.
3. A letter of offer is sent to the equity shareholders, specifying the	3. No such letter of offer need be sent to the shareholders since the

number of shares in proportion to the paid-up share capital of those shares.	company capitalises profits or reserves if it is authorised by articles and on the recommendation of Board has been authorised in general meeting.
4. If equity shareholder accepts the offer, he has to pay the specified amount.	4. Members do not have to pay any amount for such shares.
5. If the equity shareholder does not accept the offer, the Board of Directors may dispose them off in such a manner as it is advantageous to company and shareholders.	5. The company which has announced the decision of its Board recommending bonus issue, shall not subsequently withdraw the same.
6. The existing shareholding of the members as well as rights shares may be partly paid.	6. Bonus shares are always fully paid.
7. Rights shares may be renounced in favour of his nominee.	7. No such facility is available in case of bonus shares.

Check Your Progress A

1) What do you mean by issue of shares at par?

....

....

....

2) What is meant by private placement of shares?

....

....

....

3) List the conditions to be satisfied by the company before issuing bonus shares.

....

....

....

....

4) What is meant by Rights Share?

....

....

....

....

10.8 ISSUE OF SHARES AT A DISCOUNT

If the buyer of shares is required to pay less than face value of the share, for example, Rs. 9 on a share of Rs. 10, then the share is said to be issued or sold at a discount. The issue of shares at a discount is regulated by law and Section 53 provides that except as provided in section 54, a company shall not issue shares at a discount. **Section 54 allows only 'sweat equity shares' to be issued at a discount and that too subject to compliance of the specified conditions.**

Any share issued by a company at a discounted price shall be void. A company may, however, issue shares at a discount to its creditors, when debt is converted into shares or debt restructuring scheme as per RBI regulations.

Thus, if a company issues any shares, except sweat equity shares, as aforesaid, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both (Section 53 (3)).

10.9 ISSUE OF SHARES AT A PREMIUM

A company may issue securities at a premium when it is able to sell them at a price above par or above face value, for example, Rs. 100 per share at a price of Rs. 120, thereby earning a premium of Rs. 20 per share. The Act, does not stipulate any conditions or restrictions regulating the issue of shares by a company at a premium. However, the Act does impose conditions regarding the utilisation of the amount of premium collected on securities.

Firstly, the premium cannot be treated as profit and, therefore, cannot be distributed as dividend. However, the same can be capitalised and distributed in the form of bonus shares.

Secondly, the amount of premium, whether received in cash or in kind, must be recorded in a separate account, known as the "securities premium A/c".

Thirdly, the amount of share premium is to be maintained with the same sanctity as the share capital.

According to Section 52 (2), the share premium can be utilised only for:

a) issuing fully paid bonus shares to members.

b) writing off the balance of the preliminary expenses of the company;

c) writing off the commission paid or discount allowed, or expenses incurred on issue of shares or debentures of the company;

d) providing for the premium payable on redemption of any redeemable preference shares or debentures of the company.

e) for the purchase of its own shares or other securities under section 68.

Unless articles of association of company permit utilization of share premium account for purposes other than mentioned in section 78(2) [now section 53], company court cannot approve resolution to that effect **- Hyderabad Industries**

Ltd., In re [2004] 53 SCL 376 (AP).

However, Rajasthan High Court has held that a company can utilize credit balance in securities premium account for purpose of meeting deferred tax liability- **Mangalam Cement Ltd., In re [2008] 86 SCL 153 (Raj.).**

Unless and until there is diminution of the share capital and corresponding reduction of the share premium account, no company can be allowed to write off or adjust the loss against share premium account - **Hyderabad Industries Ltd., In re [2004] 53 SCL 376 (AP).**

Also in this case for utilization of the share premium account for purposes mentioned in section 78(2) [now section 53], no approval or sanction of the Court is required.

10.10 ALLOTMENT OF SHARES

You know that a public limited company invites subscriptions from the public and for this purpose a prospectus is issued. In response to this invitation, the prospective investors offer to buy shares by submitting the prescribed application form. If the application is accepted by the company, it proceeds to allot the shares. With the issue of the letter of allotment, the offer stands accepted thereby giving rise to a legally binding contract between the company and the shareholder. Thus, an allotment is the acceptance by the company of the offer to purchase shares.

The term 'Allotment' has nowhere been defined in the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons (**Re. Calcutta Stock Exchange Association Ltd. [1957]**. The Supreme Court in **Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. (1964)** defined allotment as "the appropriation out of the previously unappropriated capital of the company of a certain number of shares to a person."

Since re-issue of forfeited shares does not constitute appropriation out of unappropriated capital, it does not constitute allotment.

What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares - per Chetty, J. in **re Florence Land & Public Works Ltd. [1955]**.

10.10.1 Notice of Allotment

An allotment is the acceptance of an offer to take shares by an applicant, and like any other acceptance, it must be communicated. There can be no binding contract unless the acceptance of the offer is properly communicated. Thus, notice of allotment must be given to the allottee. If the letter of allotment is properly posted i.e., it is correctly addressed and stamped, a contract will arise even if the letter of allotment is delayed or lost in the course of transit. In this letter of allotment, besides details like number of shares applied for, the number of shares allotted, etc., the allottee is asked to pay the money due on allotment to the company's bankers within a specified time unless there is partial allotment and the allotment money is appropriated out of the excess application money.

10.10.2 Rules Regarding Allotment of Shares

The rules regarding allotment of shares can be discussed under two broad heads- (a) general rules and (b) the legal rules.

General Rules

You know that the allotment is the acceptance of an offer to purchase certain number of shares. Therefore, the general rules relating to valid acceptance of an offer must be followed. The general rules regarding allotment of shares are as follows:

i) **Proper authority:** It is the duty of the Board of' directors to allot the shares. However, the Board may delegate this authority to some other person or persons as per the provisions of the articles of association. The power to allot shares is generally given to a Committee constituted for the purpose, usually called "Allotment Committee". Allotment of shares made by an improper authority will make it void.

ii) **Reasonable time:** The offer to purchase shares of the company must be accepted within a reasonable time otherwise the applicants may refuse to take shares because after a reasonable time the offer lapses. What is the 'reasonable time' is a question of fact in each case.

ii) **Communication:** The allotment of shares should be communicated to the applicants. As noted above, the posting of a properly addressed and stamped letter of allotment will be taken as a valid communication. Even if this letter of allotment is delayed or lost in transit, the allottee will be liable. 'G' applied for certain shares in a company. The letter of allotment was despatched to him but it never reached. It was held that 'G' was liable as a shareholder (**Household Fire Insurance Co. Ltd. v. Grant**).

iv) **Absolute and unconditional:** The allotment of shares must conform to the terms and conditions of the application. If the allotment is not according to the terms and conditions, the applicant may refuse to accept the shares even though allotment has been made to him.

Thus, where the applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company and shares were allotted to him but he was not appointed the branch manager. Held, he was not bound by the allotment - **Ramanbhai v. Ghasi Ram [1918].**

If the conditions are not fulfilled, the applicant must reject the shares promptly. His silence or acceptance will debar him from this right.

v) **Allotment against application only:** An allotment can be made only against application in writing and no oral application/allotment can be made.

Legal Rules

You should note that so far as the private companies are concerned, the Act does not lay down any restrictions as to the allotment of shares. But the Act has laid down certain restrictions regarding the allotment of shares by public companies.

When no public offer is made: Where a public company does not offer its shares to the public but arranges the capital privately, the company can proceed with the allotment forthwith.

When an offer is made to the Public: Where a company offers the shares to the public:

1. **Registration of prospectus [Section 26(4)]** - A copy of the prospectus signed by every person who is named therein as a director or proposed director of the company or by his duly authorized attorney shall be duly filed with the Registrar for registration on or before the date of its publication.

   In case of contravention, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

2. **Application money [Sec. 39(2)]** - An amount payable on application on each share shall not be less than 5% of the nominal amount of the share or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf. However, as per SEBI Regulations, 2018, application money must not be less than 25% of the nominal amount of the share.

3. **Minimum subscription [Section 39(1 &3)]** - No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the 'minimum subscriptions' has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

4. **Closing of the subscription list** - Although Companies Act is silent as to the time for which the subscription list must be kept open, SEBI's regulations, 2018 provide that the subscription list for public issue must be kept open for at least 3 working days and for not more than 10 working days .In case of revision in price band, the issuer shall extend the bidding (issue) period for a minimum period of three working days.

   In case of rights issue, the issue shall remain open for a minimum period of 15 days and cannot remain open beyond 30 days.

5. **Permission to deal on a stock exchange [Sec. 40]** - Every company making public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

Where a prospectus states that an application under sub-section (1) has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

Unless permission is granted by each or every one of all the stock exchanges named in the prospectus for listing of shares to which application is made by the company the consequence is to render the entire allotment void. In other words, if permission has not been granted by any one of the several stock exchanges named in the prospectus for listing of shares, the consequence is to render the entire allotment void and the grant of permission by one or more of them is inconsequential. **[Supreme Court in Rishyashringa Jewellery Ltd. v. Stock Exchange (1995); Smt. Urmila Bharuka v. Coventry Spring and Engineering Co. Ltd. & Ors. [1997]]**.

However, where an appeal is preferred against the decision of the stock exchange, the allotment shall not be void till the appeal has been disposed off.

All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

a) for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

b) for the repayment of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

If a default is made in complying with the aforesaid provisions, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both [Section 40 (5)].

10.10.3 Procedure of Allotment

When the company receives from bankers all the share applications, a share application list is prepared. You should remember that only the names of such applicants should be recorded who have paid the application money because an application without application money is void. The directors will see that all the legal rules regarding allotment have been complied with, and then they will proceed with the allotment of shares. If the issue has been just fully subscribed, then there is no problem in allotment, the directors can allot to each applicant the number of shares asked for.

But the real difficulty arises in case of over-subscription. An issue is said to be over-subscribed if the number of shares applied for is greater than the number of share available for allotment. In case of over-subscription, the applicants will have to be allotted less number of shares than applied for, it is known as partial allotment. A scheme of basis of allotment in consultation with the designated stock exchange and conforming to SEBI Regulations, 2018, is framed. You may note that SEBI Regulations, 2018, provide for allotment on proportionate basis subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

SEBI Regulations, 2018, disallow retention of **over-subscription** under any circumstances except to the extent necessary because of proportional allotment, but not exceeding 10%.

You should remember that when lesser number of shares are allotted to an applicant, the excess application money may not be refunded to him but instead adjusted against the allotment money due from him.

In case of under-subscription, the Board of directors has only to ensure that the minimum subscription including underwriters' devolvement has been received, then they can proceed with the allotment. When the Board of directors pass a resolution confirming the allotment and, if for some reason, no shares are allotted to an applicant, then a letter of regret is sent to him along with a crossed cheque for the refund of the share application money. Alternatively, money may be transferred to his bank account through Electronic Clearance Series (ECS).

10.10.4 Return as to Allotment

You learnt the rules and the procedure of allotment of shares. Whenever a company having a share capital makes any allotment of securities**,** it shall file with the Registrar a return of allotment in such manner as may be prescribed (Section 39 (4)).

As per Rule 12 of the Companies (Prospectus and Allotment of Securities) Rules, 2014:

1) Whenever a company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form **PAS-3**, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.

2) There shall be attached to the Form a list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form as being complete and correct as per the records of the company.

3) In the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

4) In case the contract is not reduced to writing, the company shall furnish along with the Form complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899.

5) A report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract.

6) In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form.

7) In case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form **PAS-3**, the valuation report of the registered valuer.

Penalty:

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Check Your Progress B

1) What is meant by allotment of shares?

....

....

....

....

....

2) List four important conditions which must be satisfied before a company can proceed to allot the shares.

....

....

....

3) List the purposes for which the share premium amount may be utilised.

....

....

....

4) Fill in the blanks:

   i) The allotment of shares in a company must be made by a resolution of ....

   ii) The amount payable on application on each share must not be less than .... per cent of the nominal value of share.

   iii) If a company does not receive .... per cent of the issue amount, it cannot allot the shares.

   iv) If the company does not receive the amount of minimum subscription within .... days from the date of closure of issue, it must return the amount within .... days.

   v) Reissue of forfeited shares .... be termed as allotment of shares.

5) State whether the following statements are true or false.

   i) A company can allot shares immediately after the issue of prospectus.

   ii) A company cannot allot shares unless the minimum subscription has been subscribed.

   iii) When an issue is over-subscribed, the directors may allot all the shares applied for.

   iv) A company cannot issue shares for consideration other than cash.

   v) There are no restrictions on the issue of shares at a premium.

   vi) Dividend can be paid out of the share premium amount.

   vii) A company cannot issue shares at a discount.

10.11 SHARE CERTIFICATE

A share certificate is a certificate issued by the company under its common seal specifying the shares held by any member and the amount paid on each share. A share certificate is an evidence of title of the allottee or transferee to the shares. It is a declaration that the person in whose name the certificate is made out and to whom it is given, is a shareholder in the company. However, it should be remembered that it is not a negotiable instrument.

The share certificate may be in any form but a valid share certificate must have the following contents:

i) Name of the company; ii) Name and address of the shareholder; iii) Number of shares held by him; iv) Distinctive number of shares; v) Amount paid on each share; vi) Date of issue; vii) Share certificate number; viii) Stamp; ix) Signatures of two directors and the Secretary.

Every person whose name is entered as a member in the Register of members is entitled to receive share certificate(s) for his shares without payment. A share certificate is considered to be the prima facie evidence of the title of the member to the shares mentioned in the certificate.

10.11.1 Issue of Share Certificates

The Companies Act has laid down time limits within which the share certificate must be delivered. Section 56 (4) provides that every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted—

a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;

b) within a period of two months from the date of allotment, in the case of allotment of any of its shares;

c) within a period of one month from the date of receipt by the company of the instrument of transfer, or of the intimation of transmission.

d) Within a period of six months from the date of allotment in the case of allotment of debentures.

Where the securities are dealt within a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

Penalty

In case of default, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

10.11.2 Effects of a Share Certificate (Section 46)

You have learnt that share certificate is prima facie evidence of the title of the member to the shares specified therein. Following are the effects of a share certificate:

i) **Evidence of title:** When the share certificate is issued, the company is estopped from denying the title of the person to the shares whose name is mentioned in the certificate, provided that person has acquired the shares in good faith and under a genuine transfer for value. However, it is not a conclusive proof of the title of the holder. If a person has obtained some shares on the basis of a forged transfer, the company can refuse to register the transfer of shares. You should remember that share certificate is only an evidence of title and is not a document of title. It is not a negotiable instrument which can be transferred by mere 'delivery' or by 'endorsement and delivery'.

ii) **Estoppel as to payment:** You know that the share certificate states the amount paid on them. A company is estopped from stating that the amount stated as having been paid on the shares has not been paid. For example, if the share certificate states that the full amount on the shares has been paid, then the company is prevented from saying that the shares are not fully paid.

10.11.3 Duplicate Share Certificate

Section 46 (2) provides that a duplicate certificate of shares may be issued, if such certificate —

a) is proved to have been lost or destroyed; or

b) has been defaced, mutilated or torn and is surrendered to the company.

As per **the Companies (Share Capital and Debentures) Rules, 2014,Sub Rule 6 (2) says w**here a duplicate certificate is issued, it shall be stated prominently on the face of it and be recorded in the Register maintained for the purpose, that it is "duplicate issued in lieu of share certificate No…. " and the word "duplicate" shall be stamped or printed prominently on the face of the share certificate.

If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

If any person impersonates or obtains certificate fraudulently, he may be liable for punishment with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees (Section 57).

In case of dispute about the transfer of shares, duplicate shares cannot be ordered to be issued in favour of the transferee - **S. Sundaram Pillai v. P. Govindaswami [1987].**

A company can issue duplicate share certificate only to a registered shareholder.

Check Your Progress C

1) What is a share certificate?

....

....

....

....

....

2) What is the purpose of issuing a share certificate?

....

....

....

....

3) A share certificate creates two kinds of estoppel against a company. List them.

....

....

....

....

4) Fill in the blanks:

   i) A share certificate is a ....

   ii) Every company shall issue share certificates within .... months of the date of allotment.

   iii) A Company can issue duplicate share certificate to ……………….. only.

5) State whether the following statements are true or false:

   i) The approval of Central Government is necessary for issuing share certificate.

   ii) A share certificate may be partly or fully paid.

   iii) A share certificate can be transferred by delivery alone.

   iv) A shareholder is entitled to a duplicate share certificate if it is proved that the original certificate has been lost or destroyed.

10.12 CALLS ON SHARES

When a company issues shares, the applicants are generally not required to pay the full value of the shares in one instalment. They are required to pay the application money only which should not be less than 5% of nominal amount of the share (Section 39).

The balance amount is to be paid later on. Some amount is payable at the time of allotment. It is termed as ‘allotment money’. The balance amount is called by the company in instalments. Each instalment is termed as a ‘call’. You must remember that the amount paid on application and allotment are not termed as calls.

A call may be defined as a demand by the company on the shareholders to pay whole or part of the balance remaining unpaid on each share, at any time during the life-time of the company.

10.12.1 Essentials of a Valid Call

In making a call, care must be taken that:

1. i) the directors making it are duly appointed and duly qualified;

   ii) the meeting of the Board of directors has been duly convened;

   iii) the proper quorum is present;

   iv) the resolution making the call is duly passed and specifies the amount of the call, and the time and place of payment;

   v) A proper entry is made in the minutes.

Unless the aforesaid matters are attended to, the call may be invalid.

2. **Calls on shares of same class must be made on uniform basis [Sec. 49]** - For the purpose of this section, shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class (Explanation to section 49).

3. **Call to be made bona fide in the interest of the company** - Directors are the trustees of the capital of a company. Accordingly, the amount called up has to be used for the benefit of the company, and it should also be called only in the interest of the company. Thus, where the company was in difficult circumstances and the directors made a call only to enable them to draw their own remuneration, the call was held to be an abuse of power and the directors were bound to refund the remuneration drawn by them - **Alexander v. Automatic Telephone Co. [1900] 2 Ch. 56 (CA).**

4. **Notice of call** - A call must be made by serving upon members a notice of payment in accordance with the provisions of section 20. It should be a formal notice and not mere demand or request for payment. Every shareholder is under a statutory obligation to pay the full amount of his shares. Section 10 (2) of the Companies Act, 2013 declares that all money payable by any member to the company on the shares held by him under the Memorandum or Articles is a debt due from him to the company. But the liability to pay this debt arises only when a valid call has been made. Thus, where a company acquired the rights of another company in respect of its uncalled capital and demanded payments from members, it was held that such a demand could not take the place of a formal call notice - **Pabna Dhana Bhandar Co. Ltd. v.Foyezudin Mia AIR 1932 Cal. 716.**

The notice must specify the exact amount and the time of payment **- E and W Insurance Co. Ltd. v. Kamala Mehta (supra).** However, if the contents of the notice are certain in terms of money demanded and time allowed for payment, the notice will be valid even if its form is inaccurate - **Shackleford, Ford & Co. v.Dangerfield [1868] LR 3 CP 407.**

The liability of the joint shareholders shall be joint and several (section 43 of the Indian Contract Act).

10.12.2 Payment of Calls Otherwise than in Cash

Shares may be paid for in cash or in kind or in any manner that has the effect of actual cash being received by the company.

A debt due and owing by a banking company to a shareholder can be set off against outstanding calls so long as banking company is a going concern - **Hind Iran Bank Ltd. v. Raizada Jagan Nath Bali [1959].**

10.12.3 Payment of Calls in Advance

Section 50 of the Act provides that the directors may, if authorised by the Articles, allow shareholder to pay the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up.

According to Section 50 (2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the moneys so paid in advance by him until the same becomes payable.

However, Section 51 provides that dividends may be paid in proportion to the amount paid upon each share, if so authorised by the Articles.

10.12.4 Interest on Calls Due but Not Paid

A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table F provides for interest at the rate of 10% per annum or at such lower rate, if any, as the Board may determine. The Board shall, however, be at liberty to waive payment of any such interest wholly or in part.

10.13 FORFEITURE OF SHARES

You have learnt that the company does not require the shareholders to pay the full amount of shares in one instalment. It makes calls on them as and when the money is needed. If a shareholder fails to pay a valid call within the stipulated time, the company has two options: (1) the company may file a suit for the recovery of the amount, or (2) the company may forfeit the shares. The first option is a lengthy process. Therefore, the company generally decides to forfeit such shares.

The term ‘forfeiture’ means taking them away from the member. It deprives the shareholder of his property. The shares can be forfeited only if there is a provision to this effect in the articles of the company. You should note that as per Regulation 28 of Table ‘F’, shares can be forfeited only for non-payment of any call or instalment of a call and not for any other debt due from a member. However, the Articles of a company may lawfully incorporate any other grounds of the forfeiture **– Naresh Chandra Sanyal vs. Calcutta Stock Exchange (1971).**

Table ‘F’, which is generally adopted by the companies with respect to forfeiture of shares, contains the following rules:

i) The power to forfeit shares must be given in the Articles of the company.

ii) Shares can be forfeited only for non-payment of calls.

iii) The company must serve a proper notice on the defaulting member asking him to pay the amount within a fixed period, failing which the shares shall be forfeited. The shareholder must be given at least fourteen days notice to pay the amount, notice must indicate the exact amount to be paid. If there is a slight defect in the notice, the forfeiture will become invalid.

iv) The Board of directors must pass a resolution for the forfeiture of shares.

v) The power for forfeiture must be exercised in good faith and for the benefit of the company. Thus, forfeiture for the purpose of relieving a friend from liability shall be invalid.

Effects of Forfeiture

1. **Cessation of membership -** A person whose shares have been forfeited ceases to be a member in respect of the forfeited shares [Regulation 32(1) of Table F].

2. **Cessation of liability -** The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares forfeited [Regulation 32(2) of Table F]. However, notwithstanding the forfeiture, he remains liable to pay to the company all moneys which, at the date of forfeiture, were payable by him to the company in respect of the shares forfeited [Regulation 32(1) of Table F]. Thus, liability for unpaid calls remains even after forfeiture of shares.

3. **Liability as past member** - The former holder shall remain liable as a past member to pay calls if liquidation takes place within one year of the forfeiture.

4. **On forfeiture, the forfeited shares become the property of the company.** Accordingly, these may be re-issued or otherwise disposed of on such terms and in such manner as the Board thinks fit [Regulation 31(1) of Table F]. However, at any time before a sale or disposal of the forfeited shares, the Board may cancel the forfeiture on such terms as it thinks fit [Regulation 31(2) of Table F].

The right of the company upon forfeiture is only to dispose of the share and use the proceeds for discharging the liability for which the forfeiture was effected, and if there is any balance it belongs to the defaulter and, cannot be appropriated by the company **- Naresh Chandra Sanyal vs. Calcutta Stock Exchange Assn. Ltd. AIR 1971 SC 422.**

10.14 RE-ISSUE OF FORFEITED SHARES

When the shares are forfeited, they become the property of the company and, to that extent, the paid-up capital of the company stands reduced. Therefore, the forfeited shares are generally reissued by the company. The total sum paid by former holder of shares, together with amount paid on reissue and the amount unpaid on shares is not less than par value. **The forfeited shares can be reissued at any price i.e., even at discount. But the amount of discount must not exceed the amount forfeited on such shares.** The reissue is done by a resolution of the Board of directors. After the reissue, the buyer of such shares shall become liable to pay all the future calls due on shares, including the calls for which the shares were forfeited. The name of the buyer shall be recorded in the register of members and if the original shareholder has surrendered the share certificate, the same shall be transferred in the name of the buyer, otherwise a new share certificate shall be issued.

The title of the buyer shall not be affected by any irregularity or invalidity in proceedings with reference to forfeiture. It should, however, be noted that reissue of forfeited shares is a sale of shares and it does not amount to an allotment. Therefore, return of allotment need not be filed with the Registrar.

10.15 SURRENDER OF SHARES

Surrender is a voluntary act of the shareholder under which the shares are returned to the company for purposes of cancellation. Neither the Companies Act nor Table 'F' provides for the surrender of shares. But, the articles may provide for the surrender of the partly paid-up shares under circumstances where forfeiture seems to be justified.

You must note that when shares are surrendered to the company, no amount is refunded to the shareholder. It is so, because if some money is refunded it will amount to a purchase by the company of its own shares which is prohibited by Section 67 of the Companies Act.

Surrender of shares may be allowed in the following cases if its acceptance is authorised by the Articles of the company:

i) When shares are surrendered in exchange for new shares of the same nominal value, as it does not amount to any reduction of capital.

ii) When the circumstances are such where forfeiture is justified, because surrender is a short-cut to forfeiture.

If the surrender of shares is accepted by the company for any other reason, other than the reasons given above, it will be invalid.

On a valid surrender of shares, the member ceases to be a member of the company, but his name can be placed on list of contributories. Thus, if the company is wound up within twelve months of the surrender of shares, he shall be liable as a past member. If the surrender of shares is proved to be illegal, the shareholder may apply for the rectification of register of members after lapse of any number of years, provided the shares have not been reissued in the meantime.

Forfeiture and surrender of shares, both lead to the termination of membership. But in case of forfeiture it is compulsory or a forced action, while in case of surrender it is a voluntary act on the part of the member to avoid the disgrace of forfeiture.

10.16 BUY BACK OF SHARES

Section 67(1) of the Companies Act, 2013 provides that a company limited by shares or a company limited by guarantee having a share capital cannot buy its own shares. The restriction is applicable to all companies having share capital, whether public or private.

The prohibition to buy back its own shares shall not apply to a private company;

a) in whose share capital no other body corporate has invested any money;

b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or 50 crore rupee, whichever is lower; and

c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section – vide MCA notification dated 5.6.2015.

However, Section 68 allows a company to purchase its own shares or other securities subject to certain conditions. The provisions of Section 68 are as follows:

10.16.1 Sources to Buy-Back

A company can buy its own shares and other specified securities 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 shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

In case shares are bought back out of free reserves or securities premium account then Section 69 stipulates that a sum equal to the nominal value of shares bought back shall be transferred to a reserve account to be called the 'Capital Redemption Reserve Account' and details of such transfer shall be disclosed in the balance-sheet. This account may be applied by the company for issue of fully paid bonus shares.

10.16.2 Conditions for Buy-Back

1) Section 68 (2) provides that no company shall purchase its own shares or other specified securities unless:

   a) the buy-back is authorised by its articles;

   b) a special resolution has been passed at a general meeting of the company authorising the buy-back. The buy-back must not exceed twenty-five per cent of the aggregate of paid-up capital and free reserves of the company. In case of buy-back of equity shares in any financial year, buy-back cannot exceed 25% of its total paid-up equity capital in that financial year.

      However, buy-back up to ten per cent of the total paid-up equity capital and free reserves of the company may be affected by passing a resolution at a meeting of the Board of directors of the company;

   c) There cannot be more than one buy-back within a period of one year from the date of the closure of the preceding offer of buy-back.

   d) the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

   e) all the shares or other specified securities for buy-back are fully paid-up;

   f) buy back of securities by a listed company shall be as per SEBI regulations.

2) Every buy-back shall be completed within a period of one year from the date of passing the Special resolution /Board's resolution under sub-section (2) of Section 68.

3) Buy-back shall be permissible:

   a) from the existing shareholders or security holders on a proportionate basis;

   b) from the open market;

   c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

4) The company must file with the Registrar and the Securities and Exchange Board, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and 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 from the date of declaration adopted by the Board.

   No declaration of solvency shall be required to be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange.

5) 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 date of completion of buy-back.

6) Where a company completes a buy-back of its shares and other specified securities under this Section, it shall not make further issue of the same kind of shares including by way of rights or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

7) A company shall after the completion of the buy-back file with the ROC and SEBI a return containing such particulars relating to the buy-back within 30 days of such completion, as may be prescribed.

However, the aforesaid return shall not be required to be filed with SEBI if the company's shares are not listed on any recognized stock exchange.

Penalty

If a company makes default in complying with the provisions of Section 68 or any rules and regulations made thereunder, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

10.16.3 Prohibition for Buy-Back in Certain Circumstances [Section 70]

No company shall, directly or indirectly, purchase its own shares or other specified securities:

a) through any subsidiary company including its own subsidiary companies;

b) through any investment company or group of investment companies; or

c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of the Companies Act, 2013, interest payment 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 banking company. However, the buy-back shall be permissible after a period of three years from the date such default ceased to subsist.

In the following cases, however, a company is not taken to have purchased its own shares:

a) where it redeems its preference shares;

b) forfeits its shares for non-payment of calls;

c) accepts a valid surrender of shares.

10.16.4 Financial Assistance for Purchase of its Own Shares

Sub-section (2) of Section 67 further disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company.

However, the aforesaid provisions regarding the prohibition to buy its own shares or give loans or provide financial assistance shall not affect:

a) The lending of money by a banking company in the ordinary course of its business.

b) the provision by a company of money in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid-up shares in the company or its holding company, if the purchase of, or the subscription is for, the shares held by trustees for the benefit of the employees or such shares are held by the employees of the company;

c) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership. However, the amount so advanced must not exceed their salary or wages for a period of six months.

d) A company may buy its own shares from any member for prevention of oppression and mismanagement in pursuance of the Tribunal order under Section 242 of the Act.

e) A private company not being a subsidiary of a public company though not allowed to buy its own shares may advance loan or financial assistance for purchase of its shares or shares of its holding company.

f) The Section does not apply to the case of any holding company purchasing the shares of or lending money to any person for purchasing shares of its subsidiary.

If a company contravenes the provisions of section 67, it shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

10.17 BOOK BUILDING

Book Building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement or other document. It is a method of equity under-writing.

Thus, in case of public issue through the process of book building, though the total size of the issue is known, the number of shares is not known. It is because the price is at which shares will be allotted is not known, it's determined through the process of book-building only. The prospectus only mentions the price band [i.e., the lowest (floor price) and the highest (maximum price)]. As per SEBI Regulations, 2018 the maximum price cannot be more than 20% of the floor price. As part of the process, bids are invited from the prospective investors and final price is determined (that is, the price at which the issue is likely to be fully subscribed). By dividing the total issue size by the price so determined, the number of shares to be issued is arrived at. As per SEBI Regulations, 2018, an issuer company may make an issue of securities to the public through a prospectus by making 100% of the net offer to the public through book-building process.

Advantages of Book–building – Advantages of book-building include:

i) the demand for security proposed to be issued by a body corporate may be created and built-up.

ii) the quantum of security to be issued may be determined with a certain degree of accuracy.

iii) The price at which the issue is likely to be fully subscribed may be ascertained.

iv) This is the most efficient method to price the shares in IPO market.

v) This process gives investors the confidence leading to a large investor universe.

vi) As the issue is pre-sold these is no uncertainties relating to the fate of the issue.

Book building is an alternative method for allotment of securities through public offer.

Offer to Public through Book Building Process

An issuer proposing to issue specified securities through the book building process shall comply with the requirements of Schedule XIII of SEBI Regulations, 2018

Check Your Progress D

1) What is meant by a call?

....

....

....

....

2) List three essentials of a valid call.

....

....

....

....

3) Give the reason for forfeiting shares.

....

....

....

4) When is surrender of shares lawful?

....

....

....

....

5) What is buy-back of shares?

....

....

....

6) State whether the following statemnts are true or false:

i) Any director of a company can make a call on his own.

ii) The call notice must specify the amount payable, the date and place of payment.

iii) The calls on shares should be made on a uniform basis.

iv) Forfeiture of shares does not amount to reduction of capital.

v) Shares can be forfeited for non payment of call or any other debt.

vi) Forfeited shares may either be cancelled or reissued at the discretion of the Board of directors.

vii) Forfeited shares can be reissued at a discount, but the amount of discount must not exceed the amount forfeited on such shares.

viii) Surrender of shares is the same thing as forfeiture of shares.

10.18 LET US SUM UP

A company may issue shares at face value or at a price other than the face value. When shares are issued at face value, it is termed as shares issued at par.

Shares may issued either by (a) public offer (b) right issue /bonus issue or (c) private placement Public offer of shares may be initial public offer or further public offer.

By private placement of shares, a company may offer or invite to subscribe or issue of securities to a select group of person with certain conditions to be satisfied.

Shares can be issued at par or at a premium. Only sweat-equity shares can be issued at a discount, if certain conditions are satisfied. When shares are issued at a premium, the premium amount can be utilised only for writing off preliminary expenses or for writing off capital losses or for issuing bonus shares.

Allotment of shares is an important step in the process of raising the funds by the issue of shares or debentures. When a person applied tor a certain number of shares of the company in response to an advertisement or prospectus and the company accepts his offer; and allot him the shares, it results in a valid contract between the company and the applicant. The allotment must not be made until the minimum subscription has been received by the company.

The allotment should not be made unless the application money is at least five per cent of the nominal value of shares and the money is deposited in a scheduled bank. The shares of the company should be listed in one or more recognised stock exchanges.

Share certificate is the evidence of title of the member to such shares. When the shares are allotted to a person, he is entitled to receive a share certificate from the company. The share certificate is issued under the seal of the company and it contains the name and address of the member, certificate number, number of shares, amount paid up in respect of them etc.

If the original share certificate is lost, destroyed or torn, the company may issue a duplicate share certificate on certain conditions.

The entire amount in respect of shares is not demanded in one instalment. After the shares have been allotted, the company requires the members to pay the remaining money in one or two instalments known as 'calls'. The call must be made under a resolution of the Board of directors, on a uniform basis, for the benefit of the company and in accordance with the provisions of the articles of the company.

If a shareholder fails to pay the call money within the stipulated time, the shares can be forfeited. Before forfeiting the shares, the company must send a proper notice to the member. Forfeiture shall be valid only when it is made under a resolution of the Board of directors. Forfeited shares can be reissued, it does not amount to allotment but it is simply a sale of shares already issued. Surrender of shares means voluntary return of shares by the shareholder to the company for cancellation. Surrender of shares may be accepted only when forfeiture is justified. Section 67 prohibits a company from buying its own shares except on compliance of the provisions of section 68 and the SEBI Regulations.

Book building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is solicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement or other documents.

10.19 KEY WORDS

Issue of Shares at par: Shares issued at a face value.

Bonus Share: The shares issued to the existing members free of charge.

Rights Share: The shares issued by a company to its existing shareholders.

Allotment: An appropriation of a certain number of shares to a specified person in response to his application.

Issue of shares at a discount: Issue of shares at a price which is less than the nominal value of the share.

Issue of shares at a premium: Issue of shares at a price which is more than its face value.

Share Certificate: A certificate issued under the seal of the company, specifying the shares held by any member and the amount paid.

Call: An installment which a shareholder is required to pay to the company.

Forfeiture: Taking back the share for non-payment of calls thereby depriving the shareholder of his right to the shares.

Surrender of Shares: Voluntary return of the shares to the company.

Share buy-back: Act of the company to purchase its own shares.

Book-Building: The process by which an underwriter attempts to determine the price at which an IPO will be offered.

10.20 ANSWERS TO CHECK YOUR PROGRESS

B 4. i) Board of directors ii) five iii) 90%
iv) 30, next 15 v) cannot

5. i) False ii) True iii) False iv) False
v) True vi) True vii) True

C 4. i) evidence of title ii) one iii) Registered shareholder

5. i) False ii) True iii) False iv) True

D 6. i) False ii) True iii) True iv) True
v) False vi) True vii) True viii) False

10.21 TERMINAL QUESTIONS

1) What is private placement of securities ? Discuss the conditions to be satisfied for private placement of shares.

2) Distinguish between Rights shares and Bonus shares.

3) Explain the procedure of allotment of shares.
4) What is meant by return of allotment?
5) Under what circumstances can a company issue sweat equity shares at a discount?
6) State the purposes for which the securities premium amount can be utilized.
7) What is a share certificate? When must it be issued? Can a company issue a duplicate share certificate; if so, when?
8) What is meant by ‘call’? What are the requisites of a valid call?
9) Explain the procedure of forfeiting the shares. What is the effect of forfeiture? How forfeiture is different from surrender of shares?
10) Discuss the eligibility requirements for an initial public offer.
11) What is Book Building? What are its advantages?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 11 TRANSFER AND TRANSMISSION OF SHARES

Structure

11.0 Objectives

11.1 Introduction

11.2 Procedure of Transfer of Shares

11.3 Blank Transfer

11.3.1 Ills Associated with Blank Transfer

11.4 Forged Transfer

11.4.1 Consequences of Forged Transfer

11.5 Transfer of Shares under Depository System

11.5.1 Benefits of Dematerialisation

11.6 Nomination

11.7 Transmission of Shares

11.7.1 Transmission of Shares - Where Shares are Held in Joint Names

11.7.2 Insolvency of a Member/Liquidation

11.7.3 Transmission Shares held in Depository (Demat) Mode

11.8 Distinction between Transfer and Transmission

11.9 Insider Trading

11.10 Whistle Blowing

11.11 Let Us Sum Up

11.12 Key Words

11.13 Answers to Check Your Progress

11.14 Terminal Questions

11.0 OBJECTIVES

After studying this Unit, you should be able to:

- discuss the free transferability of shares of a company;
- learn the procedure to effect transfer of shares;
- explain the concept of blank transfer;
- note as to what constitutes a forged transfer and what are its consequences;
- describe the procedure regarding transfer of shares under Depository System;
- learn about the nomination facility;

- know about transmission of shares in case of death of a shareholders;
- distinguish between transfer and transmission of shares; and
- explain insider trading and whistle Blowing.

11.1 INTRODUCTION

You know that one of the most important features of a company is that its shares are freely transferable. Section 44 of the Companies Act, 2013 provides that the shares of a company shall be a movable property, transferable in the manner provided by the articles of the company. The Section thus empowers every shareholder to transfer his shares in the manner laid down in the Articles and in accordance with the various provisions of law. However, a private company is statutorily under obligation to place certain restrictions on the right of its members to transfer shares. One of the most common restrictions on transfer of shares in a private company is the "Pre-emption clause", which states that the intending transferor must offer his shares to the existing members of the company, before offering them to non-members. In case, no member is prepared to purchase those shares at a fair price to be determined as per Articles, then he may transfer those shares to any outsider.

In the case of public companies also, there may be some restrictions on the right of members to transfer shares. Regulation 20 (Table F) provides that the Board of directors may refuse to register the transfer of partly paid shares to a person of whom they do not approve. Further, the Board of directors may refuse to register the transfer of any share on which the company has a lien. Regulation 21 also envisages certain conditions which may be introduced by a company in its Articles to restrict transfer of shares. It provides that the Board may also decline to recognise any instrument of transfer unless:

a) the instrument of transfer is in the form as prescribed in rules made under sub-section (1) of section 56;

b) the instrument of transfer is accompanied by the certificate of the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer; and

c) the instrument of transfer is in respect of only one class of shares.

Right of a shareholder to transfer his share is always subject to provisions in Articles of Association **- Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd. [1992] 73 Comp. Cas. 150 (Ker.).**

The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse mala fide, i.e., they act oppressively, or corruptly, the Tribunal will interfere and order registration.

Time within which transfer must be registered: As per Section 56, a company is required, within one month after the application of transfer, to deliver the share certificates duly transferred.

Can refusal to effect transfer be made on grounds other than those stated in the Articles? - The Articles should, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. Thus a provision in the Articles empowering the Board of directors to refuse to register transfer without assigning any reasons will not be maintainable. In **Hemangini Finance & Leasing (P.) Ltd. v. Tamilnad Mercantile Bank Ltd. [1996]**, the Company Law Board (now Tribunal) held that there is no blanket authority available to a company to refuse registration of transfer, even if the articles provide absolute discretion. When the articles do not provide for any powers for refusal, the company cannot refuse. If it has restrictive power as per articles, the powers could be exercised only in regard to those matters.

Refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable **[Pawan Gupta v. Hicks Thermometers (India) Ltd. (1999)]**.

Again, merely because, with registration of transfer of shares, total holding of transferee would become dangerously close to 25%, company cannot refuse to transfer **[Bajaj Auto Ltd. v. CLB (1998)].**

11.2 PROCEDURE OF TRANSFER OF SHARES

Section 56 has laid down the following procedure for effecting transfer of shares:

1. A company shall not register a transfer of securities of the company unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee.

2. The instrument of transfer, as aforesaid, must have been delivered to the company within a period of sixty days from the date of execution.

3. The instrument of transfer must be accompanied by the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

   However, where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

   A reading of Section 56 of the Companies Act, 2013 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 - **Nuddea Tea Co. Ltd. vs. Ashok Kumar Saha [1988]**. Similarly view was held in **Kothari Industrial Corpn. Ltd. vs. Lazor Detergent (P.) Ltd. (1993)**.

   Cancellation of the stamps by the staff of the company does not make the transfer instrument duly stamped. The contention of the company that stamps were cancelled by them (the company) before the Board of directors considered the transfer shall not be upheld as valid - **Subhash Chander vs. Vardhaman Spg. & Gen. Mills Ltd. (1993)**.

4. The company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates within a period of one month from the date of receipt by the company of the instrument of transfer.

Transfer of Partly-paid Shares

Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice (Section 56 (3)).

Transfer of Shares Held in Joint Names

In the 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.

Thus, in **Shanta G. Pommerat v. Sakal Papers (P.) Ltd. [1990]** where four persons were shown as transferors of shares and only three had signed the share transfer form and fourth had not authorised the others to sign on his behalf, it was held that transfer of shares was not valid.

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]**

In a plea that the names of certain persons entered in the Register of Members were done without following the complete procedure prescribed under Section 108, now (56) the Delhi High Court held that the onus of proof will lie on the party making such allegation **[Radhey Shyam Gupta v. Kamal Oil & Allied Industries Ltd. [1999]**.

Power of the Board of Directors to Refuse Registration of Transfer of Shares: Where the Articles of association of a company give power to the Board to refuse registration of a transfer of shares such power must be exercised by a resolution of the Board. The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse mala fide, i.e., they act oppressively, or corruptly, Tribunal will interfere and order registration. The Articles may, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. Thus, where the Articles of Association of a private company contain a provision to the effect that "no share shall be transferred to an outsider if any member of the company was willing to purchase the same at fair price to be determined by the directors, and transfer to an outsider shall be allowed only when the Board of directors was unable to find a willing member within a stipulated period", the directors having offered to purchase those shares, the question of registering shares in favour of an outsider would not arise - **Satyanarayana Rathi v. Annamalaiar Textiles (P.) Ltd. [1999] 93 Comp. Cas. 386 (CLB - Chennai).**

Again in Pawan Gupta v. Hicks Thermometers (India) Ltd. [1999] 21 SCL 90 (CLB - New Delhi), it was held that the refusal to register transfer of shares of the company in the name of son of one of the collaborators of the company on the ground that under an agreement the three collaborators had the pre-emptive right to acquire each other's shares in the event of any of them deciding to part with his holding, would not be permissible under the provisions of the Securities Contracts (Regulation) Act, 1956.

Similarly, the refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable - **Pawan Gupta vs. Hicks Thermometers (India) Ltd. (supra).**

Refusal of registration and Appeal against refusal

1. **In case of a private company**

   The company must send notice of the refusal to the transferor and the transferee or to the person giving intimation of transfer or transmission, as the case may be, giving reasons for such refusal. The **notice must be sent within a period of thirty days** from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company (Section 58 (1)).

   The **transferee may appeal** to the Tribunal against the refusal within **a period of thirty days** from the date of receipt of the notice or **in case no notice has been sent** by the company, **within a period of sixty days** from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company.

2. **In case of a Public company**

   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.

   Section 58 (4) provides that if a public company without sufficient cause **refuses to register the transfer** of securities within a **period of thirty days** from the date on which the instrument of transfer or the intimation of transmission, as the case may be, is delivered to the company, **the transferee may**, within **a period of sixty days** of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

   The Tribunal, while dealing with an appeal, whether it relates to a private company or public company may, after hearing the parties, either dismiss the appeal, or by order—

   a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

   b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

Penalty

If a person contravenes the order of the Tribunal under this section, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

11.3 BLANK TRANSFER

Where a shareholder signs a share transfer form without filling in the name of the transferee and hands it over along with the share certificate to the transferee thereby enabling him to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'. Blank transfer facilitates purchase and sale of shares by mere delivery of the share certificates along with the said blank transfer form. Because of the convenience associated with blank transfers, the shares are usually sold and purchased through blank transfer. Besides easy transferability, blank transfers results in saving on stamp duty. Stamp duty is to be affixed only by the last transferee who lodges the shares with the company for the purpose of registration of transfer. Thus, all the intermediate transferees save stamp duty.

A blank transfer deed is not a negotiable instrument merely because it may be transferred by mere delivery. Accordingly, the title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor. Thus, a *bona fide* transferee from a person who has acquired a blank transfer deed by fraud does not acquire good title to the shares included in the deed.

A transfer in blank, when accompanied by a share certificate, carries to the transferee both the legal and equitable rights to the shares and also the right to call upon the company to register the transfer - **Colonial Bank v. Cady [1980]**. This right to get himself registered as a member is available to the transferee even after the death of the transferor - **In re Bengal Silk Mills Co. Ltd. [1942]**.

11.3.1 Ills Associated with Blank Transfer

1. **Loss of stamp duty** - The saving in stamp duty by the intermediate transferees is, in effect, a loss to the exchequer - the State Government (Stamp duty being a State subject).

2. **Loss of income-tax** - The facility of blank transfer enables any number of transfers till a transferee decides to become the registered shareholder of the company. Such a transferee shall fill up his name and other particulars before lodging the same with the company. From the entries in the transfer form, it will now appear as if the last transferee has purchased the shares directly from the registered shareholder. As a consequence the intermediate transferors who might have sold the shares for a gain may not report the same as a part of their income. Since the transaction has not been recorded, it may provide a convenient route to avoid the income-tax liability, thus, resulting in a loss to the exchequer.

11.4 FORGED TRANSFER

An instrument on which the signature of the transferor is forged is called a forged transfer. Forgery does not confer any title. It is because in case of forgery there is not merely an absence of free consent but there is no consent at all. Hence a forged transfer can never confer ownership upon the transferee thereof, howsoever genuine the transaction may appear. Thus, if a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and for his names to be placed back in the register.

11.4.1 Consequences of Forged Transfer

1. A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder with the consequential rights, viz., the right to receive dividends, right issue, bonus, etc. The company is bound to restore his name in the register of members - **Barton v. N. Staffordshire Rly. [1988]**.

2. If the company has issued a share certificate to the transferee and he has sold the share to an innocent purchaser, it cannot deny his title, for the certificate stops it from doing so. It will, therefore, be under a liability to compensate him if it refuses to register him as a shareholder - **Balkis Consolidated Co. Ltd. v. Fredrick Tomkinson [1893]**.

3. If the company has been put to loss by reason of the forged transfer, it may recover the loss from the person who procured registration, even though he might have acted in good faith.

A person who presents a transfer of shares for registration by a company thereby represents that the instrument of transfer is genuine and if it turns out to be a forgery, the company is not stopped from denying his title to the shares, even though he did not know that the transfer was forged when he presented it. Consequently, even if the company issues a share certificate to the person who presents the transfer, and he relies on it, the company may remove his name from the register of members, and he cannot claim damages for wrongful removal- **Sheffield Corpn. v. Barclay [1905]; Johnston v. Renton [1870].**

However, where the transfer is registered, the transferee who first secures registration will get priority over the rest irrespective of the date when his claim arose - **Moore v. North Western Bank [1891]**.

11.5 TRANSFER OF SHARES UNDER DEPOSITORY SYSTEM

The Depositories Act, 1996 provides for an alternate mode of effecting transfer of shares. Investors, however, have the choice of continuing with the existing share certificates (i.e., in physical form).

As per the available statistics at BSE and NSE, 99.9% transactions take place in dematerialised mode only. Therefore, in view of the convenience of trading in dematerialised mode, it is advisable to have a beneficial owner (BO) account for trading at the exchanges.

11.5.1 Benefits of Dematarialisation (Demat)

The benefits of Demat are enumerated below:-

- A safe and convenient way to hold securities;
- Immediate transfer of securities;
- No stamp duty on transfer of securities;
- Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc.
- Reduction in paperwork involved in transfer of securities;
- Reduction in transaction cost;

- No odd lot problem, even one share can be traded;
- Nomination facility;
- Change in address recorded with depository participant (DP) gets registered with all companies in which investor holds securities electronically eliminating the need to correspond with each of them separately;
- Transmission of securities is done by DP eliminating correspondence with companies;
- Automatic credit into demat account of shares, arising out of bonus/split/ consolidation/merger etc.
- Holding investments in equity and debt instruments in a single account.

The Depositories Act, 1996 provides for the establishment of one or more depositories. Every depository will be required to be registered with the SEBI and receive a certificate of commencement of business on fulfilment of such conditions as may be prescribed. At present two Depositories, viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are registered with SEBI. Investors opting to join the system will be required to be registered with one or more participants who will be agent for depositories. The participants will be custodial agencies like banks, financial institutions as well as large corporate brokerage firms. Upon entry into the system, share certificates belonging to the investor will be dematerialised and their names entered in the books of participants as beneficial owners. The investors' names in register of companies concerned will be replaced by the name of the 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. Investors are called as the beneficial owners under this system.

Shares in the depository mode cease to have distinctive numbers. In fact, each security is assigned a unique 12 digit alphanumeric identification number called ISIN (International Securities Identification Number), e.g.- INE383C01018. Equity fully paid up, equity-partly paid up, equity with differential voting /dividend rights issued by the same issuer will have different ISINs.

Ownership changes in the depository system will be made automatically on the basis of delivery against payment. There will be a regular, mandatory flow of information about the details of ownership in the depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person on the grounds that the transfer of security conflicts with the provisions pertaining to substantial acquisition of shares and takeovers, the company will be entitled to make an application to the Company Law Tribunal (Tribunal) for rectification of the ownership records with the Depository. During the pendency of company's application with the Tribunal, 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 Tribunal.

Any loss caused by the negligence of the Depository or the Participant will be required to be indemnified by the Depository.

It may be noted that the provisions of Section 56 are inapplicable to transfer where transferee and transferor are entered as beneficial owners in records of Depository [**Finolex Industries Ltd. vs. Anil Ramchand Chhabria (2000)**].

Check Your Progress A

1) Shares of a public company are freely transferable. Comment

....

....

....

....

2) What is a blank transfer?

....

....

....

....

3) What is a forged transfer?

....

....

....

4) State whether the following statements are True or False

i) The shares in a company are movable property transferable in the manner provided in the articles.

ii) The right to transfer shares can be curtailed by articles of the company.

iii) It is not necessary that the instrument of transfer should be in the prescribed form.

iv) An instrument of transfer need not be stamped.

v) If a company refuses to register transfer of shares, it must within a period of 30 days send notice of refusal to the transferor and the transferee.

vi) A transferee becomes a member of the company when the instrument of transfer is presented to the company.

vii) In case of forged transfer the owner can compel the company to get his name entered in the register of members.

11.6 NOMINATION

In order to allow nomination of shares and debentures, section 72 provides that

1) Every holder of shares in, or holder of debentures of, a company may, at any time, nominate, in the prescribed manner, a person to whom his shares in, or debentures, of the company shall vest in the event of his death [Sub-section (1)].

2) Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

3) The nomination will hold good in spite of any will or any other law containing an otherwise provision. Thus, nomination is overriding.

4) The security holder may change the nomination any time as per the procedure prescribed by the company.

5) Where the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

11.7 TRANSMISSION OF SHARES

Transmission of shares takes place (i) when the registered shareholder dies; or (ii) when he is adjudicated an insolvent; or (iii) where the shareholder is a company, it goes into liquida-tion.

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 of transmission of shares, a company has no powers to refuse registration of transmission of shares once the legal heir produces a proper legal representation to the estate by way of will/probate/succession certificate, etc., if the same is required in terms of the Articles, unless there is an injunction against acting in terms of the legal representation - **Anil R. Chhabria v. Finolex Industries Ltd. [1999] 22 SCL 437 (CLB - Mum.).**

Section 56 (2) provides that the company shall have the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Sub-section (4) further requires that the company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates duly transmitted within a period of one month from the date of receipt by the company of the intimation of transmission.

The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer [Sub-section (5)]

Appeal against Refusal and Penalty

Same provisions are contained in section 58 as relate to transfer of shares as discussed above.

Where petitioner filed a petition under section 111 (now section 56) seeking transmission of shares of his deceased mother on basis of succession certificate which had been restrained by issuing competent authority, **CLB (now Tribunal) in Nirav Jhaveri vs. Mit-N-Mir (P.) Ltd. [2012] 20 taxmann.com 303, (CLB – Mum.),** held that the petition had to be dismissed since the petitioner could not be treated as a legal heir.

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.

Succession certificate covering shares held by a deceased member on the date of his death, would cover subsequent issue of bonus shares and no fresh succession certificate would be required in respect of subsequently issued shares- **Arjun Kumar Israni vs. Cipla Ltd. [1999] 35 CLA 339 (CLB - Mum.).**

In the aforesaid case, the CLB (now Tribunal) further observed that the respondent company would not be justified in not acting on the succession certificate issued by the competent court on account of insufficient court fee stamps.

11.7.1 Transmission of Shares - Where Shares are Held in Joint Names

Regulation 23 of Table F, in this regard, provides that on the death of a member, the survivor or survivors where the member was a joint holder, shall be the only persons recognised by the company as having any title to his interest in the shares.

Further, Sub-regulation (ii) states that the estate of a deceased joint holder shall not be released from any liability in respect of any share which had been jointly held by him with other persons.

11.7.2 Insolvency of a Member/Liquidation

On the insolvency of a shareholder, his shares vest in the Official Assignee or Official Receiver, who can sell and transfer the shares or get himself registered as a member.

Where a shareholding company goes into liquidation, the liquidator of the company in liquidation may sell and transfer the shares.

11.7.3 Transmission of Shares held in Depository (Demat) Mode

As you have learnt in the aforesaid paragraphs that transmission is the process by which shares of a deceased shareholder are transferred to his legal heirs/ nominee. Process of transmission in case of dematerialised holdings is more convenient as the transmission formalities for all securities held in a demat account can be completed by submitting documents to the DP, whereas in case of physical securities the legal heirs/nominee/surviving joint holder has to independently correspond with each company in which securities are held or with the registrar of that company.

In the event of death of the sole holder, the claimant should submit to the concerned DP an application i.e. Transmission Request Form (TRF) along with the following supporting documents -

1. In case of death of sole holder; where the sole holder has appointed a

nominee, the nominee should submit a notarised copy of the death certificate.

2. In case of death of the sole holder; where the sole holder has not appointed a nominee, the legal heir/successor should submit a notarised copy of the death certificate **And** any **one** of the below mentioned documents:

   - Succession certificate
   - Copy of probated will
   - Letter of Administration

The DP, after ensuring that the application is genuine, will transfer securities to the account of the claimant.

11.8 DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

A transfer of shares is a voluntary act of the transferor, while a transmission is by operation of law. In both the cases the ultimate effect is that the ownership passes from one person to another. Following are the main points of distinction between transfer and transmission of shares:

S. No.	Transfer	S. No.	Transmission
i)	It is a deliberate act of the transferor	i)	It is the result of operation of law and takes place only on death or insolvency of a shareholder.
ii)	The transferor and the transferee have to execute an instrument of transfer.	ii)	Only proof of title is required.
iii)	Stamp duty is payable on its execution.	iii)	No Stamp duty is payable in this case.
iv)	Shares are transferred for some consideration.	iv)	Shares pass to the legal heir without any consideration.

11.9 INSIDER TRADING

Insider trading generally refers to "buying and selling of security in breach of fiduciary duty or other relationship of trust and confidence, while in possession of material, non public, price sensitive information about the company's security." It also includes tipping or misappropriation of such information. For example board members, auditors, internal staff who are in know of the extraordinary financial performance of the company trade securities of the company on their own account or pass this information to others before declaration of the results would constitute insider trading.

Section 195 of the Companies Act 2013 dealt with the prohibition on insider trading of securities. As per this section no person including any director or key managerial personnel of a company could enter into insider trading. Explanation in the section defined insider trading

a) i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

ii) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

b) 'price-sensitive information' means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Sections 65 of the Companies Amendment Act (2017) omitted section 195 of Companies Act (2013), and SEBI was empowered to comprehensively deal with insider trading under SEBI Act 1992 and regulations 2009. Following are some provisions:-

Disclosure of Trading by Insiders

General provisions

These provisions require that every public disclosure as required in these regulations shall be made in such form as may be specified. The disclosures required to be made by any person under this regulation shall include the trading activity of immediate relatives or any other person for whom such person takes trading decision. The disclosure shall also include trading of derivatives of securities and all such disclosures shall be maintained by company for a minimum period of five years in such form as may be specified.

Disclosures by certain persons.

1) **Initial Disclosures**

a) Every promoter, member of the promoter group, key managerial personnel and director of every company whose securities are listed on any recognized stock exchange shall disclose his holding of securities of the company as on the date of these regulations taking effect, to the company within thirty days of these regulations taking effect;

b) Every person on appointment as a key managerial personnel or a director of the company or upon becoming a promoter or member of the promoter group shall disclose his holding of securities of the company as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.

2) **Continual Disclosures**

a) Every promoter member of the promoter group, designated person and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information.

Disclosures by other connected persons

3) Any company whose securities are listed on a stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

Institutional Mechanism for Prevention of Insider trading

1) The Chief Executive Officer, Managing Director of a listed company, intermediary or fiduciary shall put in place adequate and effective system of internal controls to ensure compliance with the requirements given in these regulations to prevent insider trading.

2) The internal controls shall include the following:

   a) all employees who have access to unpublished price sensitive information are identified as designated employee;

   b) all the unpublished price sensitive information shall be identified and its confidentiality shall be maintained as per the requirements of these regulations;

   c) adequate restrictions shall be placed on communication or procurement of unpublished price sensitive information as required by these regulations;

   d) lists of all employees and other persons with whom unpublished price sensitive information is shared shall be maintained and confidentiality agreements shall be signed or notice shall be served to all such employees and persons

   e) all other relevant requirements specified under these regulations shall be complied with;

   f) periodic process review to evaluate effectiveness of such internal controls.

3) The Audit Committee of a listed company or other analogous body for intermediary or fiduciary shall review compliance with the provisions of these regulations at least once in a financial year and shall verify that the systems for internal control are adequate and are operating effectively.

4) Every listed company shall formulate written policies and procedures for inquiry in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, which shall be approved by board of directors of the company and accordingly initiate appropriate inquiries on becoming aware of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information and inform the Board promptly of such leaks, inquiries and results of such inquiries.

5) The listed company shall have a whistle-blower policy and make employees aware of such policy to enable employees to report instances of leak of unpublished price sensitive information.

11.10 WHISTLE BLOWING

Whistle blowing is an act or action aimed to draw the attention of the statutory authorities/competent authorities towards instances of practices that are unlawful and may cause loss of revenue, pecuniary benefits to few, misconduct and other related offences. In India to protect the whistle blower from harassment from any other unintended consequences the Whistle Blowers Protection Act (2014) has been passed.

The Whistle Blower (complainant) can make disclosures under the Act. Here disclosure means complaint relating to:

i) an attempt to commit or commission of an offence under the Prevention of Corruption Act, 1988.

ii) willful misuse of power or willful misuse of discretion by virtue of which demonstrable loss is caused to the Government or demonstrable wrongful gain accrues to the public servant or to any third party;

iii) attempt to commit or commission of a criminal offence by a public servant, made in writing or by electronic mail or electronic mail message, against the public servant and includes public interest disclosure.

Requirement of public interest disclosure

1) Notwithstanding anything contained in the provisions of the Official Secrets Act, 1923 any public servant or any other person including any non-governmental organization, may make a public interest disclosure before the Competent Authority.

2) Any disclosure made under this Act shall be treated as public interest disclosure for the purposes of this Act and shall be made before the Competent Authority and the complaint making the disclosure shall, on behalf of the Competent Authority, be received by such authority, as may be specified by regulations made by the Competent Authority.

3) Every disclosure shall be made in good faith and the person making disclosure shall make a personal declaration stating that he reasonably believes that the information disclosed by him and allegation contained therein are substantially true.

4) Every disclosure shall be made in writing or by electronic mail or electronic mail message in accordance with the procedure, as may be prescribed and contain full particulars and be accompanied by supporting documents, or other materials, if any.

5) The Competent Authority may, if it deems fit, call for further information or particulars from the person making the disclosure.

6) No action shall be taken on public interest disclosure by the Competent Authority if the disclosure does not indicate the identity of the complainant or public servant making public interest disclosure or the identity of the complainant or public servant is found incorrect or false.

The Competent Authority on receipt of public interest disclosure under Section (4) of the Act shall:

a) ascertain from the complainant or the public servant whether he was the person or the public servant who made the disclosure or not;

b) conceal the identity of the complainant unless the complainant himself has revealed his identity to any other office or authority while making public interest disclosure or in his complaint or otherwise.

Clauses 5 (2), (3), (4) and (5) deal with the manner in which inquiry is to be conducted by the Competent Authority. Clause 5(6) deals with closing the matter as raised in public interest disclosure and clause 5 (7) deals with possible actions in case the inquiry report reveals either willful misuse of power or willful misuse of discretion or substantiates allegations of corruption.

If any of the above is established, the Competent Authority shall recommend to the public authority to take any one or more of the following measures namely:

i) initiating proceedings against the concerned public servant;

ii) taking appropriate administrative steps for redressing the loss caused to the Government as a result of the corrupt practice or misuse of office or misuse of discretion, as the case may be;

iii) recommend to the appropriate authority or agency for initiation of criminal proceedings under the relevant laws for the time being in force, if so warranted by the facts and circumstances of the case;

iv) recommend for taking of corrective measures;

v) take any other measures not falling under clauses (i) to (iv) which may be necessary for the purpose of this Act.

Clause (8) of the Act specifies certain matters which are exempt from disclosures during the conduct of inquiry. These matters are the ones which may likely to prejudicially affect the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign State, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence –

a) as might involve the disclosures of proceedings of the Cabinet of the Union Government or any Committee of the Cabinet;

b) as might involve the disclosure of proceedings of the Cabinet of the State Government or any Committee of that Cabinet;

Protection of the persons making disclosure. Under this Act, the Central Government should ensure that no person who has made disclosure under this Act or rendered assistance to conduct an inquiry be victimized by initiation of any proceeding or otherwise; If a person is being victimized or apprehensive about victimization he may file a complaint before the Competent Authority and such Authority shall take such action as deemed fit and may give directions to the concerned public servant/authority to protect such person from being victimized or avoid his victimization. The same amount of protection is also available to witness and persons rendering assistance in the inquiry including police protection.

Protection of identity of complainant is an important feature of this Act. The Competent Authority shall conceal the identity of the complainant and documents or information furnished by him for the purpose of the enquiry unless so decided by the Competent Authority itself or as directed by the Court.

Offences and Penalty under this Act. When the Competent Authority is of the opinion that the organization or official concerned, without any reasonable cause, has not furnished the report within the specified time or malafidely refused to submit the report or knowingly given incomplete, incorrect or misleading or false report or destroyed record or information which was the subject of the disclosure or obstructed in any manner in furnishing the report, it shall impose –

a) a penalty which may extend to two hundred fifty rupees for each day till report is furnished, however, the total amount of such penalty shall not exceed fifty thousand rupees;

b) where the organization or official concerned, has knowingly given incomplete, incorrect or misleading or false report or destroyed record or information which was the subject of the disclosure or obstructed in any manner the furnishing of the report, a penalty which may extend to fifty thousand rupees.

In case the identity of the complainant is revealed either negligently or mala fidely, such person revealing the identity shall be punishable with imprisonment for a term which may extend upto 3 years and also fine which may extend upto Rs. Fifty thousand.

In case of false and frivolous complaints shall be punishable with imprisonment for a term which may extend to 2 years and also fined upto thirty thousand rupees.

Punishment to Head of Department in certain cases – (1) Where an offence under this Act has been committed by any Department of Government, the Head of the Department shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly unless he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a Department of Government and it is proved that the offence has been committed with the consent or connivance of, or is attributable, such officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Whistle Blowing provisions under the Company Act, 2013

The Companies Act 2013 lays emphasis on fraud elimination through an effective corporate vigilance mechanism; whistle blowing is an important component of an effective corporate vigilance mechanisms. Whistle blowing as such is not specifically incorporated in the Companies Act 2013, but the various sections of the Act incorporate detailed provisions related to inspection, investigation and inquiry. Section 177 (9) specifies that all public listed companies shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed. Further Section 177 (10) specifies to provide for adequate safeguards against victimization of persons who use such mechanism. In addition to this section, sections 206 to 229 of this Act provide a framework of inspection, investigation and inquiry regarding the functioning and compliance requirements of the company. Section 208 of the Act empowers the inspector (other than Registrar) to go through the records of the company and recommend further investigations in such matters of the doubt. Section 210 empowers the Central Government to order investigation and under Section 211 'Serious Fraud Investigation Office (SFIO)' has been established to investigate frauds relating to companies. Previously the auditors were not legally empowered to ascertain the fraud, they were just supposed to be primarily reporting such misappropriation, however, under this Act they are supposed to communicate the same to the Government or the appropriate concerned authorities.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 which makes it mandatory for listed companies to have a whistle blower policy for their employees and directors under regulation 22. The details of the whistle blower mechanism are to be provided on the company's website. The Audit Committee of the Board of Directors is responsible for reviewing the functioning of the whistle blower mechanism. The annual report of the companies in their corporate governance section must report about the establishment of the vigil mechanism and the whistle blower policy.

Offences by companies – (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

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

2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other office shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Check Your Progress B

1) What is meant by Nomination?

....

....

....

2) What is Transmission of Shares?

....

....

....

3) State three points of difference between 'Transfer' and 'Transmission' of Shares.

....

....

....

4 What is Insider Trading?

....

....

....

5 What do you understand by Whistle Blowing?

....

....

....

6. State whether the following statements are True or False

i) Nomination can be made only by individual members.

ii) Nomination overrides 'will' or succession through status.

iii) A minor cannot be appointed as a nominee

iv) Nominee cannot transfer those shares; he must register them in his own name.

v) In case of transmission, the legal successor may elect to become the member of the company or sell those shares.

vi) Where shares are held in joint names, the survivor joint-holder shall become the member of the company.

11.11 LET US SUM UP

Shares of a public company are freely transferable in accordance with the provisions of the Articles and the Act. Shares can be transferred by executing an instrument of transfer, also known as 'transfer deed'. Share certificate should be deposited with the company along with the instrument of transfer. If everything is in order, the Board of directors shall pass a resolution and register the transfer. If the transfer is refused, the company shall within one month of the application for transfer, send notice of refusal to the transferee and the transferor, giving reasons for such refusal.

If a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and for his name to be placed back in the register.

Shares held in depository mode can be transferred by directing the Depository Participant (DP) with whom the shareholder, called beneficial owner, has an account.

Every holder of shares in a company may, at any time, nominate, in the prescribed manner, a person to whom his shares in the company shall vest in the event of his death. The nomination will hold good against any legal successor (whether by will or status). The nominee may elect, either to be registered himself as holder of the shares or transfer the same.

Transfer of shares by operation of law is known as transmission of shares. On the death, lunacy or insolvency of a member on furnishing the necessary proof about their title, the shares are transferred in the name of the legal heir. No stamp duty is payable in case of transmission of shares. There is no consideration either.

Insider trading generally refers to buying and selling of securities in breach of fiduciary duty or other relationship of trust and confidence, while possession of material non public, price sensitive information about company's securities. SEBI has been empowered to deal with insider trading under SEBI Act and regulations.

Whistle blowing is an act or action aimed to draw the attention of statutory authorities/competent authorities towards instances of practices that are unlawful and may cause loss of revenue, pecuniary benefits to few misconduct and other related offences. In India to protect the whistle blower from harassment from any other unintended consequences the Whistle Blowers Protection Act 2014 has been passed.

11.12 KEY WORDS

Transfer of Shares: Transfer of ownership of shares which is done voluntarily by executing the instrument of transfer.

Blank Transfer: Transferor signs the 'transfer instrument' leaving all other particulars blank.

Forged Transfer: Instrument of transfer bearing the forged signature of the transferor.

Demat: Shares held in depository mode.

Nomination: Declaration by the shareholder that, in the event of his death, his shares will stand transmitted in favour of the named person.

Transmission of Shares: Transfer of shares by operation of law.

Insider Trading: Buying and selling of securities in breach of fiduciary duty or other relationship of trust and confidence.

Whistle Blowing: An act or action aimed to draw attention of the statutory/ competent authorities towards instances of practices that are unlawful.

11.13 ANSWERS TO CHECK YOUR PROGRESS

A 4 i) True; ii) False; iii) False; iv) False;
v) True; vi) False; vii) True

B 6 i) True ii) True iii) False iv) False
v) True vi) True

11.14 TERMINAL QUESTIONS

1. Explain the procedure of transfer of shares.
2. When can a company refuse to register a transfer of shares?

3. State the evils associated with 'blank transfers'.
4. State the rights of a transferee in case of company's refusal to register a transfer.
5. Explain in brief transfer of shares held under Depository mode.
6. Distinguish between 'transfer' and 'transmission' of shares.
7. Discuss the provisions of the Companies Act, 2013 with respect to nomination of shares by a member. Can nomination be made in favour of a minor?
8 What is Insider Trading? Why is it illegal ?
9. What is Whistle Blowing? What are the protections available to a person making disclosure?
10. Discuss the penalties imposed on company and head of department, if found guilty under Whistle Blowing Act.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 12 MEMBERSHIP OF A COMPANY

Structure

12.0 Objectives

12.1 Introduction

12.2 Member and Shareholder

    12.2.1 Definition of a Member

    12.2.2 Distinction between Member and Shareholder

    12.2.3 Who can become a Member?

12.3 Modes of becoming a Member

12.4 Termination of Membership

12.5 Rights of Members

12.6 Liability of Members

12.7 Register of Members

12.8 Let Us Sum Up

12.9 Key Words

12.10 Answers to Check Your Progress

12.11 Terminal Questions

12.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of a member;
- distinguish between a member and a shareholder;
- describe the modes of becoming a member;
- discuss the circumstances when a person ceases to be a member;
- list of rights and liabilities of members; and
- explain the rules relating to the maintenance of the register of members.

12.1 INTRODUCTION

You have learnt that a registered company has a corporate entity of its own which is distinct from the members who constitute it. The terms 'member' and 'shareholder' are used interchangeably. But, in law, there is a fine distinction between the two. In this unit you will learn about the exact meaning of the term 'member', modes of becoming a member, the circumstances under which a person ceases to be a member, and the rights and liabilities of members. In addition, you will learn the rules regarding the maintenance of Register of Members.

12.2 MEMBER AND SHAREHOLDER

12.2.1 Definition of a Member

Section 2 (55) of the Companies Act, 2013 defines a member in the following words :

1. The subscribers to 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 the company and whose name is entered in its register of members shall be a member of the company. In **Herdilia Unimers Ltd. v. Renu Jain [1995]**, it was held that the moment the shares were allotted and share certificate signed and the name entered in the register of members, the allottee became the shareholder, irrespective of the allottee receiving the shares or not.
3. Every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

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.

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 Tribunal'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 subscribers 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 entered in the register of members of the company.

12.2.2 Distinction between Member and Shareholder

In normal usage the two terms 'member' and 'shareholder' are used synonymously. But, legally, there is a difference between the two. A shareholder is a person who holds or owns the shares in a company, whereas a member is one whose name is recorded in the Register of Members. In some cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member. Following are the main points of difference:

i) A company limited by guarantee having no share capital will have only members but no shareholders.

ii) When a person transfers his shares, he ceases to be a holder of those shares but continues to be the member of the company until his name is replaced by the name of the transferee.

iii) the legal representatives of a deceased member become shareholders immediately on the death of the member but they do not become members until their names are entered in the Register of Members.

iv) A person whose shares are forfeited or who has surrendered his shares to the company may be held liable as a member to contribute to the assets of the company, if winding-up commences within twelve months of his ceasing to be a member, though he is no longer the shareholder of the company.

In **Kedarnath Agarwal v. Jay Engineering Works Ltd.** it was held that a member may be a shareholder, but a shareholder may not be a member.

From the above discussion, it should be clear to you that person holding shares of a company are shareholders, while members are persons who constitute the company as a corporate entity and whose names are entered in the Register of Members.

12.2.3 Who can become a Member?

The Companies Act does not specifically lay down as to who can be a member of a company. It also does not prescribe any disqualification for any person which would debar him from becoming a member of a company. The Act simply provides that any person who agrees in writing to become a member of a company can become a member. You know that a contract to purchase shares in a company is like any other contract. Therefore, only such persons can become members of a company who are competent to contract. However, as regards competency of a member, the provisions of the Indian Contract Act shall apply. **This means that minors, persons of unsound mind and those who have been disqualified by law from contracting cannot become members of a company.**

Let us now discuss the position of a few special types of members:

i) **Minor:** According to Section 11 of the Indian Contract Act, a minor is incompetent to contract, therefore, he cannot become a member of the company. **In Palaniappa vs. Official Liquidator, Pasupati Bank Ltd.,** an application was made by a father as guardian of his minor daughter describing her as minor. The company went into liquidation. It was held that the allotment was void and neither the minor nor her guardian could be held liable as contributories. But, if in ignorance of the fact of minority, a minor is allotted shares, the company can repudiate the allotment and remove his name from the Register of Members. The minor may also rescind the allotment any time during his minority. In either case, the company has to refund all moneys received from minor in respect of the shares allotted to him. If neither party repudiates allotment, the name of the minor shall continue to appear on the Register of Members, but in that event a minor incurs no personal liability.

After the minor attains majority, he can still repudiate his liability even if he had received dividends during his minority (**Sadiq Ali v. Jai Kishori**). But, he cannot repudiate the same if he had received dividends after attaining majority and intentionally permitted the company to believe him to be a shareholder (**Fazalbhoy v. The Credit Bank of India Ltd.**). Thus, it is in the interest of the companies to allot only fully paid shares to the minor because otherwise he will not be liable for the unpaid amount of shares.

There is nothing in the Act to bar a minor from becoming a transferee of fully paid shares. In **Miss Nandita Jain v. Bennel Coleman and Company Ltd.,** the Company Law Board held that the contract entered into by a minor for registration of transfer of fully paid shares through the natural guardian was a valid and binding contract. In such a case the entry in the Register of Members will be made as follows: "A (a minor) through .... guardian".

If shares are transferred to a minor, the transferor will continue to remain liable for all future calls on such shares even if he was ignorant of the minority of the transferee. If the company is aware of the minority of the transferee at the time of transfer, it can refuse to register the transfer in favour of a minor unless the shares are fully paid.

ii) **Company:** A company, being a legal person, is competent to contract. Therefore, a company may become a member of another company if it is authorised by its memorandum or articles of association. However, a subsidiary company cannot become a member of its holding company (Section 19).

iii) **Partnership firm:** A partnership firm is not a legal person. Therefore, it cannot buy shares in its own name. A firm may hold shares in the names of individual partners who may be entered as joint holders in the Register of Members. However, it can become member of a non-profit making company licensed under Section 8 of the Act. A limited liability partnership created under Limited Liability Partnership Act, 2008 is a separate legal entity and, therefore, may become a member of a company.

iv) **Hindu Undivided Family (HUF):** A HUF can have shares in a company in the name of its Karta. Thus, the Karta will be a member of the company as his name alone will be entered in the register of members.

v) **Insolvent:** If any member is declared insolvent, he remains a member of the company till his name appears on company's Register of Members. He is entitled to vote in respect of shares held by him, but the dividend on shares will be paid to Official Assignee or Official Receiver.

vi) **Foreigners:** A foreigner may become a shareholder with the general or special permission of the Reserve Bank of India under the Foreign Exchange Management Act, 1999. But if he becomes an alien enemy, his rights as a member shall be suspended.

vii) **Joint Holders:** The shares of a company may also be held jointly by two or more persons. In a public company, even joint shareholders are counted as separate members but in a private company, joint holders are treated as a single member for purposes of Section 2(68) of the Act. The joint holders of shares may get themselves registered in any order they like. The company may pay dividend to the person whose name is first written in the register of members. Similarly, a notice served by the company on the joint holder named first in the register of members will be deemed to have been served properly on all of them. You should, however, remember that joint holders are jointly and severally liable for payment of calls. The transfer of shares by the joint holders will be effective only if it is made by all of them jointly.

viii) **Public Office:** A public office like income tax department, sales tax department etc. cannot be a member of a company. It cannot register shares in its own name. A registered trade union or a registered society can hold shares in its own name.

ix) **President and Governor:** Shares in a government company can be held in the name of the President of India or Governor of a State.

12.3 MODES OF BECOMING A MEMBER

A person may become a member in a company in any of the following ways:

1) **By subscribing to the memorandum:** A signatory to the memorandum automatically becomes a member of the company on its incorporation. Neither application nor allotment of shares is necessary to constitute them members of the company. Even if his name is not entered in the register of members, he will still be treated as a member of the company.

2) **By application and allotment of shares:** A person who agrees in writing to become the member of the company and whose name is entered in the Register of Members is also a member of the company. An application for shares is an offer to take shares and allotment is the acceptance of that offer. The rules regarding offer and acceptance (Law of Contract) are applicable. Thus, if a person applies for shares subject to certain conditions, the allotment by the company must be made according to those conditions; otherwise the allottee shall not be bound to accept the shares.

3) **By transfer of shares:** You know that the shares of a public company are freely transferable. Thus, a person may buy shares in the open market and get those shares registered in his name. On the registration of transfer of shares, transferee becomes the member of the company.

4) **By transmission of shares:** A person may become a member by operation of law i.e. transmission. On the death of a member, his nominee/legal representatives have the right to get the shares of the deceased member registered in his/their names. No instrument of transfer is necessary in this case.

5) **By estoppels/holding out:** 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 (**Hans Raj v. Asthana**). But in view of the rule laid down in Section 2(55) of the Companies Act that the person must agree in writing to be a member,

a person cannot be treated as a member of a company simply because his name is entered in the register of members. Thus, he enjoys no rights of a member though he may be held liable as a member. However, he may escape liability by applying to Tribunal for rectification of register of members under section 59.

12.4 TERMINATION OF MEMBERSHIP

You learnt that a person becomes a member of a company when his name appears in the Register of Members. Accordingly, a person ceases to be a member of a company when his name is removed from the Register of Members. A person may cease to be a member in any one of the following ways:

1) **Transfer of Shares:** When he transfers his shares to another person and the transfer is duly registered by the company, the name of the transferor is removed from the Register of Members.

2) **Transmission of Shares:** On the death of a member, his shares get transmitted to his nominee/legal representatives.

3) **Forfeiture of Shares:** Shares may be forfeited for non-payment of calls and other reasons contained in the articles. The membership terminates on share forfeiture.

4) **Surrender of Shares:** When a member validly surrenders his shares to the company, he ceases to be a member.

5) **Insolvency of Member:** When a member is declared insolvent, his shares vest in the Official Receiver or Official Assignee. The Assignee or Receiver may sell these shares and when the transferee's name is entered in the Register of Members, insolvent member cases to be a member.

6) **Winding up of Company:** Membership terminates on the winding-up of the company, but he continues to be liable as a contributory.

7) **Repudiation of Contract:** If he repudiates the contract to take shares on the ground of misrepresentation or mistake in the prospectus or on the ground of irregular allotment.

8) **Enforcement of Lien:** When the company has a lien on the shares and the shares are sold by the company to enforce this lien or if the shares are sold in the execution of a decree of the court, the membership terminates.

9) **Redemption of Shares:** If a member is holding redeemable preference shares, then on their redemption his membership terminates.

10) **Tribunal's Order:** When the Tribunal passes an order for the purchase of shares of a member under Section 242 of the Companies Act, his membership terminates.

12.5 RIGHTS OF MEMBERS

A number of rights have been conferred on the members by the Companies Act, 2013, some of the important rights are as under:

i) Right to receive copies of Memorandum and Articles of Association on request and on payment of the prescribed fee.

ii) Right to receive share certificate within the prescribed period of 3 months from the date of allotment.

iii) Right to transfer his shares according to the provisions of the Companies Act and Articles of Association.

iv) Right to have his name entered in the Register of Members.

v) Right of priority to have shares offered in case of increase of capital.

vi) Right to receive notice of meetings, to attend, to appoint a proxy and vote at the meeting.

vii) Right to participate in the appointment of directors, auditors, etc. at the annual general meeting.

viii) Right to inspect register of members, register of debenture holders and copies of annual returns.

ix) Right to apply to the Tribunal for rectification of register of members.

x) Right to request to the Tribunal for calling an annual general meeting when the Board of Directors fails to call such meeting or apply for an extraordinary meeting of the company, whenever necessary.

xi) Right to receive copies of the financial statements and Director's Report before the annual general meeting.

xii) Right to receive proper notice of resolutions requiring special notice.

xiii) Right to have, on request, minutes of proceedings at a general meeting.

xiv) Right to apply to the Tribunal for ordering an investigation into the affairs of the company.

xv) Right to present petition to the Tribunal for relief in cases of oppression and mismanagement.

xvi) Right to present petition to the Tribunal for the winding up the company.

xvii) Right to share in the surplus assets of the company on winding up.

xviii) In the case of a body corporate which is a member, the right to appoint a representative to attend a general meeting on its behalf.

xix) The right to require the company to circulate resolution under section 111.

xx) Right to apply to the Tribunal under section 48 to have any variation of shareholders' rights set aside.

xxi) Right to participate in the removal of directors by passing an ordinary resolution.

From the above you must have noted that these rights are very valuable to keep the management of the company on the right track. How far these rights are exercised effectively by members is a different question.

12.6 LIABILITY OF MEMBERS

Liability of members of a company depends upon the nature of the company. This is discussed accordingly as follows:

i) **Unlimited company:** Every member of such a company is liable for all debts contracted by the company during the period when he was a member. However, a company being a separate legal entity, no member/shareholder can be proceeded against directly by the claimants/ creditors. Their liability, unlike a partnership firm, is not joint and several.

ii) **Company limited by guarantee:** Every member is liable to contribute to the extent of the amount guaranteed by him which is given in the liability clause of the memorandum.

iii) **Company limited by shares:** The majority of the companies belong to this category. In the case of such companies, the liability of a member is limited to the amount unpaid on the shares held by him. If he has paid full amount on shares, his liability is nil.

You should remember that all money payable by any member of the company under the memorandum or articles are a debt due from him to the company. If a shareholder dies and he was holding partly paid-up shares, then his estate will be liable or the legal representatives will be liable for the unpaid amount.

Check Your Progress A

1) What do you mean by the term 'member' of a company?

....

....

....

....

2) Distinguish between a 'member' and a 'shareholde'.

....

....

....

....

3) List the different ways of becoming a member of the company.

....

....

....

....

4) Give three cases when a person ceases to be the member of a company.

....

....

....

....

5) State whether the following statements are True or False:

i) The terms 'member' and 'shareholder' mean the same thing.

ii) A minor cannot become member of a company.

iii) A foreign national cannot become a member of a company.

iv) A person ceases to be a member of the company when his shares are forfeited.

v) A member has a right of priority to have shares offered in case of increase of capital.

vi) A member cannot repudiate the contract to take shares in the company on the ground that the prospectus was misleading.

12.7 REGISTER OF MEMBERS

Section 88 requires every company to maintain in the prescribed form and manner the register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India.

Every register, as aforesaid, shall include an index of the names included therein.

In case of shares held in depository mode, the register and index of beneficial owners maintained by a depository shall be deemed to be the corresponding register and index for the purposes of this Act.

Companies (Management and Administration) Rules, 2014, in this regard, inter alia, provide as follows:

1. **Entries in the Register:** The entries in the register maintained under section 88 shall be made **within seven days** after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares.

2. **Place of Keeping:** The register shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.

3. **Changes in the Entries:** Changes on account of forfeiture, buy-back, reduction, issue of sweat equity shares, transmission of shares, shares issued under employees stock option scheme, etc shall be recorded **within seven days** after approval by the Board or committee.

The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in the Register of members.

In case of shares held by a trustee,

A declaration specifying the name and other particulars of the person who holds the beneficial interest in such shares must be filed with the company. As per Rule 9 of the Companies (Management and Administration) Rules, 2014, the said declaration shall be filed within a period of thirty days from the date on which his name is entered

Penalty

If a company does not maintain a register of members or fails to maintain them in accordance with the provisions of Act, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues [Section 88 (5)].

Check Your Progress B

1) What is meant by Register of Members?

....

....

....

....

2) State whether the following statements are True or False:

   i) It is optional for a company to maintain a register of members.

   ii) Register of members may be maintained at a place other than the registered office by passing an ordinary resolution.

   iii) The entries in the register of members must be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares.

12.8 LET US SUM UP

Any person whose name appears on the register of members of a company is known as a 'member'. The terms 'member' and 'shareholder' are used synonymously. But a shareholder may not necessarily be a member and a member may not necessarily be a shareholder. Companies having no share capital have members only.

Any person may become a member of a company in any of the following ways: (i) by subscribing to the memorandum; (ii) by agreeing in writing to take shares; (iii) by estoppe/holding out; (v) by transfer or transmission of shares.

A person may cease to be a member, if (i) he transfers his shares; (ii) he dies or becomes of unsound mind; (iii) his shares are forfeited; (iv) he surrenders his shares; (v) he is declared insolvent; (vi) the company is wound-up; (vii) he repudiates the contract; (viii) the company enforces the right of lien of shares; (ix) the shares are redeemed; and (xi) by an order of the Tribunal.

Every company is required to maintain a register of its members in the prescribed form, containing the prescribed information about the members. The register must be kept at its registered office of the company.

12.9 KEY WORDS

Member: Anyone whose name is entered in the register of members.

Shareholder: A person who holds or owns the shares.

Register of Members: A register containing the names, addresses and other particulars of all the members.

12.10 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) True; ii) True; iii) False; iv) True ;

v) True; vi) False

B 2 i) False; ii) False; iii) True

12.11 TERMINAL QUESTIONS

1) Distinguish between a 'share' and a 'shareholder'.
2) Who can become a member of the company? Can a 'minor', 'partnership firm' become member of the company?
3) Can a person become a member of a company without there being an agreement in writing?
4) When does a member cease to be a member of the company?
5) Explain briefly the rights and liabilities of a member.
6) Write a note on 'Register of Members'

Problems

1) A partnership firm of A,B, C and D, wants to register shares in the name of the firm. The company refuses. What is the way out ? (see pt. 12.2.3)
2) The name of X is found in the register of a company. But X contends that he is not a member of the company. But company contents that he orally agreed, so he is a member. Discuss (refer to pt.12.3).

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 13 DIRECTORS

Structure

13.0 Objectives
13.1 Introduction
13.2 Definition of a Director
13.3 Who can be Appointed as a Director
13.4 Position of Directors
13.5 Number of Directors and Directorships
13.6 Director's Identification Number
13.7 Qualifications of a Director
13.8 Disqualifications of Directors
13.9 Appointment of Directors
13.10 Vacation of Office of a Director
    13.10.1 Retirement of a Director
    13.10.2 Resignation by a Director
13.11 Removal of a Director
13.12 Powers of Directors
13.13 Duties of Directors
    13.13.1 Statutory Duties
    13.13.2 General Duties
13.14 Liabilities of Directors
13.15 Committees of Board of Directors
13.16 Let Us Sum Up
13.17 Key Words
13.18 Answers to Check Your Progress
13.19 Terminal Questions

13.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a director;
- explain the legal position of directors;
- describe the qualifications and disqualifications of a director;
- explain the procedure of appointment of directors;
- list the circumstances when the director's office falls vacant;

- explain the mode of removing a director;
- describe the powers, duties and liabilities of directors; and
- explain the different committees of Board of directors.

13.1 INTRODUCTION

In Unit 12, you learnt about the membership of a company. You know that the number of members of a public company is usually large and are spread all over the country. Hence, they elect some persons to manage the affairs of the company. Such persons are known as directors who are responsible mainly for determining the business policies and directing and controlling the overall affairs of the company. In this unit you will learn the legal position of directors, their qualifications and disqualifications, the method of their appointment, and their power, duties and liabilities and committees of Board of Directors.

13.2 DEFINITION OF A DIRECTOR

The directors are the persons elected by the shareholders to direct, conduct, manage or supervise the affairs of the company. They manage and control the overall affairs of the company. The day to day working of the company is left to other managerial persons appointed for the purpose.

Section 2(34) of the Companies Act, 2013 defines a 'director' to mean a director appointed to the Board of a company. According to section 2(10)

Board of Directors of Board in relation to a company means collectively body of the directors of the company.

13.3 WHO CAN BE APPOINTED AS A DIRECTOR?

Section 149 of the Companies Act provides that only an individual can be appointed as director. Thus, no body corporate, association or firm can be appointed director of a company.

However, no person shall be appointed as a director of the company unless he has been allotted a **Director Identification Number (DIN)**.

No individual, who has already been allotted a Director Identification Number, can apply for, obtain or possess another Director Identification Number [Section 155].

If any individual applies for more than one DIN, he may be punished with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees. In case, the contravention is a continuing one, he may be fined further five hundred rupees for every day till the contravention continues [Section 159].

13.4 POSITION OF DIRECTORS

It is not easy to explain the legal position of the directors because the same have not been defined by the Companies Act clearly. Bowen L. J. observed "directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may, for the moment and for the particular purpose be considered." Thus, the real position of a director is not merely that of an agent, or trustee of managing partner, but a combination of all these positions. Let us now discuss their position under various headings as follows:

As Agents: The company being an artificial person cannot manage its affairs on its own. It has to be entrusted to some human agency known as directors. They are elected representatives of the shareholders and may be termed as agents of the company. The relationship between the company and its directors is that of principal and agent. Therefore, the general principles of the law of agency govern the relations of the company and its directors. As agents, it is their duty to carry on the business with reasonable care and diligence. They must act within the authority conferred upon them by the Act, Memorandum and Articles and while entering into contracts on behalf of the company within the scope of this authority, they will bind the company. In other words, if they act beyond the scope of their authority, they will be held personally liable. However, you should note that the acts done beyond the powers of the directors may be ratified by the shareholders in general meeting of the company provided such acts are not beyond the powers of the company.

To bind the company, the directors must act in the name of the company. **Directors are the agents of the company and not of the individual shareholders.**

It is, however, not correct to say that directors are the agents of the company because agents are not elected but appointed and secondly, the agents have no independent powers while the directors have independent powers on certain matters.

As Trustees: The 'trustee' means a person who holds and manages the property for the benefit of other persons. Though in the strict legal sense, directors are not the trustees of the company, but, to some extent, they have been treated as trustees of the company. They are the custodians of the money and properties of the company and as such are responsible for the proper use of such money and property. If they misuse the money or property, they have to refund or reimburse the same.

The directors must exercise their powers in good faith and for the benefit of the company, and not for their own benefit. The directors stand in a fiduciary capacity in relation to the company. The same degree of integrity and standard of conduct is expected from the directors as it is expected from a trustee. **You should note that directors are trustees for the company and not of individual shareholders.**

However, you should remember that directors are not the trustees in the strict sense because unlike a trustee a director does not enter into contracts in his own name. He enters into contracts for the company of which he is a director and he does not hold any property in trust, because the property is held by the company in its own name.

As Managing Partner: Directors have been described as the managing partners because on the one hand, they are entrusted with the management and control of the affairs of the companies and on the other hand, they are the shareholders of the company. They manage the affairs of the company for their own benefit as a shareholder and for the general benefit of the company.

But they are not managing partners in the strict sense, because the liability of the director is limited to the value of shares held by him whereas the liability of a partner is unlimited. Further, unlike a partner, a director has no authority to bind the other directors and shareholders.

As Employees: Directors are the elected representatives of the shareholders. As such, they are not employees or servants of the company. But under a special contract with the company a director may hold a salaried employment in the company and in that case he will be treated as an employee or servant of the company and he will enjoy all the rights available to an employee.

Thus, it is clear from the above discussion that directors are neither the agents, nor the trustees, nor managing partners, nor employees of the company. In fact, they combine in themselves all these positions. They stand in a fiduciary position towards the company in respect of their powers and capital under their control.

13.5 NUMBER OF DIRECTORS AND DIRECTORSHIPS

Section 149(1) provides that every company shall have a Board of Directors consisting of individuals as directors and shall have—

a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

b) a maximum of fifteen directors:

However, a company may appoint more than fifteen directors after passing a special resolution.

Besides, such class or classes of companies, as may be prescribed, shall have at least one woman director.

Number of Directorships

As per section 165 of the Companies Act, 2013 a person cannot hold office at the same time as a director in more than **twenty companies.** However, members, by passing a special resolution, may fix a lesser number. Further, out of the total number of twenty companies, his directorships in **public companies** cannot exceed **ten** including directorships in private companies that are either holding or subsidiary company of a public company.

Any person holding office as director in companies more than the specified limits immediately before the commencement of this Act shall, **within a period of one year** from such commencement—

a) choose, not more than the specified limit, companies in which he wishes to continue to hold the office of director;

b) resign his office as director in the other remaining companies.

He must intimate the choice made by him:

i) to each of the companies in which he was holding the office of director before such commencement; and

ii) to the Registrar having jurisdiction in respect of each such company.

Further, no such person shall act as director in more than the specified number of companies,—

a) after despatching the resignation of his office as director; or

b) after the expiry of one year from the commencement of this Act, whichever is earlier.

Penalty: If a person accepts an appointment as a director in more than the specified number of companies, he shall be punishable with fine of five thousand rupees for every day after the first during which the contravention continues.

13.6 DIRECTOR'S IDENTIFICATION NUMBER

Director Identification Number (DIN) is an unique identification number allotted to an individual who is an existing director of a company or intends to be appointed director of a company as per section 153 & 154 of the Companies Act, 2013.

Every individual, who is to be appointed as director of a company shall make an application electronically in Form NO. DIR-3. to the Central Government for the allotment of a Director Identification Number (DIN) along with such fees as provided in the Companies (Registration Offices and Fees) Rules, 2014. Rule 9(1).

- The Central Government shall, within one month from the receipt of the application allot a DIN to the application;
- The DIN allotted to the director is valid for the life time and the same shall not be allotted to any other person.

Section 156 of the Act provides that every existing director shall, within one month of the receipt of DIN from the Central Government, intimate his DIN to all companies wherein he is a director.

Obligation to indicate DIN

Section 158 provides that every person or company, while furnishing any return, information or particulars as are required to be furnished under the Act, shall mention the DIN in such return, information or particulars in case of such return, information or particulars relate to the director contain any reference of any director.

Punishment for contravention

Section 159 provides that if any individual or director of a company, contravenes any of the provisions of Section 155 and Section 156 such individual or director of the company shall be liable to a penalty which may extend to fifty thousand rupees and where the default is a continuing one, with a further penalty which may extend to five hundred rupees for each day after first during which such default continue.

If a company fails to furnish DIN before the expiry of the period specified with additional fee, under Section 157 the company shall be punishable with fine which shall no less than Rs. 25,000 but which may extend to Rs. 1,00,000 and every officer of company who is in default shall be punishable with fine which shall not be less Rs 25,000 but which may extend to Rs.1,00,000.

13.7 QUALIFICATIONS OF A DIRECTOR

The Companies Act has not prescribed any academic or professional qualifications for 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.

13.8 DISQUALIFICATIONS OF DIRECTORS

The circumstances in which a person cannot be appointed as a director of a company are listed in Section 164 of the Companies Act. A person shall not be capable of being appointed director of a company if:

a) he is of unsound mind and stands so declared by a competent court;

b) he is an undischarged insolvent;

c) he has applied to be adjudicated as an insolvent and his application is pending;

d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months. However, this disqualification will last only up to five years from the date of expiry of the sentence.

   But, if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

f) he has not paid any calls for six months or more in respect of any shares of the company held by him, whether alone or jointly with others;

g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

h) he has not been allotted DIN.

Besides, no person **who is or has been** a director of a company which—

a) has not filed financial statements or annual returns for any continuous period of three financial years; or

b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so. Provided that where a person is appointed as director of a company which is in default, he shall not incur disqualification for a period of six months from the date of appointment.

Additional disqualifications for directors of a private company - A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified above.

Check Your Progress A

1) Define a director.

....

....

....

....

2) Enumerate the positions in which a director acts.

....

....

....

....

....

3) What is the minimum number of directors in a public and a private company?

....

....

....

....

4) List four cases when a person becomes disqualified for appointment as director of a company.

....

....

....

....

....

5) State whether the following statements are True or False:

   i) Every public company must have at least five directors and every other company at least three directors.

   ii) Only an individual can be appointed as a director of a company.

   iii) Directors are trustees for the company and not for individual shareholders or for third persons who have entered into contracts with the company.

   iv) A person can be a director in more than twenty companies at the same time.

   v) A person who fails to pay the calls in respect of shares held by him for more than six months, cannot be appointed as a director of the company.

13.9 APPOINTMENT OF DIRECTORS

You know that only individuals can be appointed as directors of the company. Any person who is competent to contract and has obtained DIN is eligible for appointment as a director of the company. The discussion on appointment of a director may be dealt with under the following heads:

1. Appointment of first Directors
2. Appointment by shareholders at general meeting
3. Appointment by the Board of Directors
4. Appointment of Resident Director
5. Appointment of Independent directors
6. Appointment of Director elected by small shareholders.

1) **Appointment of First Directors (Section 152):** The first directors are usually appointed by name in the articles or in the manner provided therein. Where the articles do not provide for the appointment of first directors, the subscribers to the memorandum, who are individuals, shall be deemed to be the first directors of the company until the directors are duly appointed. In case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.

No appointment without DIN - No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN).

Consent to act as Director - A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director. The consent must be filed with the Registrar within thirty days of his appointment in the prescribed manner.

2) **By Shareholders in General Meeting:** According to section 152(2) every director shall be appointed by the company in general meeting except where the Act provides otherwise. In case of a public company, **at least two-thirds** of the total number of directors* must be rotational directors.

The remaining directors (i.e, one-third or less) should also, unless articles of the company provide otherwise, be appointed by the company in general meeting.

Appointment of directors in case of a private company - In case of a private company, if the articles are silent as to the appointment of directors or do not specifically provide for appointment of directors otherwise than in a general meeting, then the directors are to be appointed in general meeting by the shareholders - Calcutta High Court in the case of **Swapan Das Gupta v. Navin Chand Suchanti [1988]**.

Manner of rotation – At the first annual general meeting of **a public company** held next after the date of the general meeting at which the first directors are

*For the purposes of this sub-section, "total number of directors" shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

appointed and at every subsequent annual general meeting, one-third of the rotational directors or the number nearest to one-third, shall retire from office.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment. **Persons who became directors on the same day may** retire as per agreement among themselves. In case, there is no such agreement, it shall be determined by draw of lot.

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

Appointment of a director other than a retiring director [Sec. 160] - Section 160 along with Rule 13 of Companies (Appointment and Qualification of Directors) Rules, 2014 lay down the procedure of appointment of a person other than retiring director.

If any person, other than the retiring director wishes to stand for directorship or any member proposes a person for directorship, he must signify his intention to do so by giving 14 days' notice to the company before the general meeting and the company must inform the members at least seven days before the general meeting. The information shall be given:

1) by serving individual notices, on the members through electronic mode to such members who have provided their email addresses to the company for communication purposes, and in writing to all other members; and

2) by placing notice of such candidature or intention on the website of the company, if any.

However, it shall not be necessary for the company to serve individual notices upon the members as aforesaid, if the company advertises such candidature or intention, not less than seven days before the meeting at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and circulating in that district, and at least once in English language in an English newspaper circulating in that district.

Also, the candidate or the member who intends to propose him as director has to deposit a sum of Rs. 1 lakh or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than twenty-five per cent of total valid votes cast either on show of hands or on poll on such resolution. The deposit is not required for independent director or a director recommended by Nomination and Remuneration committee or recommended by Board of Directors.

Appointment of directors to be voted on individually - Section 162 prescribes the mode of voting on appointment of directors. No motion can be made at the general meeting of a 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. According to Sub-section (3) a motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

3) **By Board of Directors:** The Board of directors may also appoint directors in the following cases:

   i) **Additional Directors (Section 161):** The Board of directors may, if authorised by the Articles, appoint additional directors. But care should be taken to see that the total number of directors including the additional director does not exceed the maximum number fixed by the Articles. Such an additional director shall hold office only up to the date of the next annual general meeting or the last date, on which the annual general meeting should have been held, whichever is earlier.

   ii) **Alternate Director (Section 161):** The Board of directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint an alternate director to act for a director during his absence for a period of not less than three months from India. However, a person holding any alternate directorship for any other director in the company shall not be appointed.

   No person shall be appointed as an alternate director for an **independent director** unless he is qualified to be appointed as an independent director under the provisions of this Act.

   iii) **Director against a casual vacancy (Section 161):** If the office of any director falls vacant for some reason before the expiry of his term of office, such a casual vacancy may be filled by the **Board of directors at its meeting** according to the regulations of the Articles. Such a vacancy may be caused by death, resignation, insanity, insolvency etc. The person who is appointed by the Board to fill up the casual vacancy, shall hold the office only up to the date up to which the director in whose place he is appointed, would have held the office.

   iv) **Nominee directors:** Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.

4) **Appointment of Resident Director:** For the first time the Companies Act, 2013 has introduced the concept of resident director. Sub-section (3) of section 149 provides that every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year.

5) Appointment of Independent Director: Sub-section (4) of section 149 requires every listed public company to have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies. A managing director or a whole-time director or a nominee director is not an independent director.

Meaning of an Independent Director – As per Section 149 (6) of the Companies Act, 2013, to be an independent director, the individual should:

a) not be a managing director or a whole-time director or a nominee director;

b) be a person of integrity and possess relevant expertise and experience;

c) i) not be a promoter of the company or its holding, subsidiary or associate company;

   ii) not be related to promoters or directors in the company, its holding, subsidiary or associate company;

d) have or had no pecuniary (monetary) relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

e) not have any relative who has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income of fifty lakh rupees or such higher amount, as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

f) be a person who, neither himself nor any of his relatives—

   i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

   ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

      A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

      B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

   iii) holds together with his relatives two per cent or more of the total voting power of the company; or

   iv) is a chief executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

g) possess such other qualifications as may be prescribed.

You should note that under the Companies Act, 2013, nominee directors of Banks or Financial Institutions will not be considered as independent directors. Prior to passing of this Act, such directors were considered as independent directors.

Appointment of Independent Director [Section 150]

An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors. The responsibility of exercising due diligence before selecting a person as an independent director shall lie with the company making such appointment.

The appointment of independent director shall be approved by the company in general meeting. An explanatory statement is required to be annexed to the notice of the general meeting called to consider the said appointment of independent director. The explanatory statement must indicate the justification for choosing the appointee for appointment as independent director. The explanatory statement must also include a statement that "in the opinion of the Board, he fulfills the conditions specified in this Act for such an appointment."

No person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director.

Schedule IV to the Companies Act, 2013 has very elaborately given the manner of appointment of independent directors, their re-appointment, tenure, resignation, removal and separate meetings of the independent directors as well as their evaluation. A summary of these provisions is being given hereunder.

The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :

a) the term of appointment;

b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;

c) the fiduciary duties that come with such an appointment along with accompanying liabilities;

d) provision for Directors and Officers (D and O) insurance, if any;

e) the code of business ethics that the company expects its directors and employees to follow;

f) the list of actions that a director should not do while functioning as such in the company; and

g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

Re-appointment

The re-appointment of independent director shall be on the basis of report of performance evaluation.

Remuneration

Sections 149(9) and 197(7) read together provide that subject to the provisions of section 197, an independent director may receive remuneration by way of sitting fees for attending meetings of the Board or Committees thereof, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. He shall, however, be not entitled to any stock option.

Resignation or Removal

1) The resignation or removal of an independent director shall be in the same manner as that of any other director as provided in sections 168 and 169 of the Act.

2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than 180 days from the date of such resignation or removal, as the case may be.

3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

Separate Meetings

1) The independent directors of the company shall hold *at least one meeting in a year,* without the attendance of non-independent directors and members of management;

2) All the independent directors of the company shall strive to be present at such meeting;

3) The meeting shall:

   a) review the performance of non-independent directors and the Board as a whole;

   b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

   c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Evaluation Mechanism

1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.

2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Term of office

As per sub–sections 10 and 11 of Section 149, an independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.

Liability of Independent Directors - Sub–section 12 of Section 149 makes an independent director liable only in respect of such acts of omission or commission by a company

i) which had occurred with his knowledge, and

ii) with his consent or connivance **or** where he had not acted diligently.

Code of Independent Directors

The Companies Act, 2013, for the first time, laid down a code for independent directors in Schedule IV.

The code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulations and companies in institution of independent directors.

6) Appointment of director elected by small shareholders [151]

A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

'Small shareholder' means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

The Ministry of Corporate Affairs, in this regard, has prescribed the rules. Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014 requires that a company may appoint small shareholders' director where a notice to that effect is given by:

i) not less than one thousand small shareholders; or

ii) one-tenth of the total number of such shareholders, whichever is lower.

Appointment of Directors through System of Proportional Representation

You have learnt that for the appointment of every director, a separate resolution has to be passed. Normally, they are elected by a simple majority. As a result it is possible that the minority of the shareholders may not be in a position to send their representative on the Board of directors. Therefore, Section 163 of the Act provides them an opportunity to have their representative on the Board. This is done by adopting the system of proportional representation. The Articles may have a provision to this effect by which not less than two-third of the total number of directors of the company be appointed by the single transferable vote, or by a system of cumulative voting or otherwise. Such appointments may be made once in three years.

Appointment of Women Director on the Board

Section 149 of the Companies Act 2013 read along with the Rule 3 of the Companies (Appointment and Qualification of Directors) Rules 2014 prescribes for (a) every listed company and (b) every public company having a paid up share capital of not less than one hundred crores rupees or turnover of three hundred crores or more to appoint at least one women director.

A company which has been incorporated under the Act and is covered under the aforesaid criteria shall appoint at least women director within a period of six months form date of its incorporation.

In case of any intermittent vacancy of women director, the same has to be filled by the board at the earliest but not later than immediate next board meeting or three months from date of such vacancy whichever is later.

13.10 VACATION OF OFFICE OF A DIRECTOR

Section 167 provides for the office of a director becoming vacant on the happening of certain events. Sub-section (1) of section 167 provides that the office of a director shall become vacant if:

a) he incurs any of the disqualifications specified in section 164;

b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months **with or without** seeking leave of absence of the Board;

c) he fails to disclose or acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

d) he becomes disqualified by an order of a court or the Tribunal;

e) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months.

   Please note that the office shall be vacated by the director even if he has filed an appeal against the order of such court;

f) he is removed in pursuance of the provisions of this Act;

g) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified above.

Penalty: If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified above, he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both [Section 167(2)].

Disqualification of all the directors: Where all the directors of a company vacate their offices under any of the disqualifications specified above, 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. [Section 167(3)].

13.10.1 Retirement of a Director

You know that two-third of the directors are liable to retire by rotation and if a director retires at an annual general meeting and is not re-elected, he ceases to hold the office.

13.10.2 Resignation by a Director (Section 168)

A director may resign in accordance with the rules laid down in the Articles. If the Articles contain no such rule, he can resign at any time by giving a reasonable notice to the company, it is immaterial whether the company accepts his resignation or not. A resignation once made will take effect immediately when the intention to resign is made clear. A resignation cannot be withdrawn, except with the consent of the company concerned.

The resignation letter should be sent to the company at the registered office of the company. The resignation should preferably be in writing, but sometimes even oral resignation may be effective, for example, if it is made at the general meeting of the company.

13.11 REMOVAL OF A DIRECTOR

A director can be removed from office before the expiry of his term by (a) shareholders; or (b) the Tribunal. Let us now discuss them in detail.

a) **Removal by shareholders -** Section 169 recognises the inherent right of shareholders to remove the directors appointed by them. It is not even necessary that there should be proof of mismanagement, breach of trust, misfeasance or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing an ordinary resolution in the same way as they have the right to appoint directors by passing an ordinary resolution.

   Section 169 provides that a company may, by ordinary resolution of which special notice as per section 115 has been given, passed in general meeting, remove a director before the expiry of his term of office. However, the following directors cannot be so removed:

   i) Directors appointed by the Tribunal; under Section 242; and

   ii) Directors appointed under the system of proportional representation.

   In **Queen Kuries & Loans (P.) Ltd. v. Sheena Jose [1993]**, it was held that the notice must disclose the ground on which the director is proposed to be removed.

   On receipt of the special notice for removal of a director, the company must forthwith send a copy thereof to the director concerned and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

   If the director concerned has sent a written representation to the company, the company shall send a copy of the same to all the members. If the representation could not be send because of the shortage of time, it may be read at the meeting.

   A vacancy created by the removal of a director may be filled up by the appointment of another director in his place provided special notice of such appointment has been given to members. A director so appointed shall hold office only for the remaining period of the director removed. Such a vacancy can also be filled up a casual vacancy. A removed director cannot be reappointed, but he can claim compensation for loss of office.

b) **Removal by Tribunal [Section 242] -** Where an application has been made to the Tribunal under section 241 against oppression and mismanagement of a company's affairs, the Tribunal may order for the termination or setting aside of an agreement which the company might have made with any of its directors. It may also order the removal of any of the directors of the company. A director so removed shall not be entitled to claim any compensation from the company for the loss of office [Section 243 (a)].

Besides, such a director shall not be entitled to serve as a manager, managing director or director of the company without leave of the Tribunal for a period of five years from the date of Tribunal's order terminating or setting aside his contract with the company [Section 243 (b)]. However, the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

Penalty: Sub-section (2) of section 243 provides that any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

Check Your Progress B

1) How are the first directors of a public company appointed?

....

....

....

2) Who are rotational directors?

....

....

....

....

3) What do you mean by an alternate director?

....

....

....

4) List four grounds when the office of a director falls vacant.

....

....

....

5) How can the shareholders of a company remove a director?

....

....

....

6) State whether the following statements are True or False.

i) The first directors are usually named in the Articles.

ii) Unless the Articles provide for the retirement of all directors at every annual general meeting, at least one-third of the total number of directors are liable to retire by rotation.

iii) A retiring director cannot be re-appointed.

iv) An alternate director can hold office up to the next annual general meeting.

v) The office of the director does not become vacant if he fails to disclose his interest in any contract with the company before the Board.

vi) A resignation by a director is effective immediately when the intention to resign is made clear.

vii) A director cannot be removed before the expiry of his term of office.

viii) A director who is removed by the Tribunal is not entitled to any compensation for loss of office.

ix) If a new director is to be appointed, a notice in writing shall be given to the company at least twenty-one days before the meeting.

7) Who can be appointed as an independent director?

....

....

....

8) Which companies must have independent directors?

....

....

....

13.12 POWERS OF DIRECTORS

You know that the directors are appointed to manage and supervise the overall affairs of the company. Section 179 of the Companies Act, 2013 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.

In exercising the aforesaid powers or doing any of the aforesaid acts or things, the Board will be subject to the provisions contained in that behalf in the Companies Act 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. However, no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

Directors are required to act collectively in the form of Board. Directors individually cannot take any decision regarding company's affairs; decisions must be taken at the meetings of the Board or by circulation of proposal among the members of the Board. But the Board has the power to delegate authority in certain respects to an individual director or to a committee of directors.

Though, the shareholders cannot generally interfere or restrict the powers of the directors, but, in the following exceptional cases, the general meeting of shareholders may exercise powers conferred on the Board of directors:

i) where the directors act *mala fide* and against the interest of the company, for example, when their personal interest clash with their duty towards the company;

ii) where the Board of directors for some valid reasons becomes incompetent to act, for example, all the directors are interested in a particular transaction;

iii) where there is deadlock in management i.e., the directors are unwilling to exercise their powers, for example, when the directors are equally divided and, therefore; cannot come to any decision.

Powers to be exercised by Board only : Section 179(3) of the Companies Act, 2013 provides that the Board of directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board:

a) to make calls on shareholders in respect of money unpaid on their shares;

b) to authorise buy-back of securities under section 68;

c) to issue securities, including debentures, whether in or outside India;

d) to borrow monies subject to provisions of sections 180 and 186;

e) to invest the funds of the company;*

f) to grant loans or give guarantee or provide security in respect of loans;

g) to approve financial statement and the Board's report;

h) to diversify the business of the company;

i) to approve amalgamation, merger or reconstruction;

j) to take over a company or acquire a controlling or substantial stake in another company;

k) any other matter which may be prescribed:

However, the Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify.

---

* 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, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section [Second Proviso to section 179(3)].

* This power shall however be subject to the provisions of sections 180 and 186.

Other powers to be exercised at Board Meetings: Besides the powers specified in section 179 there are certain other powers also which can be exercised only at the meeting of the Board. These include:

1. The power of filling casual vacancies in the Board (Section 161).
2. Sanctioning of a contract in which a director is interested (Section 188).
3. 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.
4. The power to make political contributions (Section 182).
5. The power to appoint a person as managing director or manager who is holding either office in another company [Section 203].
6. The power to give loan to or invest in any shares of any other body corporate* [Section 186].
7. The power to enter into any contract or arrangement with a related party [Section 188].

Powers to be exercised with the sanction in general meeting: Section 180 of the Companies Act, 2013 provides that the Board of directors of a company cannot exercise the following powers without the consent of the shareholders by way of **special resolution**:

a) 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.

   The aforesaid restriction shall not be applicable to the sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

b) Invest, otherwise than in trust securities, the amount of compensation received by it as a result of any merger or amalgamation.

c) Borrow monies exceeding the aggregate of the paid-up capital of the company and its free reserves. **'Borrowing' does not include temporary loans** (i.e., loans payable on demand or within six months such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character but excluding loans for capital expenditure) obtained from the company's bankers in the ordinary course of business.

The special resolution passed by the company in general meeting must specify the total amount up to which monies may be borrowed by the Board of Directors.

a) Remit or give time for the repayment of any debt due by a director.

b) Contribute to a charitable or other fund.

However, as per **section 181**, **t**he Board of Directors of a company may contribute to *bona fide* charitable and other funds any amount the aggregate

---

* Section 186 requires that not only the resolution be passed at a meeting of the Board but it must be a unanimous resolution.

of which, in any financial year, does not exceed five per cent of its average net profits for the three immediately preceding financial years. Any contribution beyond this ceiling will require the prior approval of shareholders. But, the resolution required to be passed is **ordinary resolution** only and not the special resolution.

Other restrictions on the powers of the Board: In addition to the restrictions imposed by Section 180, there other restrictions also:

i) **Restriction on making political contributions:** According to Section 182, Government companies and companies which have been in existence for less than three financial years are prohibited from making political contributions. Any other company may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person. The amount of such contribution must not exceed seven and a half per cent of its average net profits during the three immediately preceeding financial years. Further, for making such contributions, a resolution authorising such contribution, should be passed at the meeting of the Board of directors.

   The company must disclose in its profit and loss account the amount or amounts of such contributions during the financial year to which that account relates, giving:

   a) particulars of the total amount contributed; and

   b) the name of the party to which such amount has been contributed.

ii) **Restriction on related party transactions (Section 188):** No contract or arrangement with a related party shall be entered into by the Board of directors, in the case of a company having the prescribed paid-up share capital, or transactions not exceeding such sums, as may be prescribed, except with the prior approval of the company by a **special resolution.** Further, no such member who is a related party shall vote on such special resolution.

   "related party" means –

i) a director or his relative;

ii) a key managerial personnel or his relative;

iii) a firm, in which a director, manager or his relative is a partner;

iv) a private company in which a director or manager is a member or director;

v) a public company in which a director or manager is a director or holds along with his relatives, more than two per cent of its paid-up share capital;

vi) anybody corporate whose Board of directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

vii) any person on whose advice, directions or instructions a director or manager is accustomed to act :

   a) Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

viii) anybody corporate which is –

A) a holding, subsidiary or an associate company of such company; or

B) a subsidiary of a holding company to which it is also a subsidiary;

C) an investing company or the venture of the company.

iii) **Restriction on Loans to Directors (Section 185):** Section 185 provides that a company shall not, directly or indirectly, advance any loan (including any loan represented by a book debt) to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

iv) **Restriction on payment of compensation for loss of office (Section 202):** No payment is made to a director who resigns in view of reconstruction or amalgamation of a company and takes some position as officer in reconstructed or amalgamated company or resigns or company is wound up due to the negligence or default of director or guilty of fraud, gross mismanagement or gross negligence or breach of trust.

v) **Office or place of profit (Section 188):** The same provisions that have been discussed above under restrictions on related party transactions are applicable to holding of office or place of profit by a director or his related party.

Managerial Powers of Directors

The directors are the elected representatives of shareholders and are entrusted with the power to manage the affairs of the company in the best interest of shareholders. The Board of directors has the following managerial powers:

i) power to make contracts with third parties on behalf of the company;

ii) power to recommend dividends;

iii) power to allot, forfeit and transfer shares of the company;

iv) power to appoint director to fill up the casual vacancy;

v) power to take decision regarding the terms and conditions for the issue of debentures;

vi) power to appoint managing director, manager or secretary of the company;

vii) power to form policy and issue instructions for the efficient running of the business; and lastly

viii) power of control and supervise of work of subordinates.

13.13 DUTIES OF DIRECTORS

You have learnt that directors of a company occupy an important position in the management of the company and they have vast powers. However, it is expected of them to exercise these powers for the public good and protect and safeguard the interests of the company and shareholders.

The duties of directors depend upon the nature and size of the company. While discharging their duties, they must comply with the provisions of the Articles and the Companies Act. The duties given in the Articles will certainly vary from company to company.

The duties of directors can broadly be classified under the following two heads:

1) Statutory duties; and

2) General duties.

13.13.1 Statutory Duties

Some of the statutory duties of directors are:

a) **To file return of allotments** (Section 39) **–** Directors are undr a statutory obligation to file with the Registrar, within a period of 30 days, a return of the allotments stating the specified particulars.

b) **To disclose interest** (Section 184) - 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.

c) **To disclose receipt from transfer of property** (Section 191) - 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.

d) **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 may not be able to attend all the meetings but if he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board, his office shall automatically fall vacant [Section 167(1)(b)].

e) To convene Annual General Meeting (AGM) and also extraordinary general meetings [Sections 96 & 100].

f) To prepare and place at the AGM along with the financial statements including consolidated financial statement, if any, and auditors' report, a report by the Board of Directors covering the specified particulars (Sections 134).

g) To authenticate annual financial statement including consolidated financial statement, if any (Section 134).

h) To appoint first auditor of the company (Section 139).

i) To appoint cost auditor of the company (Section 148).

j) To make a declaration of solvency in the case of voluntary winding-up (Section 305).

It may be noted that the above is not an exhaustive listing of statutory duties of the Board.

13.13.2 General Duties

There are some duties of a general nature which every director must discharge.

The following are some of the general duties:

i) **Duty of good faith:** The directors occupy a fiduciary position in a company. Fiduciary position means a position of trust and confidence. Therefore, directors must act honestly and diligently in the interest of the company and shareholders. They just not make any secret profits from their dealings with the company. If a director makes some secret profits by utilising his position, he shall be liable to account for it.

ii) **Duty of reasonable care**: The directors should discharge their duties with reasonable care. The degree of care expected from him is the same as is reasonably expected from persons of their knowledge and status. If the directors fail to exercise due care and skill in the performance of their duties, they shall be liable for negligence. But they cannot be held liable for mere errors of judgement.

iii) **Duty not to delegate:** The directors must perform their duties personally. They are appointed because of their skill, competence and integrity, therefore, the maximum delegatus non potest delegare (a delegate cannot delegate further) is applicable to them. But if permitted by Articles of the company, the directors can delegate certain functions to the extent permitted by the Act of the Articles.

13.14 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. Liabilities for breach of statutory duties.
4. Criminal liability.
5. Liability for acts of co-directors

1. **Liability to the company -** The liability of a director to the company may arise from :

   a) Breach of fiduciary duty,

   b) Ultra vires acts,

   c) Negligence, and

   d) Mala fide Acts.

a) **Breach of fiduciary duty -** Where a director acts dishonestly to the interest 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. Cramphorm Ltd. [1967]**.

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 consequently to the powers of the Board of directors. Further, the powers of the directors may be limited in terms of specific restrictions contained in the Articles of association. The directors shall be held personally liable for acts beyond the aforesaid limits, being ultra vires the company or the directors. 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 -** As long as the directors act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duties to the company. But, where they fail to exercise reasonable care, skill and diligence, they shall be deemed to have acted negligently in discharge of their duties and consequently shall be liable for any loss or damage resulting therefrom. However, error of judgment will not be deemed as negligence. But, the Court may grant relief to directors against such liability under section 463 of the Act.

d) **Mala fide acts -** Directors are the trustees for the moneys and property of the company handled by them, as well as for exercise of the powers vested in them. If they dishonestly or in a mala fide manner, exercise their powers and perform 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 course of performance of duties on behalf of the company.

Directors can also be held liable for their acts of 'misfeasance', i.e., misconduct or wilful misuse of powers.

2. **Liability to Third Parties -** The discussion on liabilities of directors towards third parties may be grouped as under:

   1. Liability under the provisions of the Companies Act, 2013.

   2. Liability for breach of warranty of authority.

   Liability under the Companies Act - The directors shall be personally liable to the third parties, inter alia, under the following provisions of the Companies Act, 2013:

   i) **Prospectus -** Failure to state any particulars as per the requirements of section 26 of the Act or mis-statement of facts in a prospectus renders a director personally liable for damages to the third party. Section 35 provides that a director 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 damages he may have sustained by reason of any untrue or misleading statement included therein. He may, however, escape liability where he proves that the prospectus was issued without his consent or he withdrew his consent before the issue of the prospectus.

   ii) **With regard to allotment -** Directors may also incur personal liability for allotment before minimum subscription is received (Section 39).

If the amount stated in the prospectus as the minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received as application money shall be returned within such time and manner as may be prescribed. In case of default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

iii) **Fraudulent conduct of business** - Directors may also be made personally liable for the debts or liabilities of a company by an order of the Tribunal under section 339. Such an order shall be made by the Tribunal where the directors have been found guilty of fraudulent conduct of business.

Liability for breach of warranty - Directors are supposed to function within the scope of their authority. Thus, where they transact any 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 any third party.

3) **Liability for Breach of Statutory Duties -** The Companies Act, 2013 imposes numerous statutory duties on the directors under various sections of the Act. Default in compliance of these duties attract penal consequences. The various statutory penalties which directors may incur by reason of non-compliance with the requirements of the Companies Act have been discussed at appropriate places.

4) **Criminal liability -** Apart from civil liability under the Act or under the common law, directors of a company may also incur criminal liability under common law, as well as under the Companies Act, and other statutes.

For non-compliance of certain provisions of the Act, directors may incur criminal liability involving fine or imprisonment or both. Some of the provisions of the Act under which the directors incur criminal liability are:

i) issue of a prospectus containing an untrue statement.

ii) Failure to deposit application money in a schedule Bank.

iii) Fraudulently inducing persons to invest money in the company.

iv) Accepting deposits or inviting any deposit in excess of the prescribed limit.

v) Destruction, mutilation, alteration or falsification of any books, papers or documents.

vi) Failure to file annual returns.

vii) Default in holding the annual general meeting.

viii) Granting loans to directors without the necessary approvals.

ix) Failure to maintain proper accounts, etc.

5. **Liability for acts of co-directors:** A director is not liable for the acts of his co-directors unless he was a party to it. A director is not the agent

of his co- directors. He cannot be held liable on the ground that he ought to have discovered the fraud. But a managing director or the chairman signing the accounts without understanding its implications cannot escape liability.

13.15 COMMITTES OF THE BOARD OF DIRECTORS

You have read that directors of a company are appointed to manage the affairs of a company. They are responsible for controlling, managing and directing the affairs of a company. Board of Directors is a team of people elected by a company's shareholders. It represents the shareholders' interest and ensures that company management acts on their behalf to discharge their functions efficiently. In order to carry out their responsibilities efficiently and to handle the issues effectively the Board may constitute various committees. Each committee is formed for some specific work and members of these committees are experts in the specified field. The role and structure of each committee is defined by the Board of Directors. The Board is responsible for the acts of the committees. The various committees constituted by the Board under Companies Act 2013 are:

1) Audit Committee (2) Nomination and Remuneration Committee (3) Stakeholders relationship Committee (4) Corporate Social Responsibility committee.

Audit Committee

As per Section 177, every listed public company and such other companies as may be prescribed, to constitute an audit committee. Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014 requires the following classes of companies to constitute an Audit Committee of the Board—

i) all public companies with a paid up capital of ten crore rupees or more;

ii) all public companies having turnover of one hundred crore rupees or more;

iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. The majority of members of Audit Committee including its Chairpersons shall be persons with ability to read and understand the financial statement.

As per the listing agreement, two third of the members of the Audit Committee shall be independent directors and the committee is required to be chaired by an independent director. The Company Secretary shall act as the secretary to the Audit Committee. The audit committee must meet at least four times a year and between two meetings not more than one hundred and twenty days shall elapse.

The primary focus of the Audit Committee is on the oversight of financial reporting and disclosures. It inter alia includes

i) making the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

ii) reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;

iii) examining the financial statements and the auditors' report thereon;

iv) approving and modification of transactions of the company with related parties;

v) scrutiny of inter-corporate loans and investments;

vi) valuation of undertaking or assets of the company, whenever necessary;

vii) evaluation of internal financial controls and risk management systems; and

viii) monitoring the end use of funds raised through public offers and related matters.

The composition of Audit Committee needs to be disclosed in the Board's Report. If the Board of Directors has not accepted any recommendation of the Audit Committee, the same along with reasons thereof, is also required to be disclosed in the Board's report.

Nomination and Remuneration Committee

Section 178 requires every listed public company and such other class **of** companies as may be prescribed, to constitute the Nomination and Remuneration Committee of the Board of Directors. Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014 requires the following classes of companies to constitute a Nomination and Remuneration Committee of the Board—

i) all public companies with a paid up capital of ten crore rupees or more;

ii) all public companies having turnover of one hundred crore rupees or more:

iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The Nomination and Remuneration Committee shall consist of a minimum of three non- executive directors with independent directors forming a majority. The chairperson of the company may be appointed as a member of the Nomination and Remuneration Committee but shall not chair the Committee. As per the listing agreement, all the members of the Nomination and Remuneration Committee shall be non-executive directors and the chairperson shall be an independent director. The Nomination and Remuneration Committee *inter alia* is responsible for:

i) identifying persons who are qualified to become directors and who may be appointed in senior management positions;

ii) specifying manner for effective evaluation of performance of Board, its committees and individual directors;

iv) formulating the criteria for determining qualifications, positive attributes and independence of a director; and

v) recommending to the Board, a policy relating to the directors, key managerial personnel and other employees.

Stakeholders Relationship Committee

Section 178(5) requires that a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders

Relationship Committee. The Stakeholders Relationship Committee is chaired by a non-executive director and may have other members as may be decided by the Board. This committee is primarily responsible for looking into the mechanism of redressal of grievances of shareholders, debenture holders and other security holders including complaints related to transfer of shares, non-receipt of annual report and non- receipt of declared dividends.

Corporate Social Responsibility Committee (CSR Committee)

As per Section 135 (1) every company having net worth of rupees five thousand crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year to constitute a Corporate Social Responsibility (CSR) Committee of the Board.

The CSR Committee shall consist of three or more directors, out of which at least one director shall be an independent director. The composition of the CSR committee shall be disclosed in the Board's Report.

The CSR committee is responsible for:

i) formulating and recommending to the Board, a CSR Policy indicating the activities to be undertaken by the company;

ii) recommending the amount of expenditure to be incurred on the CSR activities;

iii) monitoring the Corporate Social Responsibility Policy of the company from time to time.

It may be noted that the activities to be undertaken have been specified in Schedule VII of the Act and the company is required to spend, in every financial year, at least two per cent of the average net profit of the company made during the three immediately preceding financial years, on CSR activities. The activities include: (i) eradicating extreme hunger and poverty. (ii) promotion of educations; (iii) promoting gender equality and empowering women; (iv) reducing child mortality and improving maternal health; (v) ensuring environmental sustainability (vi) employment enhancing vocations skills etc.

Check Your Progress C

1) How do the directors of a company exercise their powers?

....

....

....

2) List any four powers of directors which can be exercised only at Board meetings.

....

....

....

3) Name important duties of a director.

....

....

....

....

4) List the different committees formed by the Board of Directors.

....

....

....

5) State whether the following statements are True or False:

   i) The directors of a company have the power to do all such acts as the company is authorised do to.

   ii) The power to issue debenture can be exercised only with the consent of shareholders in general meeting.

   iii) The Board has the power to recommend the rate of dividend to be declared by the company.

   iv) Casual vacancies can be filled up by the Board of Directors.

   v) The directors can remit or give time for the repayment of any debt due by a director.

   vi) A director must always act in the general interest of the company.

   vii) A director interested in a contract must disclose his interest in such contract at the general meeting of shareholders.

13.16 LET US SUM UP

Since a company is an artificial person created by law, it can act only through human agents. These agents are known as directors. The directors collectively are called as 'Board of Directors'. Directors are the persons, who are responsible for directing, controlling the overall affairs of the company.

A public company must have at least three directors, a private company at least two directors and a 'one person company' must have at least one director. A company cannot have more than fifteen directors.

No individual can be a director of more than twenty companies at the same time. However, members, by passing a special resolution, may fix a lesser number. Further, out of the total number of twenty companies, his directorships in public companies cannot exceed ten including directorships in private companies that are either holding or subsidiary company of a public company.

All persons appointed as directors of the company must file with the Registrar their consent in writing to act as such. Director's legal position is quite interesting-sometimes they act as agents of the company, sometimes as trustees and sometimes even as managing partners of the company. They are also treated as officers of the company.

A person who is competent to contract can become a director. But a person of unsound mind, undischarged insolvent, persons convicted for moral turpitude and sentenced to six months imprisonment are disqualified to act as directors.

Directors can be appointed by Articles, by shareholders in general meetings, by the Board, by the third parties and by the Tribunal. The directors may be appointed on the basis of proportional representation.

The office of the director shall fall vacant on various grounds, such as, his calls are in arrears for at least six months, he absents himself from all the meetings of the Board of Directors held during a period of twelve months **with or without** seeking leave of absence of the Board, he fails to disclose his interest in any contract, etc.

The directors of a company can also be removed by shareholders, by the Tribunal.

The Act has given wide powers to directors which must be exercised by them in good faith and for the benefit of the company. There are certain powers which can be exercised by them only at the meetings of the Board and certain powers can be exercised by them with the consent of the shareholders in general meeting.

The directors are liable to the company for negligence, breach of trust, for ultra vires acts and for wilful misconduct. The directors are liable to third parties in some cases, e.g., when he acts in his own name, for misstatements in the prospectus, etc. The directors also incur criminal liability for non-compliance of the various provisions of the Act.

In order to carry out the responsibilities effectively the Board may constitute various committees under Companies Act 2013. These Committees are : 1) Audit committee, (2) Nomination and remuneration committee (3) Stakeholders relationship committees and (4) Corporate social responsibilities committee. The Board is responsible for the acts of the committee. The role and structure of each committee is defined by the board of directors.

13.17 KEY WORDS

Director: One who performs the functions of a director.

Trustee: One who holds some property in trust for the benefit of another person or persons.

Casual Vacancy: A vacancy caused by the death, insanity or insolvency of a director

Alternate Director: A director who is appointed in place of the original director.

Rotational Director: Directors who are liable to retire by rotation.

Ultra-vires the company: Beyond the powers of the company.

Misfeasance: Wilful misconduct or wilful negligence.

Criminal Liability: Punishment by way of fine or imprisonment or both.

Audit Committee: The purpose of audit committee is to provide oversight of financial reporting and disclosures.

CSR Committee: Its main purpose is formulating and recommending CSR policy and activities to be undertaken by company.

13.18 ANSWERS TO CHECK YOUR PROGRESS

A	5	i) False;	ii) True;	iii) True;	iv) False;	v) True
B	6	i) True;	ii) False;	iii) False;	iv) False;	
		v) False;	vi) True;	vii) False;	viii) True;	ix) False
C	5	i) True;	ii) False;	iii) True;	iv) True;	v) False;
		vi) True;	vii) True			

13.19 TERMINAL QUESTIONS

1) Who are the directors of a company? How are they appointed?
2) Explain the rules regarding the number of directors and directorships.
3) Discuss the legal position of directors.
4) What restrictions have been imposed by the Companies Act in respect of appointment of directors?
5) Explain the qualifications and disqualification for the office of a director.
6) What are the circumstances when the office of a director shall become vacant?
7) How can a director be removed from office before the expiry of their term of office?
8) Discuss the powers and duties of directors.
9) Explain the liability of directors towards the company and third parties. Can a director be held liable for criminal liability?
10) Describe the role and structure of Audit Committee of a Company.
11) Discuss the responsibilities of Nomination and Remuneration Committee.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 14 MANAGERIAL REMUNERATION

Structure

14.0 Objectives

14.1 Introduction

14.2 Meaning of Managerial Remuneration

14.3 What is not Managerial Remuneration?

14.4 Modes of Payment

14.5 Individual Ceiling on Managerial Remuneration

14.5.1 Remuneration Paid to a Director in a Professional Capacity

14.5.2 Additional Remuneration from Subsidiary

14.6 Excess Remuneration Paid

14.7 Managerial Remuneration vis-à-vis Schedule V

14.8 Meaning of Effective Capital

14.9 Time when Effective Capital shall be Calculated

14.10 Let Us Sum Up

14.11 Key Words

14.12 Answers to Check Your Progress

14.13 Terminal Questions

14.0 OBJECTIVES

After study of this Unit, you should be able to:

- explain the meaning of managerial remuneration;
- learn the mode of payment of managerial remuneration;
- know the overall ceiling including individual ceilings on managerial remuneration;
- describe the position about payment of managerial remuneration in a year the company makes a loss or has inadequate profits;
- explain the concept of effective capital; and
- understand the concept of sitting fee and the provisions relating to payment thereof.

14.1 INTRODUCTION

In the previous unit, you have learnt that a company essentially functions through the Board of directors. In this Unit, you will study the manner in which the members of the Board of directors are remunerated. You will appreciate that a public company may be using public money in a big way. Directors, therefore, cannot take away unreasonable amounts by way of remuneration for the services that they render. Companies Act has, therefore, imposed certain restrictions on the amount that may be paid to them as remuneration. The amount paid to the directors for rendering their services in managing the affairs of the company is known as 'managerial remuneration'. In this Unit, you will study the definition of managerial remuneration and also the overall ceiling as well as individual ceilings imposed by the Companies Act with respect to such payments.

Before we understand the meaning of managerial remuneration, it is important to understand what constitutes a managerial position that entitles a person to receive managerial remuneration. Though the term managerial position has not been defined in the Act, a reference to section 197 clearly suggests that directors, including managing director and whole time director of the company and manager constitute managerial personnel. An executive in a company, howsoever, lofty position he may be holding in the company will not come under the concept of managerial personnel and accordingly any remuneration or compensation package received by him will not be counted as 'managerial remuneration' contemplated in the Act. Even a person carrying administrative designation of manager like general manager or any functional manager will not be included as a managerial personnel.

14.2 MEANING OF MANAGERIAL REMUNERATION

Managerial remuneration may take the form of monthly payments, say, salary, or a specified percentage of net profits or a commission and/or by way of a fee for each meeting of the Board (called sitting fee).

Section 2(78) defines "remuneration" to mean any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961. Explanation VI B to Schedule V further provides that "Remuneration" shall also include reimbursement of any direct taxes to the managerial person.

Section 197(3) provides that where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel. But, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

14.3 WHAT IS NOT MANAGERIAL REMUNERATION?

Following are not included in managerial remuneration.

- Any insurance premium paid on a policy taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company. But, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration [Section 197(3)].

- Any remuneration for services rendered by any director in any other capacity shall not be so included if—
  - a) the services rendered are of a professional nature; and
  - b) in the opinion of the Nomination and Remuneration Committee, if the company has such a Committee as per section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession [Section 197(*4*)].
- Guarantee commission' paid to a director **(*Suessen Textile Bearings Ltd. v. Union of India* [1984]**. The Court observed that *Guarantee Commission* received by the director is for personal liability which the director undertakes. Therefore, guarantee commission is not remuneration within the meaning of Section 197 (corresponding to section 309 of the previous Act) .

14.4 MODES OF PAYMENT

A director or manager may be paid remuneration by way of:

·monthly payment*; or

·specific percentage of net profit; or

·partly by one way or partly by other.

Besides, he may be paid sitting fee also for attending Board meetings.

An independent director may receive remuneration by way of sitting fees and reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

Sitting Fees: The amount of sitting fees payable to a director shall not exceed the amount, as may be prescribed. **Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014** has prescribed a ceiling of **rupees *one lakh rupees per meeting*** of the Board or committee thereof. Sitting fee is not defined in the Act. It means fee payable to director for attending meeting of the Board or Committee.

Overall Ceiling

The total managerial remuneration payable by a **public company** to its directors, including managing director and whole-time director and its manager in respect of any financial year **must not exceed eleven per cent of the net profits** of that company for that financial year [Section 197 (1)].

Check Your Progress A

1. What is the meaning of managerial remuneration?

   ....

   ....

   ....

The Delhi High Court in **Ravindra Kumar Sanghal v. Auto Lamps Ltd. [1984]** had held that the expression 'monthly ' remuneration excludes all payments what are not paid monthly, like bonus, leave encashment, etc.

....

....

2. List the modes of payment of remuneration ?

....

....

....

....

14.5 INDIVIDUAL CEILING ON MANAGERIAL REMUNERATION

Section 197 provides that *except with the approval of the company by a special resolution in general meeting*—

i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent. of the net profits of the company and if there is more than one such director, remuneration shall not exceed ten per cent. of the net profits to all such directors and manager taken together;

ii) the remuneration payable to **directors** who are neither managing directors nor whole-time directors shall not exceed:

   a) one per cent of the net profits of the company, if the company has a managing or whole time director or manager;

   b) three per cent of the net profits in any other case.

Private companies are exempted from the aforesaid ceilings of Sec. 197.

14.5.1 Remuneration paid to a Director in a Professional Capacity

Remuneration for services rendered by any director in any other capacity shall not be so included if—

(*a*) the services rendered are of a professional nature; and

(*b*) in the opinion of the Nomination and Remuneration Committee, if the company has such a Committee as per section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession [Section 197(*4*)].

14.5.2 Additional Remuneration from Subsidiary

Sub-section (14) of section 197 provides that any director **who is in receipt of any commission** and who is a managing or whole time director of a company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

14.6 EXCESS REMUNERATION PAID

If any director draws or receives, directly or indirectly, by way of remuneration any amount in excess of the limits prescribed under section 197 or without the prior sanction of the Central Government, he shall refund the same within two years. Till the time he refunds the excess amount to the company, he shall hold it in trust for the company [Section 197(9)].

Further, the company cannot waive its recovery unless permitted by the Central Government.

14.7 MANAGERIAL REMUNERATION VIS-À-VIS SCHEDULE V

Part II of Schedule **V** allows a public company, to appoint a managing or whole-time director or a manager and fix their remuneration so long as the same is in accordance with the conditions laid down in Schedule V without seeking the prior approval of the Central Government.

The **salient features of Schedule V** are as follows:

Section I: Remuneration payable by companies having profits - A company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in section 197 [*Already discussed under 'Individual ceilings on managerial remuneration'*].

Section II: Remuneration payable by companies having no profits or inadequate profits - Where in any financial year, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under (A) and (B) given below*:

A)	**Where the effective capital of a company is:-**	**Limit of yearly remuneration payable shall not exceed** (Rupees):-**
i)	Negative or less than 5 crores	30 lakhs
ii)	5 crores and above but less than 100 crores	84 lakhs
iii)	100 crores and above but less than 250 crores	120 lakhs
iv)	250 crores and above	120 lakhs *plus* 0.01% of the effective capital in excess of Rs. 250 crores

B) In the case of a managerial person who **was not:**

i) a security- holder holding securities of the company of nominal value of rupees five lakh or more; or

ii) an employee; or

iii) a director of the company or not related to any director or promoter at any time during the two years prior to his appointment as a managerial person **— 2.5% of the current relevant profit.**

* w.e.f. 12.9.18

** *Explanation*—It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

However, to pay the remuneration to a managerial person as per the aforesaid ceiling limits, it has been made mandatory that:

i) payment of remuneration is approved by a resolution passed by the Board and, where a company has Nomination and Remuneration Committee, also by the Nomination and Remuneration Committee; and

ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a **continuous period of thirty days** in the preceding financial year before the date of appointment of such managerial person.

Schedule V allows companies to pay remuneration to their managerial personnel ***up to double the amount of the aforesaid ceiling,*** by observing the required procedure as stated above *and* passing a special resolution at the general meeting which shall remain valid for a period of three years.

Section III

The following companies may pay to a managerial personnel **up to two times the amount permissible under Section II** without the Central Government approval:

a) A **foreign company** with the approval of its shareholders in general meeting subject to the limits under section 197.

b) A ***newly incorporated company*** up to a period of seven years from the date of its incorporation.

c) A ***sick company*** for a period of five years from the date of sanction of scheme of revival.

A company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to Rs. 2,40,00,000 per annum.

Besides the aforesaid remuneration, a managerial personnel of a company having no profits or having inadequate profits shall also be eligible to perquisites including contribution to provident fund, gratuity, encashment of leave at the end of the tenure.

The restrictions with regard to managerial remuneration contemplated under Sections 197 (including Schedule V) do not apply to a Private Companies

14.8 MEANING OF EFFECTIVE CAPITAL

The expression “effective capital”, for the purposes of Schedule V is as follows:

1) Paid-up share capital

   (excluding share application money or advances against shares);

2) Share Premium Account

3) Reserves and Surplus

   (excluding revaluation reserve);

4) Long-term loans and deposits repayable after one year

(excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements)

A sub total (1 + 2 + 3 + 4)

5) Investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities),

6) Accumulated losses

7) Preliminary expenses not written off.

B sub-total (5 + 6 + 7)

Effective Capital = A - B

14.10 TIME WHEN EFFECTIVE CAPITAL SHALL BE CALCULATED

Where the appointment of the managerial person is made in the year in which company has been incorporated the effective capital shall be calculated as on the date of such appointment. *In any other case,* the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Check Your Progress B

1. Mr. Weldon was appointed as a Director of Esquire Engineering Ltd. with effect from 1st October, 2012. Since the company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis and made an application to the Central Government for approval for payment of such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2013. the Central Government did not fully approve the remuneration proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was established that the company, till 31st March, 2013, has paid to Mr. Weldon a total sum of Rs.1.20 lacs in excess of the remuneration sanctioned by the Central Government.

   You are required to state with reference to the provisions of the Companies Act, 2013 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Weldon can keep the excess remuneration so received?

2. Examine whether the payment of following remuneration to Non-executive Directors (Directors who are neither in the whole-time employment of the company nor Managing Director) is in accordance with the provisions of the Companies Act, 2013:

   Sitting fee payable to Directors is increased from Rs.20,000 to Rs.30,000 per meeting by amending the Articles of Association.

   ....

   ....

....

....

....

3. State briefly the legal requirements to be complied with by a public company to give effect to the following proposals:

   i) Payment of minimum remuneration to a whole-time director in a financial year when the company has suffered a loss. The appointment has been made in accordance with the conditions specified in Schedule V to the Companies Act and he is being remunerated by way of commission on net profits.

   ii) Appointment of a person as Managing Director without remuneration in accordance with the conditions specified in Schedule V to the Companies Act, when he is already holding position of a Managing Director in a Private Company.

....

....

....

....

....

....

14.11 LET US SUM UP

The amount paid to the directors for rendering their services in managing the affairs of the company is known as 'managerial remuneration'. Managerial remuneration may take the form of monthly payments, say, salary, or a specified percentage of net profits or a commission and/or by way of a fee for each meeting of the Board (called sitting fee). Sitting fee cannot exceed rupees *one lakh rupees per meeting***.** An independent director may receive remuneration by way of sitting fees and reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

Any insurance premium paid on a policy taken by a company on behalf of its managerial person is not to be included in managerial remuneration except where such person is proved to be guilty of any negligence, default, misfeasance, breach of duty or breach of trust.

Again, any remuneration paid to a director for services of a professional nature will not be included in his remuneration provided, in the opinion of the Nomination and Remuneration Committee/ Board of Directors, the director possesses the requisite qualification for the practice of the profession.

Also, 'Guarantee commission' paid to a director is not managerial remuneration.

The total managerial remuneration payable by a **public compa-ny** to its directors, including managing director and whole-time director and its manager in respect of any financial year **must not exceed eleven per cent of the net profits** of that company for that financial year. Remuneration payable to any one managing director; or whole-time director or manager must not exceed five per cent. of the net profits of the company and if there is more than one such director, remuneration shall not exceed ten per cent. of the net profits to all such directors and manager taken together.

The remuneration payable to **directors** who are neither managing directors nor whole-time directors shall not exceed:

a) one per cent of the net profits of the company, if the company has a managing or whole time director or manager;

b) three per cent of the net profits in any other case.

Where in any financial year, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person any amount within the ceilings prescribed under Schedule V.

A private company may pay any amount to its managerial personnel including directors.

14.12 KEY WORDS

Nomination and Remuneration Committee: Nomination and Remuneration Committee is to comprise of three or more non-executive directors out of which not less than one-half shall be independent directors.

Sitting Fee : Sitting fees is the amount payable to a director for attending meetings of the Board or committees thereof.

14.13 ANSWERS TO CHECK YOUR PROGRESS

B) 1) As per Section 197, a director who is neither in the whole time employment of the company nor a managing director may be paid remuneration by way of monthly, quarterly or annual payment. No approval of the Central Government is required.

However, if any director draws or receive, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall, refund such sums to the company and until such sum is refunded, hold it in trust for the company.

The company cannot waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government.

2) **Sitting Fees:** The amount of sitting fees payable to a director cannot exceed the amount, as may be prescribed. **Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014** has prescribed a ceiling of **rupees *one lakh rupees per meeting*** of the Board or committee thereof. Since the raise is within the specified celing, it shall be legally valid.

3) i) Depending upon the effective capital of the company, a whole-time director can be paid as per Schedule V.

ii) According to section 203 read along with Schedule V, the following shall be necessary:

a) Passing of resolution of the Board of Directors.

b) Remuneration from one or both the companies should not exceed the ceiling as prescribed under Schedule V

14.14 TERMINAL QUESTIONS

1. Explain in brief the limitations under the Companies Act, 2013 regarding payment of remuneration to the managerial personnel.
2. Explain the provisions of the Companies Act regarding the payment of minimum remuneration to managing director and whole time director in the event of loss or inadequacy of profits in a financial year of the company.
3. What is meant by 'Sitting Fee'? Is there any ceiling on the amount that may be paid to the directors of a public company? Discuss.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 15 COMPANY SECRETARY

Structure

15.0 Objectives

15.1 Introduction

15.2 Meaning of a Company Secretary

15.3 Appointment of Whole-time Company Secretary

15.3.1 Compulsory Appointment of a Whole-time Company Secretary

15.3.2 Manner of Appointment of Whole-time Company Secretary

15.3.3 Whole-time Company Secretary not to Hold Office in more than one Company

15.3.4 Vacation of Office of the Whole-time Company Secretary

15.4 Company Secretary in Practice

15.5 Removal of a Company Secretary

15.6 Position of a Company Secretary

15.7 Duties of a Company Secretary

15.7.1 Statutory Duties

15.7.2 General Duties

15.8 Liabilities of a Company Secretary

15.9 Rights of a Company Secretary

15.10 Role of a Company Secretary

15.11 Let Us Sum Up

15.12 Key Words

15.13 Answers to Check Your Progress

15.14 Terminal Questions

15.0 OBJECTIVES

After studying this Unit, you should be able to:

- define a company secretary;
- describe the qualifications of a company secretary;
- learn the manner of appointment of a company secretary;
- explain the position of a company secretary; and
- describe the duties and liabilities of a company secretary.

15.1 INTRODUCTION

A company secretary plays an important role in the administration of a joint stock company. The provisions of the Companies Act have become so complicated that it needs constant attention for their compliance. It has become practically impossible for the top management to supervise the routine administration as well as ensure the compliance with the provisions of the Act. It is for relieving the top management from this responsibility that company secretary is appointed. In this unit, you will learn the meaning of company secretary, his qualifications and appointment and the role played by him. You will also learn the duties and liabilities of a company secretary.

15.2 MEANING OF A COMPANY SECRETARY

A secretary is an officer of the company who is appointed to perform the ministerial or administrative duties. You should remember that it is not his duty to manage the affairs of the company; he is primarily concerned to ensure that the affairs of the company are conducted in accordance with the provisions of the Companies Act and Memorandum and Articles of Association of the company.

The Indian Companies Act, 2013 in section 2(24) defines a '**company secretary'** or 'secretary' as follows :

"Company Secretary or secretary means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act."

The Company Secretaries Act, 1980 defines a company secretary as "a person who is a member of the Institute of Company Secretaries of India" [Section 2(1)(c)].

Thus, to be a company secretary of a company, one has to be a member of the Institute of Company Secretaries of India.

A Section 8 Company i.e., an association not for profit' may appoint a Secretary who is not a member of Institute of Company Secretaries of India.

15.3 APPOINTMENT OF WHOLE-TIME COMPANY SECRETARY

15.3.1 Compulsory Appointment of a Whole-time Company Secretary

Section 203 read along with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 (as amended) provide that every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial person which includes a company secretary.

However, in June, 2014, MCA with respect to unlisted public companies brought down the prescribed amount from ten crores to five crores in so far as appointment of whole-time company secretary is concerned. Through the insertion of Rule 8A, even the private companies with a paid up capital of rupees five crores or more are now mandated to have a whole-time company secretary.

You may note that the following classes of companies must appoint a company secretary, namely-

i) Every Listed company;

ii) Unlisted public company having a paid-up share capital of rupees five crore or more;

iii) Private company having a paid-up share capital of rupees five crore or more.

15.3.2 Manner of Appointment of Whole-time Company Secretary

The whole-time company secretary of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration [Section 203(2)].

15.3.3 Whole-time Company Secretary not to Hold Office in more than One Company

A whole-time company secretary, like any other key managerial personnel, shall not hold office in more than one company except in its subsidiary company at the same time [Section 203(3)].

However, he may be appointed a director of any company with the permission of the Board.

15.3.4 Vacation of Office of the Whole-Time Company Secretary

If the office of the whole-time company secretary is vacated, the resulting vacancy shall be filled up by the Board at a meeting of the Board within a period of six months from the date of such vacancy [Section 203(4)].

15.4 COMPANY SECRETARY IN PRACTICE

You have learnt that the term 'Company Secretary' here means a person who is a member of the Institute of Company Secretaries of India. A Company Secretary may accept full time employment as secretary of a company or he may choose to practice independently as a company secretary, either individually or in partnership with one or more practising company secretaries. According to Section 6 of the Company Secretaries Act, 1980 only a member of the Institute whether in India or elsewhere shall be entitled to practice provided that he has obtained from the council a certificate of practice.

Section 2(25) of the Companies Act, 2013 defines 'Secretary in practice' to mean a secretary who is deemed to be in practice within the meaning of sub-section (2) of section 2 of the Company Secretaries Act, 1980.

As per Section 2(2) of the Company Secretaries Act, 1980 a member of the Institute shall be deemed "to be in practice" when, individually or in partnership with one or more members of the Institute in practice or in partnership with members of such other recognised professions as may be prescribed, he, in consideration of remuneration received or to be received, engages himself, *inter alia*—

a) in the practice of the profession of Company Secretaries to, or in relation to, any company; or

b) offers to perform or performs services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, reorganization or winding up of companies; or

c) offers to perform or performs such services as may be performed by—

   i) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,

   ii) a share transfer agent,

   iii) an issue house,

   iv) a share and stock broker.

   v) a secretarial auditor or consultant.

Check Your Progress A

1) Define a company secretary.

....

....

....

2) Who can be appointed as secretary of a company?

....

....

....

3) Who appoints the company secretary?

....

....

....

4) What do you mean by a 'secretary in practice'?

....

....

....

5) State whether the following statements are true or false.

   i) Only a person who is a member of the Institute of Company Secretaries of India can he appointed as secretary of a company.

   ii) A body corporate can be appointed as the secretary of a company.

   iii) Every listed company and every other company having paid up share capital of Rs. 5 crore or more must appoint a whole-time secretary.

   iv) A person having a graduate degree in commerce can be appointed, as a secretary.

   v) A company secretary cannot be appointed as a director of the company.

15.5 REMOVAL OF A COMPANY SECRETARY

You know that the appointment of a company secretary is generally done by means of a resolution of the Board of directors, as such he can be removed by the Board of directors or by the managing director, if he is so authorised by the Board.

When a secretary is appointed, the terms and conditions of his service are stated in the service agreement. Usually, there is a clause in the service agreement which provides the manner in which he can be dismissed. The secretary, being an employee of the company is a servant of the company and his removal is governed by the common rules governing the relationship of master and servant. However, the secretary must be given due notice of termination of his employment in accordance with the terms and conditions of his employment. In case no period of notice is mentioned in the service agreement, a reasonable notice should be given, otherwise the company shall be liable to pay compensation to him. Even if the company secretary is appointed for a fixed term, the company can remove him before the expiry of the terms by giving him a reasonable notice.

The services of a secretary may, however, be terminated without notice for wilful disobedience, misconduct, negligence, incompetence or permanent disability. When the Tribunal orders compulsory winding up of the company, the order of the Tribunal shall be deemed to be the notice of discharge of a secretary along with other employees of the company.

15.6 POSITION OF A COMPANY SECRETARY

The position of a company secretary has undergone a tremendous change during the last so many years. He has arisen from the position of a clerk to an indispensible figure in the corporate hierarchy. The Companies Act, 2013 describes him as 'key managerial personnel' along with CEO/Managing director/ Manager, Whole-time director, and Chief Financial Officer. The position of a company secretary can be discussed under the following headings:

i) **As a Servant of the Company**: Lord Esher observed in the course of his judgment in **Barnett Hoares & Co. *vs.* The South London Tramways Co. Ltd.** that secretary is a mere servant, his position is that he is to do what he is told. There is a service agreement between the secretary and the company and his employment is governed by the terms and conditions of this agreement, therefore he is an employee of the company. He is to work under the control of the Board of directors. He has to carry out the orders of the directors. It is for the secretary to ensure effective execution and implementation of the management policies laid out by the Board. He cannot exercise independent discretion in the work assigned to him.

ii) **As an Agent of the Company:** Since the secretary is concerned with the administration of the company, he acts on behalf of the company. The duties of a secretary are of ministerial and administrative in nature. The routine matters relating to the company are left to be looked after by the secretary. He has to deal with the staff, workers, trade unions, shareholders and the outsiders. So he has to use his discretion in dealing with such matters. He is an important link between the company and the outsiders.

All policy decisions are conveyed by the secretary to the staff and outsiders.

iii) **As an Officer of the Company:** As one of the key managerial personnel, company secretary is treated as principal officer of the company as well as 'officer in default' for the purposes of various sections of the Act. As per section 205, the company secretary shall be responsible for—

a) reporting to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

b) ensuring that the company complies with the applicable secretarial standards issued by the Institute of Company Secretaries of India and approved by the Central Government;

c) discharging such other duties as may be prescribed.

As noted above, company secretary is responsible for the compliance of various legal formalities under different Acts. He is bracketed with the managerial personnel including directors and is liable to punishment by way of imprisonment, fine or otherwise for violation of the provisions of the Companies Act.

Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that a Company Secretary shall also discharge, the following duties, namely:-

1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

2) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;

3) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;

4) to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under theAct;

5) to assist the Board in the conduct of the affairs of the company;

6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

7) to discharge such other duties as have been specified under the Act or rules; and

8) such other duties as may be assigned by the Board from time to time.

iv) **As an Advisor to the Board:** The secretary plays an important role and enjoys a unique position in the management of the company. Though the policies of the company are formulated by the directors, but since the secretary has complete information about all internal matters and changes in the policies of the government, he is in a better position to supply the required information and advice to the directors. He advises the Board on various legal matters. He can be described as the real guiding spirit behind the Board of directors.

From the above it should be clear to you that the position of the secretary has changed over the years. Though he has no managerial functions to perform, but he is described as a responsible officer of the company, he is the principal administrative officer of the company. We can state that while the directors are the brains of the company, the secretary is its ears, eyes and hands.

15.7 DUTIES OF A COMPANY SECRETARY

The duties of a company secretary vary from company to company depending upon its size, management structure and the personal qualifications of the secretary. In India, in private and in joint sectors, apart from the secretarial duties, the company secretary is normally entrusted with legal, administrative and management functions. In large sized companies, there are separate managers incharge of the functions relating to accounts, law and personnel etc. Even in such cases the role of the company secretary as the coordinator cannot be under estimated. It can be said that the company secretary acts in three fold capacity, namely, as an agent of the Board of directors, as a person incharge of secretarial work relating to the company and as chief administrative officer of the company.

The duties of a company secretary can broadly be divided into two categories - (a) statutory duties, and (b) general duties. The statutory duties can further be subdivided into two-duties under Companies Act and duties under other Acts.

15.7.1 Statutory Duties

Following are some of the statutory duties of the company secretary under the Companies Act:

i) Signing of any document or proceedings requiring authentication by the company under (Section 21).

ii) Filing of necessary documents and returns with the Registrar of Companies, e.g. return of allotment of shares, annual returns, annual accounts etc. (Section 39).

iii) Giving the notice of the increase in the share capital to the Registrar (Section 64).

iv) Delivering the share certificate within 2 months of allotment or within one month of registration of transfer (Section 56)(4).

v) Registration of charges with the Registrar of Companies (Section 77).

vi) Getting the name painted outside every office or the place of its business and to get is engraved on the seal, if any, of the company (Section 12).

vii) To make available for inspection and furnish copies of register of members (Section 94).

viii) Sending notice of general meetings to every member of the company (Section 101).

ix) Filing of certain agreements and resolutions with the Registrar (Section 117).

x) Keeping minutes of the proceedings of general meetings and of Board of directors and other meetings.

xi) To make available for inspection register of director and key managerial personnel and their shareholding (Section 171).

xii) Maintaining the various registers and statutory books of the company.

The Secretary shall be held responsible as an officer, in default, if there is a default in complying with the provisions of the Act relating to duties. According to Section 2(6), a secretary, among others, has been defined as an officer in default.

Duties under Other Acts: A company secretary has also to see to it that the requirements of other Acts are also complied with. Under the Income Tax Act, the secretary being the 'Principal Officer' is responsible for the deduction of income tax from the salaries of its employees and its deposition in the Government treasury. Under the Indian Stamp Act, the secretary should ensure that various documents like share certificates, transfer forms etc. are properly stamped as per the requirements of the Indian Stamp Act.

The secretary is also required to comply with the provisions of various labour and industrial laws such as The Factories Act, The Industrial Disputes Act, Minimum Wages Act, etc.

15.7.2 General Duties

Apart from the statutory duties stated above, a secretary is required to perform several general duties. These include:

i) To carry out the orders of the Board of directors.

ii) To assist the Board in the formulation of policy decisions.

iii) Not to disclose confidential information relating to the affairs of the company.

iv) Not to make any secret profits on account of his position.

v) To act as a medium and link between the company and outsiders.

vi) To provide information to the shareholders.

vii) To organise, supervise and coordinate the office work.

15.8 LIABILITIES OF A COMPANY SECRETARY

You have learnt that it is the duty and responsibility of a secretary to see that the affairs of the company are conducted in accordance with the provisions of the Companies Act, Memorandum and Articles of Association. If a default is made in complying with certain provisions of the Act, a secretary, being an officer of the company, shall be liable for fine and punishment.

The liability of a company secretary can be discussed under two headings, namely, statutory liabilities and contractual liabilities.

Statutory Liabilities

The company secretary may be held liable for the following matters under Companies Act :

i) **Default in filing returns as to allotment** - If a default is made in filing returns as to allotment of shares within the prescribed time, he shall be punishable with fine which may extend to one thousand rupees for every day during which the default continues or one lakh rupees, whichever is less [Section 39(5)].

ii) **Default in the preparation of share/debenture certificates –** As per section 56(4) the company shall deliver the certificates of all securities allotted, transferred or transmitted—

a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;

b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;

c) within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of transmission under sub-section (2), in the case of a transfer or transmission of securities;

d) within a period of six months from the date of allotment in the case of any allotment of debenture:

Where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

In case of default, the company secretary, as an officer in default, shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees [Section 56(6)].

iii) **Default regarding Register of members/debentureholders, etc. –** Failure will make company secretary, if he is in default, punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues. [Section 88].

iv) **Default in the filing of particulars regarding charges** - If a default is made in filing with the Registrar the particulars of any charge created by the company, every officer of the company who is in default which includes a company secretary shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both [Section 86].

v) **Default regarding the publication of name of company -** If a default is made in getting the name and address of the registered office of the company painted or affixed or printed outside every office or place of business or printed on all its business letters, bill heads, etc., company secretary, if he is in default, shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees [Section 12].

vi) **Default in filing of annual returns -** If a company secretary fails to file the annual return in or a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees [Section 92].

vii) **Default in holding annual general meeting -** Default in holding the annual general meeting in accordance with the provisions of sections 96 to 98, shall make him liable to a fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continues. [Section 99].

viii) **Default in circulation of members' resolutions -** If a default is made in circulating members' resolution of which they have given notice to the company, he shall be punishable with fine which may extend to Rs. 25,000 [Section 111].

ix) **Default in registering certain resolutions and agreements -** This default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. [Section 117].

x) **Default in recording the minutes of the meetings -** If a default is made in recording the minutes of all proceedings of every general meeting and meetings of the Board, a fine of Rs. 5000 may be levied upon an officer in default which includes company secretary [Section 118].

xi) **Default in maintaining minute books or allowing inspection or furnishing copies of minutes to members -** If a default is made in furnishing a copy of the minutes within seven working days after the date of request by any member or if inspection is not allowed, he shall be liable for a fine of Rs. 5,000 for each such refusal or default, as the case may be. [Section 119].

xii) **Failure to give notice of Board's meeting -** A meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. Failure to give notice will make every officer of the company whose duty is to give notice under this section (company secretary is such an officer) and who fails to do so shall be liable to a penalty of twenty-five thousand rupees [Section 173].

xiii) **Failure to maintain the register of directors and key managerial personnel and their shareholding –** Company secretary in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees. [Section 172].

xiv) **Failure to maintain register of inter-corporate loans and investments -** For this default company secretary, if he is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees [Section 186].

Apart from the liability under the Companies Act, a secretary shall be liable for fine and punishment if he violates the provisions of the Income Tax Act, Indian Stamp Act, Sales Tax Act and labour and industrial laws.

The company secretary is also, as a principal officer, responsible to fulfil the duties cast upon him under the Foreign Exchange Management Act (FEMA).

Contractual Liabilities

In addition to the various statutory liabilities, a company secretary has several contractual liabilities which arise out of his service agreement, they are as follows:

i) he shall be liable for any loss or damages caused to the company by willful neglect or negligence in the discharge of his duties;

ii) he shall be personally liable if he acts beyond his authority;

iii) he shall be liable to account for the secret profits made by him by virtue of his position as a secretary;

iv) he shall be liable to indemnify the company for any loss suffered by the company as a result of disclosure of some secret information relating to the company;

v) he shall be liable for any fraud or wrong done to the company during the course of his employment.

15.9 RIGHTS OF A COMPANY SECRETARY

Some rights are given to the company secretary by the Act, Board of directors and the general meetings of shareholders. He also derives some rights out of the service agreement with the company. A secretary has the following rights:

i) right to control and supervise the working of his department;

ii) right to sign documents requiring authentication by the company;

iii) right to be indemnified for any loss suffered by him while discharging his duties.

iv) right to receive remuneration.

But a company secretary has no right to borrow money in the name of the company or to make allotment of shares or register transfer of shares without the express authority or consent of the Board of directors. He has no authority to call a meeting of the company.

From the above, it should be clear to you that secretary is responsible officer of the company and he has several statutory and contractual liabilities. But, he has to work according to the directions of the Board of directors.

15.10 ROLE OF A COMPANY SECRETARY

The company secretary plays an important role in company administration. The scope of his role depends on the size and nature of the company. He is liable not only to the company, but also to its shareholders, creditors, employees and the society.

From the discussion given above, a three-fold role of the company secretary can be visualized, namely, as a statutory officer, as a coordinator and as an administrative officer.

i) **Statutory Officer:** As a principal officer of the company, the company secretary is responsible for strict compliance with the various provisions of the Companies Act and the requirements of other Acts. He is responsible for proper maintenance of books of accounts and other registers. He has to sign several documents such as annual returns, return of allotment, filing of documents with respect to verification of registered office for commencement of business. He is responsible for authentication of the financial statements, for holding meetings of directors and shareholders and maintaining minutes of such meetings.

As a statutory officer, the company secretary is responsible to comply with the provisions of other Acts, such as Income Tax Act, Sales Tax Act, Factories Act, Industrial Disputes Act, etc.

ii) **Coordinator**: A company secretary is the link between the Board of directors and other executives of the company. The Board lays down the policy decisions, but it is the secretary who ensures their proper implementation. He acts as a link between the Board, managing director and the Chairman on the one hand and with the staff on the other hand. In a company where there are several independent departments such as sales, purchase, personnel etc., he acts as a coordinator with these functionaries for ensuring that the policy decisions are duly carried out and if there are some matters which require further consideration, the secretary shall place them before the Board and convey the decision of the Board to the concerned department.

The company secretary also acts as a coordinator with trade unionists, auditors, shareholders of the company, Government and the community at large. He is to ensure the compliance of the provisions of Companies Act and various other Acts. He should see that the company functions in a manner as to achieve the declared objectives of the Government. With respect to corporate social responsibility (CSR) of the company, the secretary can advise the Board regarding the matters where the company can contribute to the welfare of the society as well as meet its CSR obligations.

iii) **Administrative Officer:** As a general administrative officer, he is responsible for efficient administration of the company. He has to supervise, control and coordinate the functioning of different departments such as finance, personnel, organisation. He should develop a strong and efficient organisational structure. He has also to ensure the safety and proper maintenance of the assets and properties of the company. He has to ensure that they are not misused. The company secretary is responsible for ensuring that records are maintained properly. With the fast changes taking place, a secretary is expected to play a still more important role in the administration of the company. He is to assist the Board in laying down the policies and dealing with the Government and financial institutions.

Check Your Progress B

1) How can the secretary of a company be removed?

....

....

....

2) Enumerate the rights of a secretary.

....

....

....

3) List any three statutory duties of a company secretary.

....

....

....

4) What do you mean by three-fold role of a secretary?

....

....

....

5) State whether the following statements are true or false.

i) A secretary can be removed by giving him a due notice.

ii) No notice is necessary for removing a secretary for wilful misconduct, negligence or permanent disability.

iii) A secretary appointed for a fixed term cannot be removed before the expiry of the term.

iv) A secretary can convene a general meeting, make allotment of shares, register transfer of shares.

v) Company secretary is responsible for the compliance of the provisions of the Companies Act and other laws of the country.

vi) The company secretary is liable only to the directors and not to the shareholders.

vii) Some managerial powers can be delegated by the Board to the secretary.

viii) A company secretary can make secret profit by using his position.

ix) A company secretary has to ensure the safety of the assets of the company.

15.11 LET US SUM UP

The term company secretary means a person who is a member of the Institute of Company Secretaries of India. Every listed company and every other company having a paid-up share capital of Rs. 5 crores or more must have a whole-time secretary.

The Companies Act also recognises the concept of company secretary in practice. A secretary who obtains the licence from the institute can only practice. A secretary is generally appointed by the Board of directors. He can be removed by a resolution of the Board or by the managing director, if he is so authorised by the Board. Before removing a secretary, a proper notice must be given to him. However, no notice is necessary for wilful misconduct, negligence, or permanent disability.

The company secretary occupies an important position in the company administration. His position is that of a servant, agent and an officer of the company. He has several statutory and other duties. Being an officer of the company, he is liable to be fined or punished for not complying with the provisions of the Companies Act or other laws of the country. Because he is occupying a position of trust, he must not use his position to make secret profits. He must keep the matters of the company up to himself only.

A secretary plays a three-fold role-a statutory officer, a coordinator and an administrative officer of the company.

15.12 KEY WORDS

Company Secretary: A person who is a member of the Institute of Company Secretaries of India.

Secretary in Practice: An individual who is a member of the Institute of Company Secretaries of India and who has obtained from the Council a certificate to practice.

Statutory Duties: Duties laid down in the Statute.

Breach of Duty: Non-performance of a contractual or statutory duty.

Contractual Duties: Duties arising out of the contract.

15.13 ANSWERS TO CHECK YOUR PROGRESS

A	5	i)	True;	ii) False;	iii) True;	iv) False;
		v)	False			
B	5	i)	True;	ii) True;	iii) False;	iv) False;
		v)	True;	vi) False;	vii) True;	viii) False;
		ix)	True			

15.14 TERMINAL QUESTIONS

1) Define the term ‘Secretary’ under the Companies Act. Who can be appointed as a secretary of a company?

2) How is the secretary of a company appointed? State how can he be dismissed?

3) Discuss the legal position of a company secretary and state his main functions.

4) Enumerate the duties of a company secretary.

5) Discuss the statutory and contractual liabilities of a company secretary.

6) Discuss the role of a company secretary as (a) statutory officer, (b) coordinator and (c) administrative officer.

7) “The secretary is a link between the directors and shareholders of a company.” Explain.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 16 MEETINGS OF SHAREHOLDERS AND BOARD

Structure

16.0 Objectives
16.1 Introduction
16.2 Meaning of Meeting and Its Importance
16.3 Kinds of Meetings
16.4 Annual General Meeting
16.5 Extraordinary General Meeting
16.6 Class Meetings
16.7 Board Meetings
16.8 Requisites of a Valid Meeting
16.9 Notice of Meetings
16.10 Quorum for Meetings
16.11 Proxy
16.12 Voting
16.13 Chairman
16.14 Resolutions
16.14.1 Ordinary Resolution
16.14.2 Special Resolution
16.14.3 Resolution Requiring Special Notice
16.15 Minutes
16.16 Let Us Sum Up
16.17 Key Words
16.18 Answers to Check Your Progress
16.19 Terminal Questions

16.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of a company meeting;
- discuss the importance of company meeting;
- explain the various types of company meetings;
- list the requisites of a valid meeting;
- explain the rules regarding the notice, proxies, quorum, etc; and

- explain the different types of resolutions and the purposes for which they can be passed.

16.1 INTRODUCTION

A company, being an artificial person, cannot act by itself like a human being. The business of the company is carried on by the elected representatives, called as 'directors'. The decisions are taken by the directors at the meetings of the Board. But they cannot take decision on all matters relating to the working of the company. There are certain matters which are to be decided by the general body of shareholders. For this purpose, the meetings of the shareholders are held wherein decisions are taken by shareholders by means of passing resolutions. In this Unit, you will study the different types of meetings and the business transacted therein; and the rules regarding the holding and conduct of such meetings. You will also study the various types of resolutions and the purposes for which they are required.

16.2 MEANING OF MEETING AND ITS IMPORTANCE

'Meeting' may generally be defined as the gathering, assembly or coming together of two or more persons for transacting any lawful business. For proper working of the company, it is necessary that the shareholders meet as often as possible and discuss matters of mutual interest and take important decisions. Meetings provide a place for fruitful participation where free and frank discussion takes place. The decisions taken at the meetings generally become acceptable and are met with least resistance.

To constitute a valid meeting there must be at least two persons, because a meeting cannot be constituted by one person. But there are certain circumstances where one person can constitute a valid meeting, they are:

a) Where one person holds all the shares of a particular class, he alone can constitute a meeting of that class;

b) Where the meeting is called by an order of the Tribunal, the Tribunal may direct that one member of the company present in person or by proxy shall constitute a valid meeting.

Company meetings play a significant role in decision making process. They provide an opportunity to shareholders to review the working of the company and take policy decisions, thereby controlling the Board of directors. The directors are duty-bound to follow the decisions taken at the general meeting of shareholders. Meetings constitute a very important aspect in the management and administration in the company form of organisation.

16.3 KINDS OF MEETINGS

Company meetings can broadly be classified as follows

1) **Meetings of Shareholders:** Such meetings are also known as general meetings of the members which are held to exercise their collective rights. The meetings of the shareholders may again be of the following three types:

   a) Annual General Meeting;

   b) Extraordinary General Meeting; and

   c) Class Meeting.

2) **Meetings of Directors:** The directors are to act collectively in the form of a Board, and the decisions are taken at the meetings of the Board of directors. These meetings may again be of two types:

a) Meetings of the Board of directors; and

b) Meetings of the committee of directors.

3) **Other Meetings:** These meetings may be any of the following:

a) Meetings of debenture-holders;

b) Meetings of creditors

c) Meetings of creditors and contributories on the winding up of the Company.

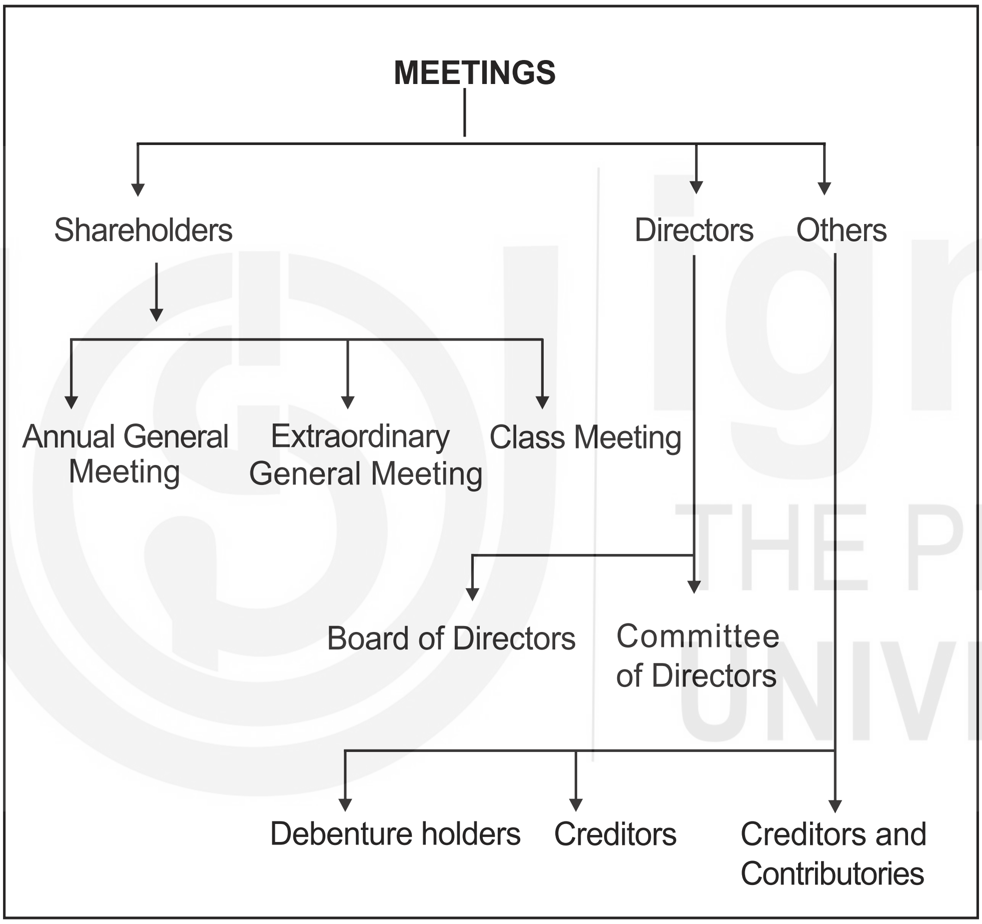


Figure 16.1: Will help you in understanding the types of meetings

Check Your Progress A

1) Define a meeting.

....

....

....

2) List the different types of members' meetings.

....

....

....

16.4 ANNUAL GENERAL MEETING

The annual general meeting of a company is an important means through which the shareholders get the opportunity to exercise their power of control. It is at this meeting that the directors retire and seek re-election. The shareholders get an opportunity of reviewing and evaluating the overall performance of the company during a year. The shareholders can place their views before the management and can seek clarifications on matters about which they are not satisfied. Thus, you may note that an annual general meeting is very important. Annual general meeting is held every year.

Every company, public or private, other than one man company must in each calendar year hold, in addition to any other meeting a general meeting, its annual general meeting and the notice must specify that it is the annual general meeting.

The holding of an annual general meeting is a statutory requirement.

Following are the rules regarding annual general meetings:

i) **First Annual General Meeting** - The first Annual General Meeting (AGM) of a company must be held within nine months from the date of the closing of its financial year. No extension of time can be allowed for holding the first AGM.

ii) **Subsequent AGMs**

   a) There must be one meeting held in each year, i.e., calendar year. Where the first AGM of a company has been held within nine months from the date of the closing of its financial year then it need not hold another AGM in the year of its incorporation.

      The meeting adjourned to next calendar year does not become meeting of that year **[Sree Meenakshi Mills Co. Ltd. v. Assistant Registrar of Joint Stock Companies** [1938] 8 Comp. Cas. 175 (Mad.).]

   b) The gap between two AGMs must not be more than fifteen months.

   c) Meeting must be held not later than six months from the close of the financial year.

Extension of Time

The Registrar may, for any special reason, extend the time within which any annual general meeting, **other than the first annual general meeting**, shall be held, by a period not exceeding three months [Section 96].

The aforesaid extension of 3 months can be given only by the Registrar. Courts are not empowered to grant the said extension - **Nungambakkam Dhanarakshaka Saswatha Nidhi Ltd. v. R.O.C. [1972]**

iii) The company must give **clear twenty-one days' notice** to: (i) every member of the company; (ii) the legal representative of a deceased member; (iii) the assignee of an insolvent member; (iv) the auditor(s) of the company; (v) every director of the company. Notice may be given either in writing or through electronic mode in the prescribed manner.

   A shorter notice may also be given if it is agreed to by 95% of the members entitled to vote at the meeting. The consent may be given in writing or by electronic mode.

iv) Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated [Section 96 (2)]. Thus, no meeting can be called on a national holiday, for example, on 15th August, 2nd October and 26th January.

However, the Central Government may exempt any class of companies from the provisions of this sub-section subject to such conditions as it may impose.

v) The Board of directors can cancel or postpone the holding of the meeting on the scheduled date, but this power should be exercised by the Board bonafide and for proper reasons. The better course for the Board will be to hold the meeting and then have the matter decided by the meeting.

vi) **Consequences of not holding Annual General Meeting**

You learnt that holding of the annual general meeting is a statutory requirement. If a company makes a default in holding the annual general meeting in accordance with the provisions of Section 96 of the Companies Act, the following two consequences will follow:

a) Any member of the company can apply to the Tribunal for calling the meeting. On such application, the Tribunal may order the calling of the meeting, or it may issue directions for calling the meeting, which may even include a direction that one person present in person or proxy shall constitute the annual general meeting. A meeting called by the order of the Tribunal shall be deemed to be annual general meeting of the company (Section 97).

b) The company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continue (Section 99).

vii) **The Business to be transacted:** According to Section 102 of the Companies Act, 2013, at the annual general meeting ordinary business is to be transacted. Any other business can also be transacted at the annual general meeting, but that will be termed as ‘special business. Thus, the annual general meeting can transact both ordinary and special business. The following ordinary business is generally transacted at every annual general meeting:

a) the consideration of the financial statements and the reports of the Board of directors and auditors;

b) the declaration of dividend;

c) the appointment of directors in the place of those retiring; and

d) the appointment of the auditors and fixing their remuneration

If any other business (other than those mentioned above) is to be transacted at the annual general meeting, it shall be treated as special business. Where any items of special business, as aforesaid, is to be transacted at the meeting, there shall be annexed to the notice calling such meeting, namely:—

the nature of concern or interest, financial or otherwise, if any, of—

i) every director and the manager, if any;

ii) every other key managerial personnel; and

iii) relatives of the persons mentioned in (i) and (ii) above.

The statement should also contain any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

You should note that the ordinary business requires an ordinary resolution, while the special business may be passed by an ordinary resolution or special resolution, as required by the Act.

You will study the details of ordinary and special resolutions later in 16.14 of this Unit.

16.5 EXTRAORDINARY GENERAL MEETING

All general meetings of a company other than the annual general meeting are called 'extraordinary meetings'. Extraordinary general meeting is a meeting which is held between two annual general meetings. These meetings are called in emergencies or on special occasions. This meeting is called to discuss some urgent special business which cannot be postponed till the next annual general meeting, for example, alteration in the Memorandum or Articles of Association, reduction of capital, issue of debentures, etc. All business transacted at such meeting is deemed to be special business.

An extraordinary general meeting may be called by

a) Board of directors on its own motion; or

b) the Board of directors on the requisition of members; or

c) the requisitionists themselves; or

d) the Tribunal.

   a) **By the Board of Directors**: Clause 42 of Table F (Schedule 1) states that "the Board may, whenever it thinks fit, call an extraordinary general meeting." Notice of not less than 21 clear days' should be given (Section 101). A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95 per cent or more of the voting rights.

   b) **By the Board on requisition:** According to Section 100 of the Act, the Board of directors must call an extraordinary general meeting of the company on the requisition of required number of members. The requisition letter for calling this meeting must be signed by members holding at least one-tenth of the paid-up capital and having a right to vote on the matter of requisition. In the case of a company having no share capital, it must be signed by those members who have at least one-tenth of the total voting power.

The requisition must state the purpose for which the meeting is requisitioned and it must be deposited at the registered office of the company. You should note that only such matter can be taken up at the meeting which is specified in the requisition.

On receipt of a valid requisition, the Board of directors should, within 21 days, move to call a meeting and the meeting must actually be held within 45 days of the date of deposit of the requisition. A notice of 21 clear days is necessary for calling the extraordinary general meeting. A duty has been imposed on the management to disclose, in an explanatory statement all material facts relating to every special business to enable the members to form a judgement on the business.

c) **By the Requisitionists:** If the Board of directors fails to call the meeting within 21 days and the meeting is not held within 45 days of the deposit of the requisition, the meeting may be called by the requisitionists themselves. But the equisitionists must hold the meeting within three months from the deposit of the requisition. Such meeting must, as nearly as possible, be held in the manner as called by the Board of directors. When the requisitionists themselves call a meeting, they may recover the reasonable expenses incurred from the company, and the company may deduct such amount from the amount of remuneration payable to the directors in default.

   If the meeting is called by requisitionists, it can only transact the special, business for which it has been expressly convened. The resolutions, which are properly passed at such requisitioned meeting, shall be binding upon the company.

d) **By the Tribunal:** Under Section 98 of the Act, the Tribunal is empowered to call, hold or conduct such a meeting, if for any reason it is impracticable to call or conduct an extraordinary general meeting. The term 'impracticable' means not possible to call, hold or conduct the meeting in accordance with the provisions of the Act and Articles, for example, if the meeting cannot be called because of the rivalry of two groups.

   The Tribunal may order for the calling, holding and conducting such a meeting:

   a) on its own motion, or

   b) on an application of any director, or

   c) on an application of any member entitled to vote at that meeting.

The Tribunal should use this power sparingly and on being convinced that it is in the larger interest of the company. While calling a meeting, the Tribunal may give such directions as it thinks fit, including the direction, that one member present in person or by proxy would constitute the quorum.

Like any other general meeting, the notice of the extraordinary general meeting must also be given at least 21 clear days before the date of the meeting specifying the date, time and place of the meeting. The notice must also specify the special business to be transacted at the meeting. You should note that unlike an annual general meeting, extraordinary general meeting may be held on any day including a national holiday. The meeting may be held at a place other than the registered office of the company or even outside the city in which the registered office is situated.

16.6 CLASS MEETINGS

Section 48 provides that where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied. To vary such rights, consent in writing of the holders of at least 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 must be obtained.

In case variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained.

Rights of dissentient shareholders

If the holders of 10 per cent of the issued shares of that class did not assent to the variation, they may make an application to the Tribunal. The application must be made within 21 days of the date of the consent or the passing of the special resolution. The Tribunal may, after hearing the interested parties, either confirm or cancel the variation. The company must, within 30 days of the service of the Tribunal's order, forward a copy of the order to the Registrar.

In case of default in complying with the aforesaid provisions, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

Check Your Progress B

1) What is an annual general meeting?

....

....

....

....

2) What is the purpose of holding annual general meeting?

....

....

....

....

3) What business is usually transacted at the annual general meeting of a company?

....

....

....

4) What is an extraordinary general meeting?

....

....

....

5) Who can call an extraordinary general meeting?

....

....

....

6) What is the minimum number of members who can requisition an extraordinary general meeting?

....

....

....

7) State whether the following statements are True or False.

i) The time interval between two annual general meetings shall not exceed fifteen months.

ii) The first annual general meeting must be held within fifteen months from the date of its incorporation:

iii) An annual general meeting may be called by giving a notice shorter than 21 days if all members entitled to vote give their consent.

iv) Declaration of dividend is an item of ordinary business.

v) Members of a company holding 5% of the voting power can requisition an extraordinary meeting.

vi) In an extraordinary general meeting of a company all business transacted is deemed to be special business.,

vii) The requisitionists may themselves convene an extraordinary general meeting within six months of depositing the requisition.

viii) An extraordinary general meeting can be called on a national holiday and at a place other than the registered office of the company.

ix) Rights of a particular class of shareholders may be varied by passing a special resolution at a general body meeting of all the shareholders.

16.7 BOARD MEETINGS

You have learnt that directors exercise their powers collectively at periodical meetings of the Board. The rules regarding the holding and conduct of Board meetings are laid down by the Act and the Articles. Important provisions of the Companies Act, in this regard, are as follows:

1. **First Meeting:** According to section 173(1), every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation.

2. **Subsequent Meetings:** Every company must hold a minimum number of four meetings of its Board of Directors every year and the gap between two Board meetings must not be more than one hundred and twenty days.

   A One Person Company, small company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days. Also the requirement as to quorum, as set out in section 174, shall not apply to One Person Company in which there is only one director on its Board of Directors [Section 173(5)].

3. **Participation of directors through video conferencing or other audio visual means [Section 173(2)]**

   The participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, as may be prescribed.

4. **Notice of Board Meeting**

   A meeting of the Board shall be called **by giving not less than seven days' notice in writing** to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

   A meeting of the Board may be called at **shorter notice to transact urgent business** subject to the condition that at least one independent director, if any, shall be present at the meeting.

   In case independent directors are absent from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any [Sub-section (3)].

5. **Time and place of Board meeting**

   The notice must state the date, time and place of the meeting. Unlike the provisions of the Act regarding annual meetings, there is no provision in the Act specifying that Board meetings must be held at the registered office of the company or between business hours, namely, 9 A.M to 6 P.M. Thus, Board meetings may be held at any place and outside the business hours according to the convenience of the directors.

6. **Quorum**

   According to section 174(1), the quorum for a meeting of the Board of directors shall be 1/3rd of its total strength (any fraction contained in that 1/3rd to be rounded off to one) or two directors, whichever is higher. "Total strength" *shall not include* directors whose places are vacant. Again, interested director(s) shall not be counted for the purposes of quorum. The participation of the directors by video conferencing or by other audio visual means shall also be counted for the purposes of quorum.

Can Articles fix a higher quorum? In *Amrit Kaur Puri* v. *Kapurthala Flour Oil & General Mills Co. (P.) Ltd.* [1984] 56 Comp. Cas. 194 (P&H), Punjab and Haryana High Court held 'yes', articles can fix higher quorum, they cannot, however, fix a lower number.

7. ***Interested directors:*** If, at any time, the number of interested directors exceed or is equal to 2/3rd of the total strength, the remaining directors, that is to say, the number of directors who are not interested, present at the meeting, being not less than two, shall be the quorum of such meeting [Section 174(3)].

Adjournment for want of quorum

If a meeting of the Board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a national holiday, at the same time and place [Section 174(4)].

Passing of Resolution by Circulation

No resolution shall be deemed to have been duly passed by the Board unless the resolution has been circulated in draft, together with necessary papers to all Directors, by post or by hand or by courier or by electronic means.

Where not less than 1/3rd of the total number of Directors require that any such resolution must be decided at the meeting, the Chairperson shall put the resolution to be decided at a meeting of the Board. Such resolution shall be a part of minutes of such meeting.

Check Your Progress C

1) What are the legal rules as regards the frequency of Board meetings?

....

....

....

2) What is the quorum in a director's meeting?

....

....

....

....

3) State whether the following statements are True or False:

   i) A meeting of the Board of directors must be held at least once in every four months and at least three such meetings must be held in every year.

   ii) The quorum for a Board meeting is one-third of its total strength or two directors, whichever is less.

iii) Every company must hold first meeting of the Board of director within six month of its incorporation.

iv) The Notice of the Board Meeting should not be less than seven days in writing.

16.8 REQUISITES OF A VALID MEETING

The decisions taken at the general meeting shall be valid and binding only if the meeting itself has been properly called and conducted. Any irregularity in calling or conducting the meeting shall invalidate the proceedings of the meeting. The company meetings must be conducted in accordance with the rules and regulations laid down in the Act and the Articles of Association. The following are the requisites of a valid meeting:

1) **Proper Authority**: The meeting shall be valid only when it is called by a proper authority. The proper authority to convene the meeting is the Board of directors. The Board of Directors should pass a resolution at its meeting to call the general meeting, otherwise the notice calling the meeting will become invalid and the proceedings of the company shall not be effective (**Harban vs. Phillips**). Thus, a notice issued by the secretary without the authority of a resolution of the board is patently invalid.

   Though the Board of directors is the authority to convene a general meeting, but under certain circumstances the meeting may be called by requisitionists or by the Tribunal.

2) **Proper Notice**: 'Notice' means an advance intimation of the meeting so as to enable the person concerned to prepare himself for it. A proper notice should be given to every member, legal representative of every deceased member, the assignee of an insolvent member; auditors and directors of the company. The notice must be clear and should state the purpose for which the meeting is called. The notice must either be in writing or through prescribed electronic mode. It must be given at least 21 clear days before the date of the meeting.

   You should note that deliberate omission to serve notice to one or more members will invalidate the meeting. But an accidental omission will not render the meeting invalid. Similarly, the non-receipt of the notice will not affect the validity of the meeting. The notice must state the place, date, day and hour (i.e., time) of the meeting.

3) **Quorum**: Quorum means the minimum numbers of members whose presence is necessary at the meeting for transacting the business of the company. In the absence of a quorum, no meeting can be held. Any resolution passed at a meeting without quorum shall be invalid.

4) **Chairman**: Every general meeting of the company should be presided over by a chairman. The chairman has to be there to conduct the meeting in a proper and smooth manner. The Articles usually provide the mode of appointment of the chairman of a meeting.

   If the Articles do not provide otherwise, the members who are personally present at the meeting shall elect one of themselves to act as the chairman of the meeting. The chairman should act bonafide and in the interest of the company, he must act in an impartial manner.

5) **Properly Conducted**: It is essential that the business at the meeting must be conducted according to rules. Company meetings are held for discussing particular issues relating to the company's working and taking a decision on the same. The matter should be placed in the form of a resolution, it should be discussed thoroughly, amendments to it should be carefully considered and then it should be decided by voting by show of hands or poll.

6) **Proper Record**: A proper record of the proceedings should be kept in the Minutes Book. Every company is required to maintain minutes of the proceedings of every general meeting and meetings of the Board and its Committees. When the minutes are confirmed and signed by the chairman, they are acceptable in a court of law as evidence of the proceedings.

16.9 NOTICE OF MEETINGS

The normal rule for any meeting of shareholders of a public company is that the meeting should be called by giving a notice of not less than 21 clear days.

The essentials of a valid notice are:

a) It must clearly state the date, time and place of the meeting as also the purpose of the meeting.

b) The notice must be issued on the authority of a resolution of the Board of directors.

c) The notice should be signed by a person authorised by the Board. Usually, a director of the Board or the company secretary would sign the notice.

d) It must be sent to all persons who are entitled to receive the notice.

The words "clear days notice" indicate that the day of serving the notice and the day of meeting are excluded. Thus in normal practice, 21 clear days would mean 23 days. Further, if the notice is to be sent by post, another 48 hours are to be added to the 23 days. Thus the notice must be sent at least 25 days before the date of the meeting. A shorter notice can also be given if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting. The consents can be given either before or at the meeting.

Persons Entitled to Notice

Section 101 states that notice of every meeting of the company must be sent to :

i) every member of the company;

ii) the legal representative of a deceased member;

iii) the assignee of an insolvent member;

iv) the auditor(s) of the company; and

v) every director of the company.

However, if the notice pertains to the meeting of a particular class of shareholders, then it should be sent only to the shareholders of that class.

16.10 QUORUM FOR MEETINGS

A quorum is the minimum number of persons who must be present in order to constitute a valid meeting. If the quorum is not present, the meeting shall not be valid and the business transacted at such meeting will be invalid. The main purpose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may not be acceptable to the vast majority of members.

Generally, the quorum is fixed by the Articles of the company. According to Section 103 of the Companies Act, 2013 unless the Articles provide for a larger number,

a) **In case of a public company**,—

   i) five members personally present if the number of members as on the date of meeting is not more than one thousand;

   ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;

   iii) thirty members personally present if the number of members as on the date of the meeting exceeds five thousand.

b) **In the case of a private company**, two members personally present, shall be the quorum for a meeting of the company.

   If within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved [Section 174(3)].

   In any other case, if there is no quorum within half an hour from the time fixed for holding the meeting, the meeting shall stand adjourned to the same day in the next week, at the same time and place, or to such other day and at such other time and place as the Board may determine and notify.

   If at the adjourned meeting also, there is no quorum within half an hour from the time appointed for holding the meeting, then the members present shall form the quorum. But you must remember that there must be at least two persons to hold the meeting.

   According to Regulation 44 of Table F, the quorum must be present at the time when the meeting begins and proceeds, to take up business. It means that the quorum must be present at the beginning of the meeting and it need not be present throughout or at the time of taking votes on any resolution. But as regards the meetings of the Board of directors, the quorum must be present throughout the meeting. You should note that a quorum is presumed unless it is questioned at the meeting.

16.11 PROXY

The term 'proxy' means the person who is authorised to act and vote for another at a meeting of the company. Section 105 of the Companies Act, states that any member of a company who is entitled to attend and vote at a meeting of the company, is entitled to appoint another person as his proxy to attend and vote instead of himself. Thus, any person may be appointed as a proxy whether he is a member of the company or not. Unless the Articles provide otherwise, a proxy cannot be appointed in the case of a company having no share capital.

1) As per Rule 19 of the Companies (Management and Administration) Rules, 2014, a member of a company registered under section 8 (i.e. association not for profit) shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

2) The appointment of proxy shall be in the Form No. MGT.11**.** Section 105(7) provides that an instrument appointing a proxy, if in the Form No. MGT.11, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the Articles.

3) A person can act as proxy on behalf of members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying voting rights. However, a member holding more than ten percent, of the total share capital of the Company carrying voting rights may appoint a single person as proxy and such person shall not act as proxy for any other person or shareholder.

The proxy Form must be signed by the appointer or his attorney duly authorised in writing and must be stamped. The instrument appointing a proxy should be deposited with the company forty eight hours before the commencement of the meeting. Any provision in the Articles of the company requiring the proxy form to be deposited earlier than 48 hours will be invalid.

The proxy has no right to speak at the meeting. However, a proxy can demand a poll. A proxy is not allowed to vote except on a poll.

Every notice of a meeting must clearly state that a member is entitled to appoint a proxy and that the proxy need not be a member. If default is made, every officer in default shall be punishable with fine up to Rs.5,000. But no invitation to appoint any person as proxy be made at the expense of the company and in case any such invitation is issued, the officer in default will be liable to fine up to Rs. one lakh.

Every member entitled to vote at a meeting of the company is entitled to inspect the proxies deposited at any time during the business hours. However, he must have given at least 3 days notice in writing of his intention to so inspect. Inspection may be done 24 hours before the meeting or during the meeting.

You must remember that a proxy is always revocable, but it can be revoked before the proxy has voted. For revoking the proxy, the company must be informed. Death or insanity of a member appointing the proxy revokes the proxy, but proper intimation to the company is necessary. If the member appointing the proxy personally attends and votes at the meeting, the proxy shall stand revoked.

16.12 VOTING

You have learnt that the business of the company is transacted at meeting. A motion becomes a resolution when it is duly passed at the meeting. The shareholders have the right to discuss every proposed resolution and propose amendments therein. After the motion is discussed, it is put to vote. The voting may be (a) by show of hands or (b) by taking a poll. (c) by postal ballot:

a) **By show of hands**: At any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under section 109 or the voting is carried out electronically, be decided on a show of hands. On a show of hands, each member shall have one vote. Unless the Articles otherwise provide, proxies are not entitled to vote in case of such voting, The chairman counts the hands 'for' and 'against' a resolution and declares the result and when it is recorded in the minutes it becomes a conclusive proof of the fact. However, the dissatisfied shareholders may challenge the validity of the passing of the resolution or they may demand a poll.

b) **By taking a Poll**: Section 109 provides that before or on declaration of the result of the voting on any resolution on a show of hands, a poll can be demanded. The chairman on his own motion may order voting by poll.

A poll shall be ordered to be taken by the Chairman, if a demand for poll is made by the person or persons specified below, namely

a) **In the case of a 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, or

   ii) on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up;

b) **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.

The demand for a poll may be withdrawn at any time by the persons who made the demand.

Time of taking poll - On a valid demand for poll having being made, the chairman must order the poll to be taken forthwith where demand for poll relates to : (i) Adjournment (Section 109); (ii) Election of Chairman of the meeting [Section 104].

Where demand for poll relates to any other question, a poll must be taken at such time not being later than forty-eight hours from the time when the demand was made, as the chairman may direct.

Where a poll is to be taken, the chairman of the meeting shall appoint persons to scrutinize the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.

You should note that as soon as a demand for poll is made, all decisions taken by voting by show of hands stand cancelled.

Also note that in a poll, the voting rights of a member are in proportion to his share of the paid-up equity capital of the company. If the Articles so provide, members holding shares on which calls are in arrear or in regard to which the company has right of lien, may not be allowed to vote in a poll.

When more than one resolution is put to vote, poll should be taken on each separately.

The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

Postal Ballot: Postal Ballot means voting by ballot, post or through electronic means. A company may transact those items through postal ballot which are prescribed by Central Government by notification. This does not apply if the directors or auditors have a right to be heard in a meeting.

16.13 CHAIRMAN

Chairman is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. A chairman is necessary for conducting a meeting properly. He is the chief authority in the meeting, he is the umpire of debates and he regulates the meeting.

Articles usually provide the mode of appointment of the chairman of a meeting. But if there is nothing in the Articles, the members personally present at the meeting shall elect one of themselves to be the chairman of the meeting. If a poll is demanded on the election of the chairman, it must be taken forthwith and a chairman elected for the purpose [Section 104].

Regulations 46 and 47 of Table F state the rules regarding the appointment of chairman. Companies usually incorporate these regulations in their Articles. As per these Regulations, if there is no such chairman or if he is not present within fifteen minutes of the time fixed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one amongst themselves to be chairman of the meeting. If at any meeting, no director is willing to act as chairman or if no director is present within fifteen minutes of the time fixed for holding the meeting, the members present shall choose one of themselves as the chairman.

The chairman has *prima facie* authority to decide all questions which arise at a meeting and which require decision at the time. He has the power to give his ruling on points of order, to expel any unruly member, to adjourn the meeting if it becomes impossible to conduct the meeting smoothly, to regulate the taking of poll, to sign and date the proceedings of the meeting. If so authorised by the Articles, the chairman may give his casting vote to decide the issue where the members are equally divided for and against the resolution.

The chairman must see to it that the proceedings of the meeting are conducted according to the rules, that proper order is maintained at the meeting, that proper opportunity is given to members to express their views. He should see that the voting is fair and the sense of the meeting is properly ascertained on each and every motion. He must act bonafide at all times and in the interest of the company.

16.14 RESOLUTIONS

Decisions of the members at a general meeting are expressed by way of resolutions. At the meetings a definite proposal in the form of a 'motion' is placed, it is discussed thoroughly and finally is put to vote. When the motion is passed by the requisite majority, it is called a resolution. In simple words, resolution means the decision taken at the meeting.

The Companies Act provides for three types of resolutions that may be passed at the general meeting of a company: (i) Ordinary resolution; (ii) Special resolution; and (iii) Resolution requiring special notice.

16.14.1 Ordinary Resolution [Section 114(1)]

An ordinary resolution is one which is passed by a simple majority that is to say that the votes cast in favour of the resolution exceed the votes cast against the resolution. For example, if at a meeting where, say, 81 members cast their votes in a manner that 41 cast votes in favour and 40 against the motion, the ordinary resolution is said to be taken as passed. The voting may be either by show of hands or through electronic mode or by poll. An ordinary resolution is required to pass the annual financial statements, to declare dividend, to appoint auditors, to elect directors, to increase authorised share capital, etc.

16.14.2 Special Resolutions [Section 114(2)]

A special resolution is one which is required for transacting special business and is required to be passed by a three-fourths majority. Again, the voting may be by show of hands or through electronic mode or by poll. In determining the three-fourths majority, all the votes cast by members, whether personally or by proxy, are considered.

According to Section 114(2) of the Companies Act, a resolution shall be a special resolution when :

a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members;

b) the notice required under the Companies Act (i.e., at least 21 clear days' notice) has been duly given of the general meeting;

c) the votes cast in favour of the resolution (whether by show of hands or on poll), by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution. Abstentions, if any, are not to be taken into account.

The special resolution is necessary to transact important business. The Articles of the company may specify purposes for which a special resolution is required. The Companies Act also expressly requires the passing of special resolution on certain matters. The following are some of the instances where special resolution is necessary :

i) to change the name of the company;

ii) to alter the Articles of Association;

iii) to shift registered office of the company from one State to another;

iv) to reduce capital;

v) to issue sweat equity shares;

vi) to buy-back its own shares;

16.14.3 Resolution Requiring Special Notice [Section 115]

A resolution requiring special notice is, in fact, not a type of resolution, but is a kind of ordinary resolution for which a prior notice of intention to move the resolution has to be given to the company. With regard to certain matters, a special notice is required to be given of a resolution to be moved at a meeting of the company. The object is to give members sufficient time to consider the proposed resolution. Where special notice of a resolution is required by the Act or the Articles, notice of the intention to move such resolution shall be given to the company by **such number of members holding not less than one per cent of total voting power or holding shares on which aggregate sum not exceeding five lakh rupees or such amount, as may be prescribed, has been paid-up.** The company, in turn, shall give its members notice of the resolution in such manner as may be prescribed.

Rule 23 of the Companies (Management and Administration) Rules, 2014, in this regard, provides as follows:

i) **t**he notice shall be **sent by members** to the company **not earlier than three months but at least fourteen days before the date of the meeting** at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

ii) **The company shall** immediately after receipt of the notice, give its members **notice of the resolution at least seven days before the meeting**, exclusive of the day of dispatch of notice and day of the meeting in the same manner as it gives notice of any general meetings.

iii) Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company.

iv) The notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

Special notice is required to move, besides the resolutions mentioned in the Articles, the following resolutions:

1) a resolution appointing an auditor other than the retiring one [Section 140];

2) a resolution purporting to remove a director before the expiry of his period of office [Section 169]; and

3) a resolution to appoint another director in place of the removed director [Section 169].

16.15 MINUTES

The Companies Act provides that every company must keep the minutes of the meetings containing a fair and correct summary of all proceedings of the meetings. The minutes of a meeting should be recorded within 30 days of the meeting in the books called the minute book, kept for the purpose. Each page of the minute book should be initialled and last page signed and dated by the chairman of the meeting. Section 120 allows keeping of the minutes in electronic form in the prescribed manner. The minutes duly signed by the chairman are presumptive evidence that the meeting was duly called and held and all proceedings duly carried out. The minutes book should be kept in the safe custody so as to avoid any tempering of the same. The minutes book relating to the general meeting is open to inspection of any member of the company without charge during business hours for at least for 2 hours.

Further, a member of the company is entitled to be furnished within Seven days of his request with a copy of any minutes of the general meeting on payment of such sum as may be prescribed.

Check Your Progress D

1) What is meant by notice of a meeting?

....

....

....

....

....

2) To whom the notice of meetings must be sent?

....

....

....

....

3) Define Quorum.

....

....

....

....

4) What is the quorum for the general meeting of members?

....

....

....

....

5) What do you understand by proxy?

....

....

....

....

6) When should a proxy be deposited with the company?

....

....

....

....

7) What is 'poll'?

....

....

....

....

8) What is a resolution?

....

....

....

....

9) What is a special resolution?

....

....

....

....

10) List three instances which require a special resolution?

....

....

....

11) What is a resolution requiring special notice?

....

....

....

....

12) Why is a chairman necessary for a meeting of a company?

....

....

....

....

13) State whether the following statements are True or False.

i) The quorum at a general meeting of a public company is the personal presence of three members.

ii) For the purposes of quorum, only members present in person and not by proxies, are to be counted.

iii) One person cannot constitute quorum under any circumstances.

iv) The proxy must be a member of the company.

v) A proxy can speak at a general meeting and cast his vote on a show of hands.

vi) A resolution put to vote at a general meeting shall be decided on a show of hands in the first instance.

vii) A poll can be demanded by any ten members of the company.

viii) An ordinary resolution is passed by a simple majority.

ix) A special resolution is passed by a two-third majority.

x) A special resolution is required to be passed for changing the name of a company.

xi) An ordinary resolution is necessary for issuing sweat equity shares.

xii) For appointing another director in place of the removed director, a resolution requiring special notice is necessary.

16.16 LET US SUM UP

The general meetings of members are of great importance in the working of the company. The members in the general meetings give the guidelines to the directors for carrying on the business of the company.

The meeting of the members can be of three types: (a) annual general meeting, (b) extraordinary general meeting, (c) Class meeting.

An annual general meeting is required to be held each year to transact ordinary business, such as presentation of audited financial statements, declaration of dividends, appointment of directors and auditors. The first annual general meeting must be held within a period of 9 months from the close of the first financial year. Subsequent annual general meetings must be held every calendar year with a gap not exceeding 15 months between the two AGMs. Besides, AGM must be held within a period of 6 months from the close of the financial year. Every person entitled to receive the notice, must get a notice at least 21 clear days before the date of the meeting.

Any meeting other than an annual general meeting is called an extraordinary general meeting. Such meetings may be convened at any time to transact some urgent business which cannot be postponed till the next annual general meeting. Such meeting can be convened by the directors either on their own motion or on requisition from members or by the requisitionists themselves on the failure of the Board to call the meeting or by the Tribunal.

The directors exercise their powers collectively at periodical meetings of the Board. Every company shall hold first meeting of the Board of directors within thirty days of its date of incorporation. It must hold minimum four meetings of the Board of directors every year. The participation of directors can be in person or through video conferencing. A meeting of the Board shall be called by giving not less than seven days in writing.

Unless the Articles provide for a larger number, the quorum shall be two members personally present in the case of a private company and **in case of a public company—**

i) 5 members personally present if the number of members present are up to 1000;

ii) 15 members personally present if the number of members present are more than 1000 but up to 5000;

iii) 30 members personally present if the number exceeds 5000.

Members of a company having share capital have a statutory right to appoint proxies. A proxy need not be a member of the company. A proxy cannot speak at the meeting but he can vote on a poll. The voting at the general meetings may be either by show of hands, through electronic mode or by taking a poll.

The decisions in meeting are taken in the form of resolutions. There are three types of resolutions : (i) ordinary, (ii) special, and (iii) resolution requiring special notice.

Ordinary resolution is one which is passed by simple majority of votes of members present in the meeting. An ordinary resolution is needed to transact ordinary business, for example, to adopt financial statements, declare dividend etc.

Special resolution is one where it is specifically mentioned in the notice calling the meeting. Such a resolution can be passed only by three-fourths majority. Special resolution is necessary for altering the Memorandum, for reducing share capital, for issue of sweat equity shares, for purchase of its own shares by a company, etc.

A resolution requiring a special notice is one where the mover of the resolution is required to give notice to the company at least 14 days before but not earlier than 3 months of the date of the meeting about the intention to move the resolution. A special notice is required before moving a resolution for removing a director before the expiry of his term, for appointing another person as a director in place of the removed director, for providing that the retiring auditors shall not be reappointed etc. Every company must keep the minutes of the meeting containing a fair and correct summary of all proceedings of the meetings. The minutes should be recorded within 30 days of the meeting in the minute book.

16.16 KEY WORDS

Meeting: An assembly of two or more persons for transacting some lawful business.

Notice: An intimation in writing about the date, day, place and time of the meeting.

Quorum: Minimum number of members who must be present at a meeting to transact a business.

Agenda: Matters to be discussed at the meeting.

Chairman: The person who presides over the meetings.

Motion: A proposal put before the meeting for consideration.

Resolution: When a motion is duly passed, it becomes a resolution or decision.

Proxy: A person appointed by the shareholder to represent and vote for him at a meeting.

Poll: A method of voting where a member records the number of votes in proportion to equity shares held by him.

Minutes: Written record of the proceedings of a meeting.

16.17 ANSWERS TO CHECK YOUR PROGRESS

B	7	i) True;	ii) False;	iii) False;	iv) True;
		v) False;	vi) True ;	vii) False;	viii) True;
		ix) False			
C	3	i) True ii) True iii) False iv) True			
D	13	i) False	ii) True	iii) False	iv) False
		v) False	vi) True	vii) False	viii) True
		ix) False	x) True	xi) False	xii) True

16.18 TERMINAL QUESTIONS

1) What are the different types of meetings of a company? Explain the purpose of holding such meetings.
2) What are the requisites of a valid meeting?
3) What is 'notice' of a meeting? Explain briefly the rules regarding the notice of general meeting.
4) What is the significance of annual general meeting? What business is generally transacted at such meetings?
5) How an extraordinary general meeting be convened?
6) What is a 'special resolution'? For what purposes are such resolutions necessary?
7) Is a special resolution and a resolution requiring special notice same thing? Indicate two instances where special notice is necessary.
8) What do you mean by 'quorum'? What happens if there is no quorum at a meeting?
9) Write an explanatory note on proxies.
10) Discuss the provisions of the Companies Act regarding the meeting of the Board of Directors.

> **Note:** These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 17 DIVIDEND

Structure

17.0 Objectives
17.1 Introduction
17.2 Meaning of Dividend
  17.2.1 Provisions Relating to Dividend
17.3 Sources of Dividend
  17.3.1 Declaration of Dividend
  17.3.2 Interim Dividend
17.4 Payment of Dividend
17.5 Unpaid Dividend
17.6 Investor Education and Protection Fund
17.7 Let Us Sum Up
17.8 Key Words
17.9 Answers to Check Your Progress
17.10 Terminal Questions

17.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of a dividend;
- describe provisions relating to dividend and its declaration;
- explain the sources of dividend and interim dividend;
- distinguish between paid and unpaid dividend; and
- explain Investor Education and Protection Fund.

17.1 INTRODUCTION

There is a difference between profit and divisible profit. All profits of a company are not divisible. Divisible profits are profits available for distribution. The profit available for dividend means profits which the directors consider should be distributed after making provision for past losses, transfer to reserves or for other purposes. In this unit you will learn about meaning and provisions relating to dividend, sources of dividend, declaration of dividend, You will also learn about payment of dividend, unpaid dividend and investor education and protection fund.

17.2 MEANING OF DIVIDEND

The word 'Dividend' has not been defined in the Act. Section 2 (35) says "Dividend includes any interim dividend". In **CIT vs Girdhar Das & Co. (P)**

Ltd (1967) 21 Comp. L J Supreme Court defined 'Dividend' as under:

"As applied to a company, which is a going concern, it ordinarily means the portion of the profit of the company which is allocated to the holders of shares in the Company". Thus, it is the share of company's profit distributed among the members not retained in the company".

Bonus shares issued by capitalising accumulated profits to existing shareholders are not dividend. Equity shares with 'differential rights as to dividend and voting' can be issued by a company (Section 43(a) (ii).

17.2.1 Provisions Relating to Dividend

The provisions relating to dividend are as follows:

i) A company may, if so authorised by its articles, pay dividend in proportion to the amount paid up on each shares (Section 51).

ii) The amount of dividend, including interim dividend shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of dividend.

iii) The dividend shall be paid to registered shareholders only or to his order or to his banker. No dividend shall be payable except in cash. Any dividend payable in cash may be paid by cheque or warrant or any other electronic mode.

iv) In case of preference shares dividend in always paid at a fixed rate.

v) No dividend can be paid if the provisions under section 73 and 76 relating to acceptance of public deposit are not complied with.

vi) The dividend not claimed within thirty days from declaration date shall be transferred to 'unpaid dividend account'.

17.3 SOURCES OF DIVIDEND

The dividend may be paid:

i) Out of profits of current financial year after deducting depreciation in accordance with provisions of Schedule II **or**

ii) Out of profits for any previous financial year or years arrived at after providing for depreciation as per schedule II and remaining undistributed or out of the reserves **or**

   Out of Both (i) and (ii)

   But in computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an assets or of a liability on measurement of the asset or liability at fair value shall be excluded **or**

iii) Out of money provided by Central or State Government for payment of dividend by the company in pursuance of a guarantee given by that government.

   a) Provided the company may, before declaration of dividend in any financial year, as it may consider appropriate transfer such percentage of its profits to the Reserves.

b) Provided due to inadequate or absence of profits in any financial year, any company proposes to declare dividend out of accumulated profits earned by it in previous years and transferred by company to the free reserves, such declaration shall be made according to rules framed by Central Government.

17.3.1 Declaration of Dividend

i) No Dividend shall be declared or paid by a company from its reserves other than free reserves.

ii) A company shall not declare dividend unless carried over previous losses and deprecation not provided in previous year or years are set off against profits of the company of the current year.

iii) A company which fails to comply with provisions of Section 73 and 74 (acceptance and repayment of public deposits) shall not, so long as such failure continues, declare any dividend on its equity shares.

iv) In case of preference shares, under Section 43(a), payment of dividend, either a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax, be paid before equity shares.

v) The company in annual general meeting may declare dividend, but no dividend shall exceed the amount recommended by the Board (Table F(80). However a company which could not declare dividend at an annual general meeting may do so at a subsequent general meeting.

17.3.2 Interim Dividend

A company may distribute a part of the profits before its final accounts are passed and dividends are declared in the annual general meeting. Such dividends are called "Interim Dividends".

The provisions relating to interim dividend as per section 123(3) are as follows:

1) The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of annual general meeting out of the surplus in the profits and loss account or out of profits of the financial year in which such interim dividend is sought to be declared or out of profits generated in the financial year till quarter preceding the date of declaration of the interim dividend.

   Provided that in case the company incurred loss during the financial year upto the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during immediately preceding three financial years.

2) Table F(81) lays down that subject to Section 123, the Board may from time to time pay to the members such interim dividend as appear to it to be justified by the profits of the company.

3) Interim dividend like final dividend is considered as a debt due. Directors cannot revoke it by a resolution except under circumstances under which final dividend may be revoked.

   A general meeting cannot pass a resolution for payment of interim dividend. It may rescind it before payment is made.

Check Your Progress A

1) What is dividend?

....

....

....

....

3) What is interim dividend?

....

....

....

4) State whether the following statement are True or False.

   a) Decision by directors to pay an interim dividend does not create a debt.

   b) Preference Shares have an inherent right to a fixed dividend.

   c) Payment of dividend can be effected by credit to a shareholders account.

   d) Divisible profits and profits are the same.

   e) A decision for payment of final dividend can be revoked.

17.4 PAYMENT OF DIVIDEND

i) No dividend shall be paid by a company except to the registered shareholder of such share or to his order or to his banker.

ii) If transfer of shares has not been registered, it shall transfer dividend to 'Unpaid Dividend Account'.

   The shareholder can authorise company in writing to pay dividend to the transferee as mentioned in instrument of transfer.

iii) No dividend shall be paid except in cash or by cheque or by electric mode or by warrant. However, capitalisation of profit or reserves of the company for the purpose of issuing fully paid up bonus shares or paying up any amount, for the time being unpaid on any shares held by the members of the company is not prohibited.

iv) In case of joint shareholders, dividend shall be paid to shareholder whose name appears first in the register of members, or such person and to such address as the holder or joint holders may in writing direct.

v) The amount of dividend, including interim dividend, shall be deposited in a scheduled bank within five days of the date of declaration of such dividend by the company (except a Government Company).

vi) Dividend warrant or cheque should be posted within thirty days. It is not an offence if the shareholder does not receives it or not within this time.

Penalty : In case of failure to distribute dividend, every director of the company, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine, which shall not be less than one thousand rupees for every day during which such a default continues and company shall be liable to pay simple interest at the rate of eighteen percent per annum during the period for which such default continues

Defences:

a) Where the dividend could not be paid by reason of the operation of any law.

b) Where a shareholder has given direction to the company regarding the payment of dividend and those directions cannot be complied with and the same has been communicated to him.

c) Where there is a dispute regarding the right to receive the dividend.

d) Where dividend has been lawfully adjusted by the company against any sum due to it.

e) Where for any other reasons, failure to pay the dividend or to post the warrant within the specified period was not due to any default on the part of the company.

17.5 UNPAID AND UNCLAIMED DIVIDEND

According to Section 124 where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called “unpaid dividend account”.

The company shall within a period of ninety days of making any transfer to unpaid dividend account prepare a statement containing names, their last known address and the unpaid dividend to be paid to each person and place it on the website of the company, if any or any other website.

If any default is made in transferring the total amount, it shall pay from the date of such default, interest on so much of the amount as has not been transferred, the company shall pay interest at the rate of 12% p.a.

Any person claiming dividend shall apply to the company. All money transferred to unpaid dividend account, unpaid or unclaimed for a period of seven years shall be transferred to the fund established under section 125(1) **Investor Education and Protection Fund** to be managed by administrating authority of the fund, which will issue a receipt to the company.

All shares in respect of which dividend has not been paid or claimed for seven consecutive years or more shall be transferred by the company in the name of aforesaid Fund. However any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Educational Protection Fund in accordance with such procedure and on submission of such document as may be prescribed.

Penalty : If the company fails to comply with any requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees, but which may be extended to twenty five lakhs rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupee but which may extend to five lakh rupees. [Sub Section (7)].

17.6 INVESTOR EDUCATION AND PROTECTION FUND

The Central Government set up this Fund Under Companies Act, 1956. The Companies Act, 2013, under section 125 lays down the sources and purposes for which the fund monies can be utilised. An authority called "Investor Education and Protection Fund Authority" administers it. It has a chairperson, members not exceeding seven and a Chief Executive Officer.

Sources: The following amount shall be credited to the funds:

a) The amount given by Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the fund;

b) Donations given to the Fund by the Central Government, State Governments, companies or any other institution;

c) The amount in the Unpaid Dividend Account of Companies;

d) The amount in the general revenue account of the Central Government and amount lying in the Fund under the Companies Act 1956 as it stood immediately before the commencement of the Companies (Amendment) Act 1999 and remaining unpaid or unclaimed on the Commencement of this Act.

e) The amount lying in the investor Education and Protection Fund under Section 205C of Companies Act, 1956.

f) Interest or other income received out of investment made from the fund;

g) Amount received under section 38(4) i.e., amount received through disgorgement or disposal of securities;

h) The application money received by companies for allotment of any securities and due for refund;

i) Matured deposits with companies (except banking companies);

j) Matured debentives with companies;

k) Interest accrued on amounts referred above in (g) and (h);

l) Sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

m) Redemption amount of preference shares remaining unpaid or unclaimed for seven or more years.

n) Such other amount as may be prescribed.

Amount referred in (h) to (j) will not form part of the fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

Utilisation : The fund shall be utilized for :

a) The refund in respect of unclaimed dividends, matured deposits, matured debentures, application money due for refund and interest thereon;

b) Promotion of investors' education, awareness and protection;

c) Distribution of any disgorged amount among eligible and identifiable applicants for shares, or debentures, shareholders, debenture holders or depositors who have suffered losses due to wrong action by any person, in accordance with the orders made by the court which has ordered disgorgement;

d) Reimbursement of legal expenses incurred in pursing class action suits by members, debenture holders or depositors as may be sanctioned by the Tribunal; and

e) Any other purpose incidental thereto.

Check Your Progress B

1) What is investor education and investor fund?

....

....

....

2) What are the penalties if the dividend is not paid by the Company?

....

....

....

3) Mention any four sources of 'Investor Education and Protection Fund'.

....

....

....

4) Fill in the blanks:

   a) The shareholder can transfer in writing the dividend to ....

   b) In case of joint shareholders, dividend should be paid to ....

   c) The dividend declared by a company has not been paid or claimed within thirty days is transferred to..................

   d) All shares in respect of which dividend has not been paid or claimed for a period of seven consecutive years shall be transferred by the company to..................

17.7 LET US SUM UP

There is a difference between profits and divisiable profits available for. It may be paid out of profits or past revenues. Dividend is paid at a fixed rate amount to preference shareholders. Interim Dividend is dividend paid between two annual general meetings. Dividend is paid to registered shareholder or to his order or to his banker. Dividend, including interim dividend shall be deposited in a scheduled bank in a separate account within five days from its declaration. Dividend payable in cash may be paid by cheque or warrant. Unclaimed and unpaid dividend within 30 days from its declaration, shall be deposited in separate account 'unpaid dividend account' within 7 days after expiry of said 30 days by the company. The amount in the unpaid account is transferred to 'Investor Education and Protection Fund'. The dividend is to be credited to this fund should not have been paid or claimed for seven consecutive years or more.

17.8 KEY WORDS

Dividend: It is that share of company's profit which is distributed among the members.

Interim Dividend : The dividend that is declared and paid in the middle of an accounting year before a company has determined its year earnings, of the year.

Investor Education and Protection Fund (IEPF): The fund created by the Central Government under provisions of Company Act. The fund is utilised for promoting investor awareness and protection of investor interest.

17.9 ANSWER TO CHECK YOUR PROGRESS

A) 4 (a) false (b) true (c) true (d) false (e) false

B) 4 (a) to any person (b) shareholder whose name appears first (c) unclaimed dividend account (d) Investor Education and Protection Fund

17.10 TERMINAL QUESTIONS

1) What are the provision of the Act relating to unpaid and unclaimed dividend?

2) Discuss "Investor education and protection fund".

3) "Dividend cannot be paid by a company except out of profit". Discuss.

4) Explain the rules relating to interim dividend.

5) What provisions and rules have been observed by a company before declaring dividend?

> **Note:** These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 18 ACCOUNTS

Structure

18.0 Objectives

18.1 Introduction

18.2 Books of Account to be Kept

18.3 Inspection of Books of Account

18.3.1 Persons Responsible for Keeping Books of Account

18.3.2 Books of Account of a Branch

18.3.3 Period for which Account Books to be Retained

18.3.4 Reopening of Accounts on Court or Tribunal Order

18.3.5 Voluntary Revision of Financial Statements

18.4 Financial Statements

18.5 Provisions Relating to Books of Accounts

18.6 Corporate Social Responsibility Committee

18.7 Let Us Sum Up

18.8 Key Words

18.9 Answers to Check Your Progress

18.10 Terminal Questions

18.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the books of account kept by a company and persons responsible for keeping them;
- explain how inspection of books of account is done;
- discuss voluntary revisions of financial statements and accounts books of a branch;
- describe the various legal provisions relating to books of account; and
- discuss about corporate social responsibility committee.

18.1 INTRODUCTION

The 'books of account' are to be maintained by a company as per Companies Act. The form of Balance Sheet and Profit and Loss Account is prescribed in schedule III of the Act. In consolidated financial statements additional information is to be given of parent and subsidiaries (Indian and Foreign), minority interest in all subsidiaries Associates (Indian and Foreign) and Joint Ventures (Indian and Foreign). The Financial statements should be prepared according to prescribed accounting standards. The rates of depreciation for assets are prescribed in Schedule II. In this unit you will study about Books of Accounts to be kept, inspection of Books of Accounts, Persons responsible for keeping them and accounts books of a branches. You will also learn about period for which these books are retained, reopening of books of account and provisions relating to book of account and corporate social responsibility committee.

18.2 BOOKS OF ACCOUNT TO BE KEPT

The Books of Account include record maintained with respect to :

a) All sums of money received and expended by the company and the matters in respect of which receipts and expenditure take place;

b) All sales and purchases of goods by the company;

c) All assets and liabilities of the company; and

d) The items of cost as may be prescribed (Section 2(13)).

Every Company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of affairs of the company, including that of its branch office or offices, if any, and explain transactions effected both at registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The Books of account should be kept at the registered office of the company unless decided by Board of Directors at other place. In such a case company is required to file full address of that other place by giving a written notice to the Registrar within seven days. Branch office is required to send proper summarised returns to the Head Office or other place referred.

The Company may maintain books of account and other relevant documents in electronic form. (Section 128(1). The Proper books of account constitute such books of account as are necessary to exhibit and explain transactions and the financial position of the business of the company. The proper books of account also include Cost Accounting records and stock records. The Central Government may order that companies engaged in production of such goods or providing such services, as may be prescribed, to maintain detailed cost records including utilization of material or labour or other items of cost.

18.3 INSPECTION OF BOOKS OF ACCOUNT

Books of account and other books and papers shall be open for inspection by any director during business hours. Inspection of a subsidiary company accounts is permitted only by a person duly authorised by the Board of Directors by passing resolution in this regard (Section 128(3)).

The Registrar, by a written notice, may call on the company to produce the books of account, books, papers and explanations as may be required (Section 206(1)).

The Registrar shall record his reasons in writing for issuing such notice.

The Central Government also may appoint an inspector to carry out inspection of books of account and papers to investigate into the affairs of the company (Section 206 (5)).

The Directors, officers and employees of the company are duty bound to produce all such documents, other statements, information and explanations before the registrar or inspector. Registrar or inspector can make or cause to be made copies of books and account and other books and papers.

When default is made by any director, officer or employee in above matters, they shall be punishable with fine which shall not be less than rupees twenty five thousand, but which may extend to rupees one lakh and also with imprisonment for a term which may extend to one year. Further, the director or officer, if convicted, shall, on and from the date of conviction, be deemed to have vacated his office as such and shall be disqualified for holding such office in any company. This disqualification extends to private companies as well (Section 207(1)).

18.3.1 Persons Responsible for Keeping Books of Account

The managing director, the whole time director in charge of finance, the Chief financial officer or any other person who has been given the responsibility of keeping proper books of account and other matters shall be held responsible for keeping proper books of account.

Punishment : In case of contravention of these provisions, the above persons shall be punishable with imprisonment for a term which may extent to one year or with fine which shall not be less than rupees fifty thousand, but which may extend to five lakh rupee or both. There is no provision in the Act to prosecute the company concerned. Only the functionaries identified in these sections who alone can be charged and prosecuted.

18.3.2 Books of Account of a Branch

Where a company has branch office in or outside India, the books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are to be sent by the branch office to the company at its registered office or at any other specified place (Section 128(2)).

18.3.3 Period for which Books of Account to be Retained

The books of accounts of every company relating to the period of not less than eight years immediately preceding the current year shall be preserved in good order, along with relevant vouchers. If the company is in existence for less than eight years, then it should keep books of account and related vouchers in good order right from the first accounting year of the company Section 128(5).

18.3.4 Re-Opening of Accounts on Court's or Tribunal's Order

A company shall not reopen its books of account and shall not recast its financial statements, unless an application in this regard is made by the Central Government, Income tax authorities, the Securities and Exchange Board, any other statutory body or authority or any person concerned and an order is made by Court or Tribunal to that effect that –

i) The relevant earlier account were made in a fraudulent manner; or

ii) The affairs of the company were mismanaged during a relevant period, casting a doubt on the reliability of financial statements.

The Court or Tribunal shall take into consideration the representations if any, made by above authorities.

No order shall be made in respect of reopening of books of account relating to a period earlier than eight financial years immediately preceding current financial year. The Central Government may order more than eight years for reopening the accounts (Section 130), if the central government has ordered that books of accounts to be kept for more than eight years. The accounts so revised shall be final.

18.3.5 Voluntary Revision of Financial Statements or Board's Report

If it appears to directors of the company that

a) the financial statements of the company ; or

b) the report of the Board do not comply the legal provisions, they may prepare a revised financial statements or revised report in respect of any three financial years after taking the approval of the Tribunal, on an application made by the company, and a copy of the order passed by Tribunal shall be filed with the Registrar.

The Tribunal shall give a notice to the Central Government and income tax authorities. The revised financial statement or report shall not be prepared or filed more than once in a financial year. The detailed reasons for revision of such financial statement or Board's report shall be given in Board's report.

18.4 FINANCIAL STATEMENTS

"Financial Statements" in relation to a company include:

i) a balance sheet at the end of the financial year;

ii) A profit and Loss account; in case of company carrying on any activity not for profit, an income and expenditure account for the financial year;

iii) Cash Flow Statement for the financial year;

iv) A statement of changes in equity, if applicable; and

v) Any explanatory note annexed to or forming part of, any document referred to in (i) to (iv) above (Section 2(40)).

The cash flow statement need not be prepared in case of one person company and small company.

18.5 PROVISIONS RELATING TO FINANCIAL STATEMENTS

i) Financial statements shall give a true and fair view of the state of affairs of the company. (except insurance company or banking company or company engaged in generation or supply of electricity. To such companies their respective Acts apply). The financial statements shall be in accordance with accounting standards as per section 133.

ii) Where a company has one or more subsidiaries or associate companies, a consolidated financial statement of such companies shall be laid before the annual general meeting. A separate statement with salient features of financial statements of such companies shall be attached with company financial statements. Copies of financial statements including consolidated financial statements shall be filed with the Registrar.

iii) According to Section134(1) the financial statements including consolidated financial statement, if any, shall be approved by the Board of Directors. They shall be signed at least by the chairperson of Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer. They are also required to be signed by Chief Financial Officer and the Company Secretary of the company if appointed, and in case of one man company, only by one director. The financial statements of all companies shall be approved by the Board of directors before they are signed on behalf of the Board in accordance with this section and before they are submitted to the auditors for their report.

iv) Each member shall have right to get a copy of audited financial statements.

v) The various documents shall be attached to every financial statement which include:

   a) The auditor's report;

   b) The report by the Board of Directors. Among others, this report shall include:

      i) The web address, if any, when annual return has been placed;

      ii) Number of meetings of the Board;

      iii) Directors Responsibility Statement;

      iv) Details about fraud reported by auditors;

      v) A statement on declaration given by independent directors;

      vi) The state of company affairs;

      vii) The applicable accounting standards (Section 134);

      viii) The Composition of Corporate Social Responsibility Committee (Section 135);

      ix) Patriculars of loans, guarantees or investments (Section 186);

      x) The amount, if any, proposed to carry to any reserve;

      xi) The amount, if any, recommended to be paid by very of dividend.

18.6 CORPORATE SOCIAL RESPONSIBILITY COMMITTEE

Every Company having a net worth of rupees five hundred crore or more or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be independent direct. If there is no independent director two or more directors shall constitute CSR Committee.

The CSR Committee shall (a) formulate and recommend to the Board CSR policy which shall indicate to the activities to be undertaken by the company in areas or subjects as prescribe in schedule VII (amended in 2014) (b) recommend the amount of expenditure to be incurred on such activities (c) monitor the CSR policy of the company from time to time.

The company shall spend in every financial year, at least two per cent of the average net profit made during three immediately preceding financial years in the pursuance of CSR policy.

The company shall give preference to the local areas and areas around it where it operates for spending the amount ear marked for CSR activities.

Check Your Progress A

1) What is 'books of account'?

....

....

....

2) What are Financial Statements?

....

....

....

3) State whether following statements are True or False.

   a) Items of Cost may not be included in 'Books of account'.

   b) Chief Financial Officer also has responsibility for keeping proper "Books of Account".

   c) For preparation of financial statements accounting standards are compulsory to be complied with.

   d) Members are not authorised to get copy of the audited financial statements.

4) Fill in the Blanks

   i) Company ______________ reopen books of account.

   ii) The Registrar may call on the company to _______________ Books of Account.

   iii) Securities and Exchange Board of India can apply to Tribunal for ____________ of a company.

   iv) Corporate Social Responsibility Committee of Board should consist three or more directors with at least one ____________________

   v) Financial statements also includes ________________ statement.

18.6 LET US SUM UP

The Act requires a company to keep at its registered office certain books, known as statutory books and also keep copies of certain documents and deed. Among various statutory books are Books of Account. Books of account are to be kept at registerd office of the company unless decided by the Board of Directors to keep it at other place. The Registrar is to be informed. The transactions that effect only branch in or outside India, they are to be kept there. The books of account are open for inspection at head office. The books of accounts are to be kept for a period of at least eight years. The managing director, whole time director of finance, the Chief finance officer or any other person given such responsibility are responsible for keeping proper books of accounts.

The Financial Statements along with directors report and explanations are to be circulated to each member, be presented in general meeting and a copy should be sent to Registrar. They should be drawn according to format given in Schedule III and accounting standards. They can be reopened by Court or Tribunal on their own or on application of central government, income tax authorities and securities and Exchange Board of India. Insurance companies and Banking Companies have to draw their financial statements as per law relating to them.

The Act requires certain companies to constitute a Social Responsibility Committee of the Board. Board's report shall include report on CSR. The amount to be spent on CSR areas is given in schedule VII of the act.

18.7 KEY WORDS

Books of Account: It includes record maintained with respect to all sums of many received and expanded. Sales and purchases, assets and liabilities and items of cost.

Financial Statement : This include balance sheet, profit and loss accounts, cash flow statement, a statement of changes in equity.

18.8 ANSWERS TO CHECK YOUR PROGRESS

4. (a) False (b) True (c) True (d) False (e) True
5. (i) Can (ii) Produce
2. Reopening of Accounts (iv) Independent Director

   (v) Cash Flow

18.9 TERMINAL QUESTIONS

1) How the inspection of books of accounts is done. Explain
2) The Books of Account can be re-opened. Discuss.
3) Who are the responsible persons for keeping books of account?
4) What are the provisions relating to financial statements?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 19 AUDIT

Structure

19.0 Objectives

19.1 Introduction

19.2 Provisions Relating to Audit

19.3 Appointment of an Auditor

19.3.1 Who can be Appointed as an Auditor

19.3.2 Who cannot be Appointed as an Auditor

19.3.2.1 Disqualification due to Fraudulent Acts

19.3.2.2 Disqualification due to Professional Misconduct

19.3.3 Appointment of First and Subsequent Auditors, Tenure of Appointment and Ceiling on Audit

19.3.4 Casual Vacancy, Resignation and Removal of an Auditor

19.4 Rotation of an Auditor

19.5 Rights of an Auditor

19.6 Auditor's Report

19.7 Secretarial Audit

19.8 Let Us Sum Up

19.9 Key Word

19.10 Answers to Check Your Progress

19.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe provisions relating to audit;
- explain appointment, tenure and rotation of an auditor;
- describe the contents of an audit report; and
- discuss Secretarial Audit.

19.1 INTRODUCTION

After the financial statements are ready, they need to audited. The object of audit is two fold (a) to detect and prevent errors and (b) to detect and prevent frauds. Every concern, small or big, sole proprietorship, partnership or company etc. should get accounts audited. For listed companies and for specified unlisted public companies and private companies accounts must be audited compulsorily. An auditor must be a qualified chartered accountant certain companies must have internal audit department. Cost audit is done by a qualified cost accountant. An auditor has certain rights and duties as well. Any breach of legal duty by an auditor invites punishment under Act. An auditor has to follow the prescribed auditing standards. In this unit, you will learn about provisions relating to audit, appointment of an auditor, qualifications, disqualifications, first auditor, subsequent auditor, tenure and ceiling. You will also learn about rotation of an auditor, auditor's report and secretarial autit.

19.2 PROVISIONS RELATING TO AUDIT

1) **Audit Committee :** The Board of Directors of every listed public company or such other class or classes of companies, as may be prescribed shall constitute an audit committee. It shall consist of minimum three directors with independent directors forming a majority. The Chairman and majority of members should have ability to read and understand the financial statements. The Committee shall have terms of reference as may be specified by the Board of Directors. The terms of reference, amongst others, shall include:

    i) The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

    ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process;

    iii) Examination of financial statements and auditor's report thereon;

    iv) Approval or any subsequent modification of transactions of the company with related parties.

        Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the Company subject to such conditions as may be prescribed.

        Provided further that in case of transactions other than third partly related transactions and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.

        Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

        Provided that these provisions shall not apply to a transaction between holding company and its wholly owned subsidiary.

    v) Scrutiny of inter corporate loan and investment

    vi) Valuation of undertaking or assets of the company

    vii) Evaluation of internal financial controls and risk management systems

    viii) Monitoring the end use of funds through public offers and related matters.

The Committee shall have to hear at their meetings the auditors and other managerial personnel. A vigil mechanism for directors and employees shall be established to report genuine concerns, and the committee shall make provision for adequate safeguard against victimisation of persons using the mechanism and provide direct access to chairperson of the Audit Committee (Section 177)

2) **Internal Audit :** Internal audit may be conducted by the employees of company or by a Chartered Accountant or a Cost Accountant or any other professional. The scope, period, functioning and methodology shall be determined by Audit Committee. It is mandatory to appoint an internal auditor by listed or unlisted company having paid up share capital of rupees fifty crores or more or turnover of rupees two hundred crores rupees or more during the preceding financial year or outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more or outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year. Every private company also having turnover of rupees two hundred crore rupees or more or outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during preceding financial year shall appoint an internal auditor (Section 138).

3) **Cost Audit :** This audit is done for verifying cost of manufacture or production of an article on the basis of accounts as regards utilisation of materials or labour or other items of cost maintained by the company. Only a cost accountant holding valid certificate of practice from Institute of Cost and Management Accountants of India can conduct such audit. The Cost Audit is conducted in addition to audit of financial statements. The cost auditor shall comply with costing standards, as are issued by Institute of Cost and Management Accountant of India (Section 148). The cost auditor is subject to the same qualifications, disqualifications rights, duties and obligations as prescribed under section 143 of the Act for the auditors appointed under Section 139.

4) **Auditing Standards :** Section 141 (9) requires the auditor to comply with the auditing standards as laid down by the Institute of Chartered Accountants of India in consultation with the National Financial Reporting Authority.

19.3 APPOINTMENT OF AN AUDITOR

19.3.1 Who can be Appointed as an Auditor (Qualifications)

Section 141(1) of the act prescribes the qualifications and disqualifications for the appointment of an auditor.

1) A person shall be eligible for appointment or reappointment as an auditor, commonly called statutory auditor, only if he is a Chartered Accountant i.e., who holds a valid certificate of practice under Chartered Accountants Act, 1949. (Section 141(1)).

2) Where a firm including limited liability partnership is appointed as an auditor or reappointed, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.

19.3.2 Who cannot be Appointed as an Auditor (Disqualifications)

The following persons/entities cannot be appointed as an auditor of a company [Section 141 (3)].

a) A body corporate other than a limited liability partnership registered under the limited liability Partnership Act, 2008;

b) An officer or employee of the company;

c) A person who is a partners or who is in the employment, of an officer or employee of the company;

d) A person who or his relative or partner:

   i) is holding any security of or interest in the company or its subsidiary or of its holding or associate company or a subsidiary of such holding company. However, the relative may hold security or interest in the company of face value not exceeding, one thousand rupees or such sum as may be prescribed;

   ii) is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; **or**

   iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company for such amount as may be prescribed;

e) A person or a firm, whether directly or indirectly has business relationship with the company or its subsidiary or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

f) A person whose relative is a director or is in employment of the company as a director or key managerial personnel;

g) A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor. If such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

h) A person who has been convicted of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

i) A person who, directly or indirectly, renders any service prohibited to the company or its subsidiary company.

19.3.2.1 Disqualification due to Fraudulent Acts

The Tribunal either **Suo Motu** (on its own) or on an application by the Central Government or by any person concerned, is satisfied that auditor, directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by or in relation to the Company or directors or officers direct the company to change the auditors. Within fifteen days on application of Central Government, the Tribunal may order and Central Government may appoint any other Auditor. An auditor against whom a final order has been passed shall not be eligible for appointment as an auditor of any company for a period of five years from the date of passing the order. He shall be tried for offence of fraud.

19.3.2.2 Disqualification due to Professional Misconduct

In case of professional or other misconduct, the National Financial Reporting Authority (NFRA) has the power to debar the member or the firm from being appointed as an auditor or internal auditor for undertaking any audit in respect of financial statements or internal audit of functions or activities of any company or body corporate or performing any valuation as provided under Section 247. The debarment would be for a minimum period of six months but may extend upto ten years [(Section 132(4)].

19.3.3 Appointment of First and Subsequent Auditors, Tenure of Appointment and Ceiling on Audit

The first auditors shall be appointed by Board of Directors within thirty days from the date of registration of the company. The first auditor/auditors shall hold office until the conclusion of first annual general meeting. If the first auditor is not appointed by the Board then members shall appoint first auditors in an extraordinary general meeting.

As per section 139(1) an auditor is appointed by the company from the conclusion of first annual general meeting until sixth annual general meeting and thereafter till the conclusion of every sixth meeting. If the annual general meeting is adjourned, the auditor shall continue till the conclusion of adjourned meeting. The matter relating to such appointment shall be placed for ratification by members at every annual general meeting. The subsequent auditor/auditors are appointed by members in annual general meeting by passing an ordinary resolution. The company has a right to remove the auditor before the tenure is over. Similarly, an auditor may resign from his office before his term is over, but he has to clearly state his reasons of resignation.

A person cannot be an auditor of more than twenty companies. Only public companies and private companies having paid up capital of Rupees one hundred crore or more are to be considered. One person companies, small companies and private companies having paid up capital less than rupees one hundred crore are excluded in this counting.

19.3.4 Casual Vacancy, Resignation and Removal of an Auditor

j) If there arises a casual vacancy by any reason other than resignation by the auditor, the Board of Director has the power to appoint the auditor within thirty days.

ii) If casual vacancy is caused by resignation of auditor, it can be filled only by company in general meeting to be convened within three months of the recommendation of Board.

iii) If auditor resigns before his term he needs to file a statement within thirty days of his resignation with the Registrar, failure to file a statement would make him liable to a penalty fifty thousand rupees or an amount equal to his remuneration, whichever is less. If the failure continues, a further penalty of five hundred rupees each day after the first during which such failure continues, however it cannot exceed five lakh rupees.

iv) An auditor may be removed before the expiry of the term by passing a special resolution after obtaining prior approval of the Central Government and giving the auditor a reasonable opportunity of being heard. The matter of his removal is first consideration at Board meeting and Board's resolution is passed. Within sixty days of the Central Government approval , the general meeting of members shall be held for passing the special resolution.

19.4 ROTATION OF AN AUDITOR

The Act provides for compulsory rotation of the auditors for listed companies, unlisted public companies having paid up capital of rupee ten crore or more and all private limited companies with paid up share capital of twenty crores or more. Companies having public borrowings from financial institutions, banks or public deposits of rupees fifty crore or more are also covered even if their paid up capital be lower than amount prescribed.

No listed company or a company belonging to such class or classes of companies as may be prescribed shall appoint or reappoint:

a) an individual as a auditor for more than one term of **five** consecutive years in the same company whereas

b) an audit firm as auditor for more than two terms of five consecutive years in the same company.

A company may resolve to appoint more than one auditor to audit its accounts. In such a case the company may follow the rotation of auditors in such a manner that both or all of the joint auditor do not complete their term in same year.

As per provisio to Section 139(2) an individual auditor or audit firm that has completed the prescribed tenure of five or ten consecutive years respectively shall have a cooling off period of five years during which it shall not be eligible for reappointment as auditor in the same company. The act has prescribed a company break up of five years before an auditor or a firm becomes eligible for reappointment as auditor in the same company.

In case of central or State Government owned companies or jointly owned by them, the Comptroller and Auditor General of India shall appoint a duly qualified auditor (section 139).

19.5 RIGHTS OF AN AUDITOR

The rights of an auditor are as follows:

i) Rights to access the books and account.

ii) Right to obtain explanation or information.

iii) Right to sign the report.

iv) Right to receive notice of general meetings.

vi) Right to visit the branch offices.

vii) Right to claim remuneration.

The remuneration of an auditor is fixed by the company in the general meeting or in a manner as may be determined in the general meeting. In case of first auditor/auditors remuneration may be fixed the Board. The remuneration mentioned shall in addition to the fee payable to an auditor, includes the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him.

An auditor cannot render certain services like internal audit, actuarial services, investment services, management services and account and book keeping services and any other kind of services as may be prescribed.

19.6 AUDITOR'S REPORT

The auditor has a duty to report to members on the accounts examined by him and on every financial statements which are required to be laid before the company in general meeting. The report shall also confirm that accounting and auditing standards have been followed and matters which are required to be included have been duly included.

The auditor should report whether to the best of his information and knowledge the said accounts and financial statements give a True and Fair view of the state of affairs at the end of financial year and Profit and Loss and cash flows for the financial year.

The auditor shall include in his report the following:

a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for audit.

b) Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him.

c) Whether the report on accounts of any branch office audited under section 143 (8) by a person other than company's auditor has been sent to him and how he has dealt with the same in preparing auditor's report.

d) Whether company's Balance Sheet and Profit and Loss Account dealt with in the report are in agreement with books of account and returns.

e) Whether the report the Profit and Loss Account and Balance Sheet have complied with accounting standards.

f) The observations and comments of the auditor on financial transactions or matters which have any adverse effect on the functioning of the company.

g) Whether any director is disqualified from being appointed as director.

h) Any qualification, reservation or adverse remarks regarding maintenance of accounts and other matter connected therewith.

i) Whether the company has adequate internal financial controls with reference to financial statements in place and operative effectiveness of such controls.

j) Other matters to be reported :

   i) Whether the company has disclosed the impact, if any, of pending litigation on its financial position in its financial statements.

   ii) Whether the company has made provisions as required under any law or accounting standards for material foreseeable losses, if any, on long term contracts including derivatives contracts.

iii) Whether there has been any delay in transferring amounts required to be transferred to Investors Education and Protection Fund by the Company (Section 143).

19.7 SECRETARIAL AUDIT

According to Section 204 (1) the following types of companies shall have mandatory secretarial audit and the secretarial report by a secretary in practice.

i) Every listed company;

ii) Every public company having a paid up capital of rupee fifty crore or more; or

iii) Every public company having a turnover of rupees two hundred and fifty crore or more.

The secretarial audit is required to be conducted by a company secretary in practice.

The secretary in practice report shall be annexed to the Board's report. The company shall provide all assistance and facilities to the company secretary in practice. The Board shall explain about any qualification or reservation or other remarks made in secretary in practice report.

The company or any officer shall be fined rupees not less than rupees one lakh but which may extend to rupees five lakhs in case of any contravention. The secretary in practice may also be fined similarly. (Section 204).

Check Your Progress A

1) Who can be appointed as an auditor?

....

....

....

2) What is an audit committee?

....

....

....

3) State whether following statements are True or False

a) A firm of auditors can be appointed as an auditor of a company.

b) An officer or employee of the company cannot be appointed as an auditor.

c) Sometimes the first auditor(s) is are named in Articles of Association.

d) The auditors of a listed company may not be compulsorily rotated.

e) An auditor cannot be removed before the expiry of his term.

f) The Profit and Loss Account and Balance Sheet, in the opinion of the auditor, should comply with auditing standards.

4 Fill in the blanks:

i) A person cannot be an auditor of more than_________________ companies.

ii) The first auditor or auditors of a company shall be appointed by the Board of Directors within _________ days.

iii) The period of rotation of an auditor is __________ consecutive years.

iv) The auditor's report should state that the accounts and financial statements give a ____________ state of company's affairs.

v) Secretarial Audit should be done by a ___________________ .

19.8 LET US SUM UP

Only Chartered Accountant holding a certificate of practice is eligible to be appointed as an auditor. Cost audit can only be done by a cost accountant holding a valid certificate of practice. The secretariat audit is required to be conducted by company secretary in practice. A person cannot be an auditor of more than twenty companies. First auditors of a company are appointed by Board of directors, subsequent auditors shall be appointed in first annual general meeting An individual shall hold office for a period of five consecutive years. A retiring auditor shall be reappointed subject to certain conditions. An auditor can resign at any time. An auditor can be removed before expiry of his term. An auditor has certain rights e.g. to attend annual general meeting or to sign audit report etc. An Auditor is required to give his report on certain specified matters and language. He should conduct audit according to auditing standards. He can be penalised for contravention of provisions under section 139 to 146. A company should have an audit committee of the Board of directors. The remuneration of an auditor, cost auditor and auditor for secretarial audit is determined by members in general meeting. There should be an internal audit department for certain companies.

19.9 KEY WORDS

Audit : It is official examination and inspection of books of account by an auditor.

Secretarial Audit: It is required to be conducted by a Company Secretary in practice.

19.10 ANSWERS TO CHECK YOUR PROGRESS

3) (a) True (b) True (c) True (d) False (e) False (f) true

4) (i) 20 (ii) 30 (iii) Five (iv) True and fair

(v) Company Secretary in practice.

19.10 TERMINAL QUESTIONS

1) Describe the provisions relating to audit.
2) Discuss the qualifications and disqualifications of an auditor.
3) What is secretarial audit?
4) How first and subsequent auditors are appointed?
5) Discuss about the ceiling, rotation and removal of an auditor.
6) When auditor's report is given ? What information is given in auditor's report?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 20 WINDING UP

Structure

20.0 Objectives

20.1 Introduction

20.2 Meaning of Winding Up

20.3 Modes of Winding Up

20.4 Procedures for Winding Up Order

20.4.1 Preferential Payments

20.4.2 Contributory

20.5 Removal of Name of a Company

20.6 Let Us Sum Up

20.7 Key Words

20.8 Answers to Check Your Progress

20.9 Terminal Questions

20.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of winding up of a company;
- distinguish between winding up and dissolution of a company;
- describe the modes of winding up of a company;
- explain the procedure for winding up of a company;
- define preferential payments and contributory; and
- explain the procedure for removal of name of a company.

20.1 INTRODUCTION

A company is a person, artificial, invisible, intangible and exists in the eyes of law. It has a perpetual succession. It never dies. The end of a company comes only through its winding up procedure. The Companies Act 2013 came into force on 29th August, 2013. It has been amended in 2015, 2017, 2018 and 2019. Latest changes have been brought by the Insolvency and Bankruptcy Code 2016, mainly in provisions of winding up of a company. The mode of voluntary winding up has totally been dropped by this code given in part II from sections 304 to 323 of the Act 2013. A company now be wound up under the Companies Act, 2013 only by the tribunal. In this unit you will learn about meaning of winding up, difference between winding up and dissolution, modes of winding; procedures for winding up, and preferential payments and contributory and removal of the name of the company.

20.2 MEANING OF WINDING UP

The "winding up" or "liquidation" is a process of bringing about an end to the life of a company. In the words of Gower "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 liabilities and finally distributes the surplus among the members in accordance with their rights.

Even a solvent company may be wound up. After winding up, a company is "Dissolved formally and will not have any assets or liabilities. The legal personality of the company shall come to an end.

When a company is unable to pay its debts, its liquidation will be under newly passed. "Insolvency and bankruptcy code 2016". The code relates to insolvency, liquidation, voluntary liquidation or bankruptcy. The Company shall thus be wound up either under Companies Act, 2013 or liquidated under Insolvency and Bankruptcy Code 2016, as applicable.

Difference between Winding up and Dissolution

Winding and dissolution of the company are not the same thing. A company is not dissolved immediately on the commencement of winding up proceedings. Winding up is the prior stage and dissolution is the next. On dissolution, the name of the company is struck off by the Registrar from the Registrar of Companies i.e., it ceases to exist. While on winding up the Company's name is not stuck off from the register. The legal entity of a company remains even after the commencement of winding up and it can be sued in a court of law. Dissolution is the final stage of the Company's winding up process. But a company can be dissolved without winding up under certain circumstances such as when it merges with another company. In winding up the assets of the company are sold and the proceeds are utilized in paying off the debts and other liabilities of the company. It is the first stage of terminating the life of a company. While the dissolution is the next stage and after this company ceases to exist. The winding up proceedings are carried out by a liquidator of the company while in case of dissolution no such proceedings are carried out. Creditors can prove their debts in the winding up but not in the dissolution of the company.

20.3 MODES OF WINDING UP

Winding up by the Tribunal

Winding up may be ordered by the Tribunal in following cases, which are grounds for **compulsory winding up:**

a) If a company has, by special resolution, resolved that the company be wound up by the Tribunal;

b) If the company has acted against the interest of sovereignty and integrity of India, the security of state, friendly relations with foreign states, public order, decency or morality;

c) If on an application made by Registrar or any other person authorised by the Central Government by notification under the Act, the Tribunal is of the opinion that the affairs have been conducted in a fraudulent manner or the Company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affair have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

d) If the company has made default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

e) If the company is unable to pay it debts.

e) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up (Section 271)

20.3.1 Winding Up by Special Resolution

The Company may by a special resolution resolved that the company to be wound up by the Tribunal. The Tribunal has to examine whether the resolution is in the interest of the company or is not opposed to public interest. If not, the winding up may not be ordered. The company can file a petition before the Tribunal for winding up even without passing a special resolution (Section 272). A company whose name is not in the register of companies is not entitled to file a winding up petition.

20.3.2 Company Acting against the Sovereignty and Integrity of India, Security of the State, the Friendly Relations with Foreign States, Public Order, Decency and Morality.

If the company acting against the interest of sovereignty and integrity of India, the security of state, the friendly relations with foreign states, public order, decency and morality, the petition on this ground shall be made by Central or a State Government to the Tribunal. The words 'decency' and 'morality' have not been defined in the Act.

20.3.3 Affairs being Conducted in a Fraudulent or Unlawful Manner

The Registrar or any other person authorised by the Central Government may make an application to the Tribunal for winding up on this ground. The Tribunal may order winding up on the following grounds.

i) The affairs of the company are being conducted in a fraudulent manner; or

ii) The Company was formed for fraudulent or unlawful purpose; or

iii) The persons concerned in the formation of the company or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith.

It may be noted, besides above provision, Central Government may directly file a petition for winding up in case of inspector's, report on investigation.

20.3.4 Default in Filing Financial Statements or Annual Returns with to the Registrar

The company has to file two separate documents (a) financial statements and (b) annual return to the Registrar.

The default in not filing these documents should have been for immediately preceding five consecutive financial years, only then winding up may be ordered. If default is for two or three or four years, this provision cannot be invoked. Again, it may be noted that winding up may be ordered if the default relates to either non-filing of financial statements or annual returns. It is not necessary that the default has to be for both financial statements and annual return. The default has to be in respect of immediately preceding five consecutive financial years. It means that default in the earlier year is not a ground for winding up under the clause.

20.3.5 Inability to Pay its Debts

A company shall be deemed to be unable to pay its debts,

a) if a creditor by assignment or otherwise, to whom the company is indebted for an amount exceeding one lakh rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty-one days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor;

b) if any execution or other process issued on a decree or order of any court or tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part; or

c) if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.

20.3.6 Just and Equitable

These words have not been defined in the Act. The power under this clause, according to A. Ramaiya, should be used only "when there is a strong ground because companies as far as possible, should be left to self governance and self determination through the wishes of majority of shareholders". The Tribunal should not make an order on this ground for winding up, if there is any other remedy available. It is a remedy of last resort.

The following grounds, based on leading cases, have been held as "Just and Equitable".

a) **Loss of Substratum:** It means sole purpose or main objects, for which company was formed, cannot be achieved e.g. it fails to obtain a patent for invention on the assumption that it will be granted or it fails to acquire the business which the company was formed to purchase or fails to build a building on ground that local authority did not grant permission. In re, **Kailtal and General Mills Co. Ltd (1955)** 31 Comp. Cons. 46], the Court laid down the following test to determine as to whether the substratum of the company has disappeared:

   a) Where the subject matter of the company has gone; or

   b) The object for which it was incorporated has substantially failed; or

   c) It is impossible to carry on the business of the company except at loss which means that there is no reasonable hope that the object of trading at a profit can be attained or

d) The existing or probable assets are insufficient to meet the existing liabilities.

b) **Illegality of objects and fraud:** If any company's objects are illegal or become illegal by change of law, it will be wound up by Tribunal. Similarly, if a company is promoted in order to perpetrate a serious fraud or deception on the person who are invited to subscribe for its shares, the Tribunal will wind it up.

c) **Deadlock in management:** If a private company has only two members-directors and the two are not on speaking terms. Tribunal will make a winding up order, even though there is a provision in articles that one director shall have a casting vote at board meetings or that the disputes shall be settled by arbitration. If there is a loss of confidence in the Board of directors or refusal by one of the three directors to attend meeting to make a quorum.

d) **Bubble Company:** If the company is just on paper and never carried on its business.

e) **Oppression:** A winding up petition may lie where the majority shareholder have adopted an aggressive policy towards minority under Section 241. Also, any member of a company may complain that the affairs of the company have been or are being conducted in a manner prejudicial to public interest or oppressive to him and other members. Under section 242 (1b) the Tribunal can order winding up on "just and equitable" ground.

f) **Other:** If the number of members fall below the statutory minimum, its winding up can be ordered on "just and equitable ground'. Similarly, if company is not following democratic principles of fairness or lacking in commercial morality or where directors making charges against each other the Tribunal can order winding up of the company.

Who can file Petition?

The following can file petition to the Tribunal for winding up of a company.

1) The Company; or

2) The contributory or contributories i.e., persons who are liable to contribute to the assets of the company; or

3) The Registrar; or

4) The Central or State Government or any other person authorised by Central Government; or

5) Any creditor or creditors;

6) No (1), (2) and (5) together

20.4 PROCEDURE FOR WINDING UP

In brief, the following procedure is followed in winding up:

1) **Filing of Petition:** It is presented by the company to the Tribunal, along with the statement of affairs. If it is filed by any other person, company is allowed to file objections.

Provisional Liquidator: At any time after presentation of winding up petition and before the making of a winding-up order, the Tribunal may appoint a provisional liquidator. Before making such appointment, however, the Tribunal 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 Tribunal.

2) **Company Liquidator:** On a winding up order being made in respect of a company, the Tribunal shall appoint official liquidator or liquidator. The liquidator should be registered under insolvency and bankruptcy Code 2016. A liquidator can be replaced or removed.

3) **Winding up Committee:** Within three months of winding up order, the company liquidator shall make an application to form a winding up committee to assist and monitor progress of winding up. A monthly report along with the minutes of meeting of the winding up committee shall be placed before the Tribunal by company liquidator, the convener.

   The company liquidator must submit a preliminary report to the Tribunal within sixty days from the winding up order.

4) **Advisory Committee:** The Tribunal may, at the time of making winding up order of a company, or at any time thereafter direct to form an advisory committee to act with company liquidator and to report to Tribunal on such matters as Tribunal may direct. The maximum members of the committee is twelve, being creditors and contributories. The committee has the right to inspect books of accounts and other documents, assets and properties of the company under liquidation at reasonable time. The quorum is 1/3rd of total members or two whichever is higher.

   The company liquidator shall chair the meetings of the Advisory Committee.

5) **Dissolution of the Company**

   When the affair of a company have been completely wound up, the company liquidator shall make an application to the Tribunal for dissolution of the company.

   Upon receipt of the report from the company liquidator or otherwise, the Tribunal on forming an opinion that it is just and reasonable to order dissolution, shall make an order for dissolution of the company. The company shall be dissolved effective from the date of order.

   When the company is dissolved, no suit or proceeding will lie against the company because a dissolved company has no existence in the eyes of law.

20.4.1 Preferential Payments

In the event of winding up certain payments are to rank in priority to others. These are called preferential payments. Under section 326 the following shall be paid in priority to other debts:

1) Workmen dues;

2) Where a secured creditor has realised a secured asset, so much of debts due to such secured creditor, as could not be realised by him or the amount of workmen's portion in his security if payable, under law, whichever is less, PariPassu with workmen's dues.

Under Section 327, order of priority subject to section 326 is given below:

1) All revenues, taxes, cesses and rates due to the Central or a State Government or to a local authority. The amount should have become due and payable within twelve months before winding up order.

2) All wages or salary of an employee due for a period not exceeding four months.

3) All accrued holiday remuneration becoming payable to an employee on his termination or death.

4) All amount due in respect of contributions payable during twelve months under Employees State Insurance Act.

5) All amounts in respect of any compensation payable under Workmen's Compensation Act.

6) All sums due to an employee from provident fund, a pension fund, a gratuity fund or any other fund

7) Expenses of any investigation, held in pursuance of section 213 or 216 in so as they are payable by the company.

Thus the order of priority in paying off debts in winding up shall be follows:

a) workmen's dues and debts due to secured creditors

b) Cost and expenses of winding up

c) Preferential debts

d) Floating charge

e) Unsecured Creditors

20.4.2 Contributory

A contributory is a person liable to contribute to the assets of a company in the event of winding up and includes the holder of any shares which are fully paid up (section 2(26). A holder of fully paid up shares shall have rights as a contributory and no liability as a contributory.

The following persons shall be liable as a contributories on the winding up of a company.

a) Present and Past Members: Every present and past member liable to contribute to the assets of the company for payment of debts, liabilities and costs of winding up and for adjustment of rights of the contributories is a contributory. A past member shall be liable to contribute the amount unpaid on the shares in respect of which he is a contributory or the amount he has guaranteed to pay in the event of winding up. A past member shall not be liable to contribute:

   i) if he ceased to be a member for one year or more before commencement of winding up; or

   ii) in respect of any debt or liability contracted after he ceased to be member; or

   iv) the present members are able to the satisfy the contribution required.

b) A director and manager whose liability is unlimited except if he ceased to hold office for a year or upward before commencement of winding up.

A past director or manager shall not be liable for contribution if the debt and liability of the company was contracted after he ceased to hold that office.

c) Assignee of a contributory, legal representative of a deceased member, liquidator of a company which is a member and Debtors are other contributories.

d) Subscribers to the Memorandum: Subscribers to the Memorandum shall be deemed as contributories for the amount unpaid on the shares they agreed to subscribes for.

20.5 REMOVAL OF THE NAME OF THE COMPANY

Once the affairs of the company are fully wound up, the official liquidator shall submit a final report to the Central Government, with a copy to Tribunal. The Cental Government shall order dissolution of the company and Registrar shall strike off the name of the company from the register of companies and publish a notification to this effect. The company will cease to be an artificial person created by law.

Check Your Progress A

1) What is Winding Up?

....

....

....

2) List the 'Just and Equitable grounds' of winding up?

....

....

....

3) Who can file petition for winding up?

....

....

....

4) Fill in the Blanks

   i) A Company can be wound up under the Companies Act 2013 only by ____________

   ii) The Company can be wound up if it makes a default in filing with the Registrar its financial statements and annual returns for immediately preceding ___________consecutive financial years.

   iii) Within______________ of winding up order the company liquidator shall form a winding up committee time.

   iv) Company liquidator has to make an application to the Tribunal for constitution of a____________

   v) When a company is dissolved by the Tribunal, it ceases to be a______________

20.6 LET US SUM UP

Winding up of a company means a process whereby its legal personality is ended. The process begins by a petition to Tribunal by specified mode. The Tribunal appoints a Liquidator. He makes a list of creditors and assets. The assets are sold and the money so realized is distributed among creditors. For deficiency contributories are asked to pay for any amount due. After this process he prepares a report submits it to the Tribunal. The Tribunal orders dissolution of the company. The Tribunal has wide powers and may order winding upon 'Just and equitable' ground.

The petition may be filed by the company, contributories, Registrar, Central or State Government or any person authorised by Central Government. The Tribunal may allow liquidator to constitute a winding up committee to assist him as well as advisory committee, consisting of creditors and contributories of not more than twelve persons. The Liquidator has to make certain payment to rank in priority to others. They are called "Preferential Payments".

20.7 KEY WORDS

Winding Up: A process by which the life of a company comes to an end.

Dissolution: The company ceases to exit.

Liquidator: The person who helps the court to complete the liquidation proceedings.

Just and equitable: Any ground which in the opinion of the court, is reasonable and is in the interest of the concerned parties.

20.8 ANSWERS TO CHECK YOUR PROGRESS

(B) (i) Tribunal (ii) Five Consecutive years (iii) three months (iv) Advisory committee and winding up committee (v) Legal person

20.9 TERMINAL QUESTIONS

1) What do you understand by winding up of a company ? How is it different from dissolution of a company?

2) Discuss the winding up of a Company by the Tribunal.

3) Writes a Short notes on:

   a) Advisory Committee

   b) Preferential Payments

   c) Winding Up Committee

4) Explain the 'just and equitable grounds' for winding up of a company.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

SUGGESTED READINGS

G. K. Kapoor and Sanjay Dhamija, Company Law, Taxmann.

Avtar Singh, Introduction to Company Law, Eastern Book Company.

Sharma J. P., An Easy Approach to Corporate Laws, Ane Books Pvt. Ltd. New Delhi.

(Latest Edition of the book is recommended)