

B.COM. (PROGRAMME)/B.COM. (HONS.)

COMPANY LAW

**DISCIPLINE SPECIFIC CORE (DSC-5)
SEMESTER - II COURSE CREDIT - 4**



**DEPARTMENT OF DISTANCE AND CONTINUING EDUCATION
UNIVERSITY OF DELHI**

AS PER THE UGCF-2022 AND NATIONAL EDUCATION POLICY 2020

Editorial Board

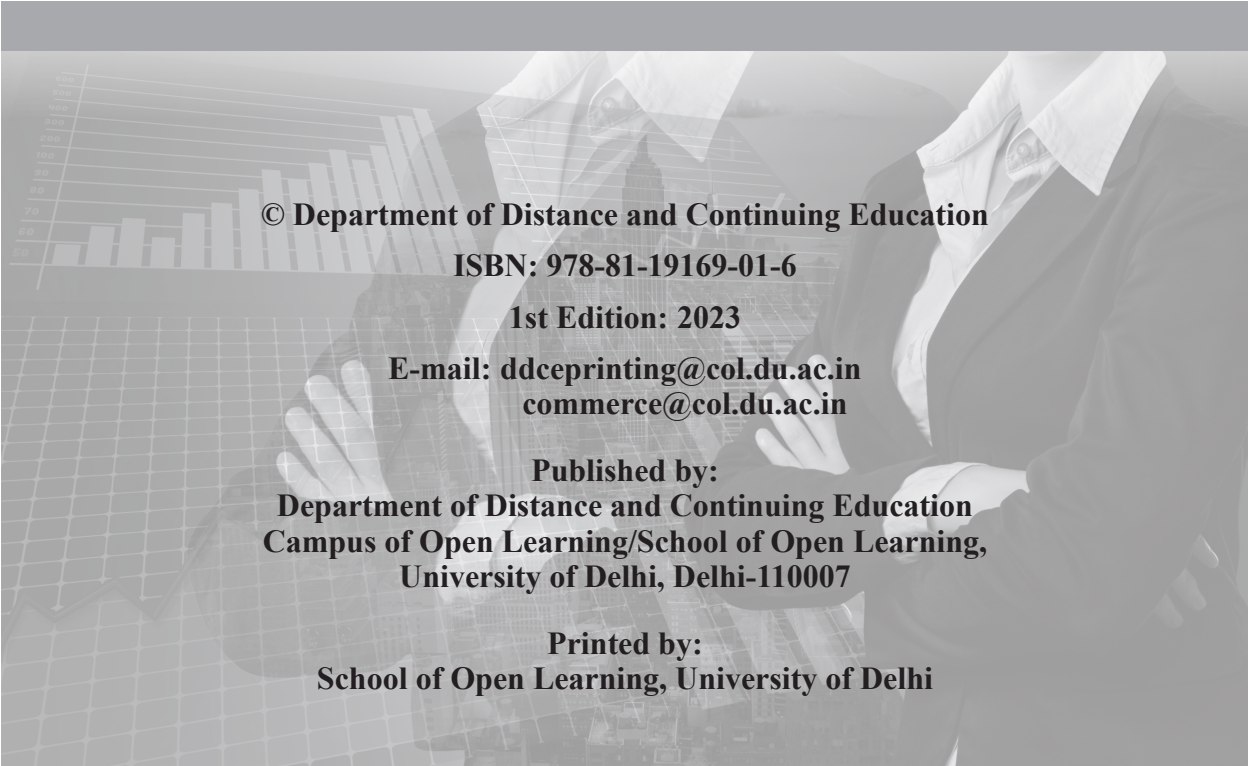
Dr. Sneh Chawla
Dr. Rutika Saini

Content Writers

Kumari Shilpi, Dr. R C Garg

Academic Coordinator

Mr. Deekshant Awasthi



© Department of Distance and Continuing Education

ISBN: 978-81-19169-01-6

1st Edition: 2023

E-mail: ddceprinting@col.du.ac.in
commerce@col.du.ac.in

Published by:

Department of Distance and Continuing Education
Campus of Open Learning/School of Open Learning,
University of Delhi, Delhi-110007

Printed by:

School of Open Learning, University of Delhi



This Study Material is duly recommended in the meeting of Standing Committee held on 08/05/2023 and approved in Academic Council meeting held on 26/05/2023 Vide item no. 1014 and subsequently Executive Council Meeting held on 09/06/2023 vide item no. 14 {14-1(14-1-11)}

- ◆ **Unit I-V are edited versions of study material prepared for the courses under Annual & CBCS Mode.**
- ◆ **Corrections/Modifications/Suggestions proposed by Statutory Body, DU/ Stakeholder/s in the Self Learning Material (SLM) will be incorporated in the next edition. However, these corrections/modifications/suggestions will be uploaded on the website <https://sol.du.ac.in>. Any feedback or suggestions may be sent at the email- feedbackslm@col.du.ac.in**

Printed at: **Taxmann Publications Pvt. Ltd., 21/35, West Punjabi Bagh,
New Delhi - 110026 (15000 Copies, 2023)**



Contents

PAGE

UNIT - I

Lesson 1 : Introduction

1.1	Learning Objectives	3
1.2	Introduction	3
1.3	Meaning of a Company	4
1.4	Characteristics of a Company	5
1.5	Lifting or piercing of Corporate Veil	9
1.6	Summary	19
1.7	Answers to In-Text Questions	19
1.8	Self-Assessment Questions	20
1.9	Suggested Readings	20

Lesson 2 : Administration of Company Law: National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT), Special Courts

2.1	Learning Objectives	22
2.2	Introduction	22
2.3	Meaning of a Company	22
2.4	Constitution of NCLT and NCLAT	23
2.5	Selection of Members [Section 412]	25
2.6	Terms of Office	26
2.7	Advantages of NCLT and NCLAT	27
2.8	Powers of NCLT and NCLAT	28
2.9	Special Courts and Company Law Board (CLB)	34
2.10	Summary	37

PAGE | i



	PAGE
2.11 Answers to In-Text Questions	38
2.12 Self-Assessment Questions	38
2.13 Suggested Readings	38
Lesson 3 : Types of Companies: On Basis of Incorporation and on the Basis of Members	
3.1 Learning Objectives	40
3.2 Introduction	41
3.3 Distinction Between Company and Partnership	41
3.4 Classification of Companies on the Basis of Mode of Incorporation - Chartered Company, Registered Company, Statutory Company	42
3.5 Classification of Companies on the Basis of Number of Members - Public Company, Private Company, Small Company, One Person Company	46
3.6 Difference Between Private and Public Company	57
3.7 Summary	61
3.8 Answers to In-Text Questions	61
3.9 Self-Assessment Questions	62
3.10 Suggested Readings	62
Lesson 4 : Types of Companies : On the Basis of Control, Government Companies, Foreign Companies, Dormant Companies, Association Not-for-Profit and Illegal Association	
4.1 Learning Objectives	64
4.2 Introduction	64
4.3 Classification of Company on the Basis of Control - Holding Companies, Subsidiary Companies and Associate Company	64
4.4 Foreign Companies	70
4.5 Dormant Companies [Section 455]	74
4.6 Associations Not-for-Profit/formation of Companies with Charitable Objects [Section 8]	76



4.7	Illegal Association (Section 464) [Prohibition of Association of Partnership of Persons Exceeding Certain Number (Section 8)]	80
4.8	Summary	81
4.9	Answers to In-Text Questions	82
4.10	Self-Assessment Questions	82
4.11	Suggested Readings	82

UNIT - II

Lesson 1 : Formation of the Company, Promoters and Online Registration of a Company

1.1	Learning Objectives	87
1.2	Introduction	88
1.3	Formation of Company [Section 3]	88
1.4	Promoter [Section 2(69)]	93
1.5	Preliminary or Pre-incorporation Contract	97
1.6	Online Registration of a Company	101
1.7	Summary	104
1.8	Answers to In-Text Questions	104
1.9	Self-Assessment Questions	104
1.10	Suggested Readings	104

Lesson 2 : Memorandum of Association

2.1	Learning Objectives	106
2.2	Introduction	106
2.3	Contents of Memorandum [Section 4]	108
2.4	Alteration of Memorandum of Association	116
2.5	Summary	128
2.6	Answers to In-Text Questions	129
2.7	Self-Assessment Questions	129
2.8	Suggested Readings	130



Lesson 3 : Articles of Association

3.1	Learning Objectives	131
3.2	Introduction	132
3.3	Contents and Form of Articles	132
3.4	Entrenchment Clause	133
3.5	Relationship Between Memorandum and Articles	134
3.6	Difference Between Memorandum and Articles of Association	135
3.7	Alteration of Articles of Association Articles	136
3.8	Doctrine of Constructive Notice	140
3.9	Doctrine of Indoor Management	141
3.10	Summary	144
3.11	Answers to In-Text Questions	145
3.12	Self-Assessment Questions	145
3.13	Suggested Readings	145

UNIT - III

Lesson 1 : Prospectus

1.1	Learning Objectives	149
1.2	Introduction	150
1.3	Definition of Prospectus	151
1.4	Objects of a Prospectus	152
1.5	Types of Prospectuses	152
1.6	Contents of Prospectus	155
1.7	Statutory Requirements Regarding Issue of a Prospectus	160
1.8	Misstatement in a Prospectus	163
1.9	Book Building	169
1.10	Summary	172
1.11	Answers to In-Text Questions	173
1.12	Self-Assessment Questions	173
1.13	Suggested Readings	174

**Lesson 2 : Shares**

2.1	Learning Objectives	175
2.2	Introduction	176
2.3	Allotment of Shares	176
2.4	Forfeiture of Shares	179
2.5	Issue of Sweat Equity Shares	181
2.6	Employee Stock Option Scheme	186
2.7	Bonus Issue	191
2.8	Right Issue	193
2.9	Buy-Back of Securities [Section 68]	195
2.10	Membership of Company	200
2.11	Modes of Acquiring Membership	206
2.12	Who May Become a Member	209
2.13	Rights and Liabilities of Members	212
2.14	Transfer and Transmission of Shares	213
2.15	Demat System	214
2.16	Summary	217
2.17	Answers to In-Text Questions	217
2.18	Self-Assessment Questions	218
2.19	Suggested Readings	218

UNIT - IV

Lesson 1 : Company Management

1.1	Learning Objectives	221
1.2	Introduction	222
1.3	Meaning of Directors	222
1.4	Legal Positions of Directors	222
1.5	Number of Directors	224
1.6	Classification under the Companies Act	224



	PAGE
1.7 Further Classification of Directors	224
1.8 Appointment of Directors	225
1.9 Director Identification Number (DIN)	232
1.10 Disqualification for Appointment of Director	233
1.11 Removal of Directors	234
1.12 Powers of Directors	235
1.13 Duties of Directors	237
1.14 Key Managerial Personnel	237
1.15 Summary	240
1.16 Answers to In-Text Questions	240
1.17 Self-Assessment Questions	241
1.18 Suggested Readings	241
Lesson 2 : Meetings	
2.1 Learning Objectives	242
2.2 Introduction	243
2.3 Kinds of Meeting	243
2.4 Board Meetings	243
2.5 Annual General Meetings	251
2.6 Extraordinary General Meeting	254
2.7 Class Meetings	256
2.8 Requisites of a Valid Meeting	257
2.9 Voting and Poll	263
2.10 Resolutions	265
2.11 Postal Ballot	268
2.12 E-Voting	271
2.13 Summary	275
2.14 Answers to In-Text Questions	276
2.15 Self-Assessment Questions	277
2.16 Suggested Readings	277



UNIT - V

Lesson 1 : Dividend, Audit and Auditors

1.1	Learning Objectives	281
1.2	Introduction of Dividends	282
1.3	Provisions Related to Payment of Dividend (Interim and Unpaid & Unclaimed Dividend)	282
1.4	Audit & Auditors – Introduction	285
1.5	Qualification of Auditor	286
1.6	Disqualification of Auditor	286
1.7	Appointment of Auditor	287
1.8	Auditor’s Rotation	288
1.9	Removal of Auditor	289
1.10	Auditor’s Report	291
1.11	Powers of Auditor	292
1.12	Summary	294
1.13	Answers to In-Text Questions	296
1.14	Self-Assessment Questions	297
1.15	Suggested Readings	297

Lesson 2 : Winding Up

2.1	Learning Objectives	298
2.2	Introduction	299
2.3	Meaning of Winding Up	299
2.4	Distinction Between Winding Up and Dissolution	300
2.5	Modes of Winding Up	300
2.6	Circumstances for Winding Up by Tribunal	300
2.7	Winding Up of Company Under Just and Equitable Grounds	301
2.8	Petition for Winding Up	302
2.9	Powers of Tribunal	303



	PAGE
2.10 Direction for Filing Statements of Affairs	303
2.11 Provisions for Winding Up under Insolvency and Bankruptcy Code, 2016	304
2.12 Summary	311
2.13 Answers to In-Text Questions	311
2.14 Self-Assessment Questions	312
2.15 Suggested Readings	312
Glossary	313

UNIT - I



Introduction

Author: Kumari Shilpi

Revised by: Ms. Chandani Aswal

STRUCTURE

- 1.1 *Learning Objectives*
- 1.2 *Introduction*
- 1.3 *Meaning of a Company*
- 1.4 *Characteristics of a Company*
- 1.5 *Lifting or Piercing of Corporate Veil*
- 1.6 *Summary*
- 1.7 *Answers to In-Text Questions*
- 1.8 *Self-Assessment Questions*
- 1.9 *Suggested Readings*

1.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Define company and explain its characteristics.
- ◆ Explain about the company administration and special courts.

1.2 Introduction

The term company is taken from the Latin word where- “Com” means together, panis means “bread” which refers to an association of people taking their bread together. It means the association of people who contribute capital and employee common purpose (profit). The Companies Act passed from time to time in India and followed by English Companies Act with certain modifications which suit Indian Condition. Corporate law is a body of law which governs and determines rights, relations and conduct of persons, companies and organisations. It deals with the legal aspects of corporations.



1.3 Meaning of a Company

According to section 2(20) of the Companies Act, 2013 define a company as, “A company incorporated under this act or under any previous company law”.

Lindleys’s L.J. defines a company as, “an association of many people who contribute money or money’s worth to a common stock and employ it in some common trade or business (*i.e.*, for a common purpose), and who share the profit or loss (as the case may be) arising there from. The common stock so contributed is donated in money and is the capital of the company. The person who contributes it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted.”

Chief Justice Marshall of the USA defined company “as a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as accidental to its very existence.”

Hence company is a legal entity without any physical appearance.

Indian Companies Act, 2013.

Contain - 470 section, 7 schedules and 29 chapters.

It became applicable from the financial year 2014-15.

The Companies Act, 2013 was enacted broadly to achieve following Objective:

- 1. To gain a high standard of corporate governance, management, accountability and transparency.**
- 2. To take strict steps or action towards those companies who are involved in fraudulent activities and non-compliance of latest company provision.**
- 3. To identify new policy concepts to protect the interest of stakeholders.**



4. To set up more effective institutional structure in the form of authorities, bodies, panes which verify roles of professionals and other experts.

Some Previous Companies Acts, 1913, 1956.

1.4 Characteristics of a Company

1. Separate Legal Entity	2. Incorporated Association
3. Artificial Person	4. Limited Liability
5. Common Seal	6. Perpetual Succession
7. Transferability of Shares	

The distinguishing characteristics of a company are:

1. Separate Legal Entity: It means a company has a separate legal entity from its members. It has all legal rights which are separate and members of a company are not liable for it. In case of any contract of a company, the company name is used, and the contract binds the company not its member. The company's property, assets, Liability belong only to the company. Even members are not liable to the debts of the company and the liability of members are limited. The principle of separate legal entity of the company was judicially recognised by the House of Lords in 1867 in case of *Oakes v. Turquand and Hoarding* (1867).

Example: Ashish and Co. is totally different from Ashish as he holds all shares, but the property of the Co. is not the property of Ashish.

The principle of Separate legal entity was explained and emphasized in this famous case:—

Salomon v. Salomon & Co. Ltd. 1897 A.C.22. Salomon transferred his boot business which initially ran as a sole proprietorship, to a newly formed company for 40000 pounds. The price for such transfer was paid to Salomon by way of shares and debentures having floating charge (security against debt) on the assets of the company. There are 7 shareholders, his (wife, one daughter and 4 sons each having one share of the company). The company went into liquidation within a year due to trade depression. When the company was wound up, its assets were found to be worth 6000



pounds and its liabilities are 17000 pounds. 10000 pounds secured Salomon due to debenture preference and 7000 pounds are due to unsecured creditors. The unsecured creditor claimed that Salomon and his company were one and the same person, so they demanded priority for the payments of debts, but it was held that the company was, in the eyes of the law, a separate person independent of Salomon and not an agent. Hence the plea of the unsecured creditor for precedence was rejected.

There are so many cases which confirm the concept of separate legal entities.

1. Lee v. Lee's Air Farming Ltd. (1961).

2. Re. Kondoli Tea Co. Ltd. (1886)

3. Abdul Haq v. Das Mal (1910).
--

- 2. Incorporated Association:** Company is an incorporated association of persons and it is formed by registration under various Companies Act either 2013 or previous Companies Act. For forming a public company at least 7 persons are required and for private companies at least 2 people are required. The name of persons subscribed in memorandum of association, and they are complying with other legal requirements in respect of registration and incorporation of a company.
- 3. Artificial Legal Person:** Company does not exist in physical form- No body, no soul, no conscience it means, it doesn't have attributes like people, and we can call it fictitious person. It has existence in the eyes of law. It has its own property, liabilities and legal rights can sue and be sued in its own name. It has domicile, nationality and residence but the company cannot enjoy the fundamental rights which are given to natural persons mentioned in the Constitution of India or Citizenship Act. Company cannot be treated as a citizen of the country on behalf of its members.

Case: *State Trading Corporation of India v. C.T.O (Commercial Tax Officer)* 26th July 1963. In this case State Trading corporation sought relief in the form of appropriate writs or directions against various agencies of State Governments on account of Sales Tax assessed against the Corporation. The petition was filed under Article 32 of



the Constitution of India, which empowers the Supreme court “to issue directions or orders or writs. Appropriate for the enforcement of fundamental rights.” The corporation contested the claims saying that it is a Government company, hence the department of the same. But the appeal dismissed by the court because of the following reason:

1. Distinction between person and citizens.
2. All citizens are persons, but all persons are not citizens.

Judgment Says: The corporation has no physical existence, it is mere “Abstraction of law” and the functions of state trading being commercial and cannot be regarded as one of the departments of the Government of India.

- 4. Limited Liability:** A company’s liability is different from the liability of the shareholder. Shareholders have limited liability to the unpaid value of shares, once they have paid full amount on the shares held by them and they have no obligation toward the company. In the case of losses shareholders are not called to manage the losses of the company. The creditor cannot claim personal wealth of the shareholder. And in the case of a guaranteed company the members are liable to pay a specified amount to the assets of the company in the case of the company being wound up.
- 5. Perpetual Succession:** A company has perpetual succession. It never dies nor the life of it depend upon the life of members. It is incorporated by law and ends only by process of law. The death of a member doesn’t lead to the death of the company, the existence of the company is independent. It is not affected by death, mental disorder, or the retirement of any of its members. The company’s aim is to maintain continuity forever until it is dissolved, members may come and go and the company will be there.

Case: *Re. Meat Supplier Guildford Ltd.*- During the war all the members of this company, while in general meeting, were killed by a bomb. But the company survived, not even a hydrogen bomb destroyed it.

A company’s existence is persisting irrespective of the change of composition of its members.



6. Common Seal: A company is an artificial person, and it doesn't have hands like a human being so it cannot sign any document personally. Every company has its common seal which works as its signature. The document within a company is authorized by the common seal. The company may act through its agents and all such contracts entered by its agent must be under the seal of the company. In Companies (Amendment) Act, 2015, the common seal has been made optional.

Example: In India a share certificate is given under the common seal of the company and each usage of the common seal is documented in the statutory registry of the company.

7. Transferability of Shares: The company's capital is divided into small units called shares, the share of the company is transferable in case of public companies it transfers freely but in case of private companies there are some restrictions. Section 44 of the Companies Act, 2013, it provides that the shares, debentures or other interest of the members of a company are movable property. Hence, they are transferable in the manner as provided in the company's articles of association.

IN-TEXT QUESTIONS

1. In which section of the Companies Act, 2013, company's meaning is defined:
 - (a) 2(34)
 - (b) 2(28)
 - (c) 2(20)
 - (d) 2(35)
2. Which of the following are special characteristics of company?
 - (a) Artificial company
 - (b) Separate legal entity
 - (c) Limited liability
 - (d) All of the above



3. A company is not created when it is registered under the Companies Act. (True/False)
4. A company is a natural person. (True/False)
5. A Companies Act, 2013 came into force on _____.
6. The famous case in which the concept of separate legal entity was introduced was _____.

1.5 Lifting or Piercing of Corporate Veil

Meaning of Corporate Veil: A company is a separate legal entity and the corporate veil is a curtain between company and its member.

Company (**differ**) Members/Shareholders:

Property	Property
Liabilities	Liabilities
Rights	Rights
Duties	Duties
Powers	Powers
Functions	Functions

Corporate veil is a legal concept that separates the action of an organisation to the action of the company's member or shareholders. Some members of the company sometimes indulge in fraudulent activities and their ingenuity, dishonesty let them take advantage of corporate personality or separate legal entity of the company and earn their own profit. In this case, there is ignorance of the corporate veil concept and lifting or piercing of the corporate veil is done and look at the person behind the company who are the real beneficiaries of the corporate fiction. This doctrine has been established for business efficiency, necessity and convenience.

Effect of corporate veil:

Company itself is liable for its acts and its members/directors/employees/shareholders are not liable for the acts of the company.

The cases in which the doctrine of the lifting of the veil has been applied can be put under two categories:

**Doctrine of the lifting the corporate veil:****1. Judicial interpretation. (At discretion of Court)**

1. Determination of character or nature of company.
2. Benefits or protection of revenue.
3. Evasion of personal and statutory obligation/Prevention of fraud.
4. Avoidance of welfare Legislation.
5. Diversion of business opportunity.
6. Determining Expertise of company.
7. When company is sham or facade.

2. Statutory provision: According to the provision of Companies Act.

1. Reduction of minimum number of members.
2. Holding and subsidiary company relationship.
3. Investigation of ownership in a company.
4. Directors with unlimited liability.
5. Investigation in the affairs of the company.
6. Fraudulent Conduct of Business.
7. Failure to return Application Money.
8. Misrepresentation in prospectus.
9. Mis-description of Name.
10. Pre-incorporation Contracts.
11. <i>Ultra vires</i> Acts.
12. Liability under other statutes.

Judicial interpretation:

- 1. Determination of Character or Nature of Company:** In case, if it is identified that the company is owned by the enemies of the country then the Court lifts the corporate veil concept and investigates those who have real control of the corporate affairs. The alien enemies are not allowed to trade.

Case: *Daimler Co. Ltd. v. Continental Tyre and Rubber Co.* (1916) - A Daimler company was incorporated in England to sell tyres which are manufactured by German companies. In that company majority of shares except one held by German residents and all the shareholders and Directors are German. During World War 1



in 1914 that company brought a case to recover trade debt from another England based company (Continental tyre). But the court restrained the company from this because that Co. belonged to alien enemies.

It was observed that the company is not a natural person with sense or conscience, it cannot be loyal, dishonest, enemy or friend, but the company determine as enemy company when the real control of the company is in the hands of residents of the enemy country and the court upheld the corporate veil concept.

- 2. Benefits or Protection of Revenue:** In case the Court may break the corporate shell of the company if it found that the company is formed for the purpose of evasion of tax or to remove tax obligation which is against the interest of the revenues of the government.

Case: Sir Dinshaw Maneckjee Petit (1927) - Sir Dinshaw was an affluent and wealthy person, and he did large investments from which he was getting huge dividends and interest income. For tax evasion he formed four private companies and distributed his investment as an agent for it. The income received was credited in the account of the company and the company handed back the amount to him as a pretended loan. He divided his income to reduce tax liability.

Later Court held that the company was formed by assessee and only for avoiding tax and the company was nothing more than assessee himself. And the corporate veil concept was lifted.

- 3. Evasion of Personal and Statutory Obligation/Prevention of Fraud:** Courts may ignore the concept of separate legal entity when it appears that there is evasion of contractual and statutory obligation by person.

Case: *Gilford Motor Co. v. Horne* (1933) - Horne was appointed as a managing director of Gilford motors. He signed a contractual agreement that he would not solicit the customers of the company so long as he was working in that company or afterwards. But he started his own company and Co. was in the name of his wife and he left Gilford Co. As he was an ex-employee, he has knowledge about customers of Gilford Co., and he started soliciting them.



Later it was held that Horne company was a fraud company and he breached his agreement against solicitation, and therefore, it was restrained from enticing away Gilford Motor Company's customers.

- 4. Avoidance of welfare Legislation:** Court will not permit resorting to devise or incorporation of a company to evade welfare legislation. It is the duty of the courts in every case where ingenuity is expended to avoid welfare legislation to get behind the smokescreen and discover the true state of affairs.

Case: *Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd.* - In this case the company incorporated a subsidiary company and transferred its investment and securities to divide investment and profit of the main company which lead reduction of bonus obligation towards workers.

Supreme Court held that separate existence of the subsidiary company would be disregarded for the purpose of evasion of bonus amount which is payable to workers.

- 5. Diversion of Business Opportunity:** When a company is to divert the business of another company then the corporate veil is lifted.

Case: *Gencor ACP Ltd. v. Dalby (2002)* - Dalby was director of Gencor Co. He formed a private company called British Virgin Islands. He dishonestly diverted assets and sold the material of a public company to his private company. Court considered its inappropriate conduct of business and lifted the corporate veil of the private company and found personal benefits of Dalby and he was found responsible for diversion of the opportunities of public company.

- 6. Determining Expertise of Company:** The expertise and experience of shareholders could be regarded as the expertise of the company.

Case: *New Horizons Ltd. (NHL)* was a joint venture company wherein Indian and foreign group companies held shares. The groups had contributed towards the resources of the NHL in the form of machines, equipment and expertise. The Supreme Court held that in respect of such a joint venture company, the experience could mean the experience of the constituents of the company. Thus, it was thought proper to pierce the corporate veil to determine the expertise of the company.



7. When Company is Sham or Facade: An argument that a corporation is a sham or facade can be used to lift the corporate veil on the ground that the corporate form was incorporated or used as a “mask” to hide the real purpose of the company controller.

Case: *Re FG Films Ltd.* (1953) - The company, FG Films made a film called “Monsoon”. The company had no premises except its registered office and no employees. Film Group Incorporated, an American based company who financed and provided all facilities necessary to make the film. FG Films sought to have the film registered as a British Film. This is a sham or facade as the company was not the maker of the film. Therefore, the court lifted the corporate veil and prohibited film from enjoying the benefit given by the British government as that is just sham by FGI.

Statutory provision

The companies act and other statutes determine the circumstances where the corporate veil of the company uplifted or disregarded. Some of those cases are:

- 1. Reduction in Members of the Company:** As per section 3A of Indian Companies Act, 2013, when the number of members reduce below specified in public - minimum 7 members and in private companies 2 members minimum required and if business carried with members below required for more than 6 month then each existing members of company who are aware of this shall be liable for payment of debts because of reduction in number of members after 6 month from such reduction.
- 2. Holding and Subsidiary Company Relationship:** As per section 2(46) of Indian Companies Act, 2013, a “Holding company” is defined as, in relationship to one or more other companies, a company of which such companies are subsidiary companies. The holding company and its subsidiary company are considered two different companies and separate from each other, and both have separate corporate veils except to the extent that the statute indicates the nature of holding company and subsidiary company. The lifting of holding and subsidiary companies being separate in two cases:



1. **To present better picture of the group as whole as per section 129(3):** a holding company to attach its copies of balance sheet, Profit and Loss account, Director's report, Auditors report of each subsidiary companies to make consolidated balance sheet and to determine the financial position of overall companies as group of wholes, all stakeholders concern.
2. **When the court opined that** the profits of subsidiary companies as well as its control is completely with the nominees of the holding company.
3. **Investigation of ownership of the company (sec. 216).** The central government on its own or on orders of the tribunal may appoint one or more inspectors to investigate matters related to the company regarding to membership for purpose of determining the true person:
 - (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, or
 - (c) Who has or had beneficial interest in shares of the company or who are or have been beneficial owners or significant beneficial owners of a company:
 - (i) Without prejudice to its powers sub-section (1), the central government shall appoint one or more inspectors under the sub-section, if the tribunal, in the course of any proceeding before it, directs by an order that the affair of the company ought to be investigated as regards the membership of the company and other matters relating to the company, for the purpose specified sub-section (1).
 - (ii) While appointing an inspector under sub-section (1), the central government may define the scope of the investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to the matters connected with particular shares or debentures.



Subject to the terms of appointment of an inspector, his powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purpose of his investigation.

- (iii) **Directors with Unlimited Liability:** Ordinarily, the liability of a director in a limited company is the same as that of the member of the company. There is nothing in the act, however, to prevent their liability being made unlimited by memorandum of the company or if limited by memorandum, being converted into an unlimited liability in pursuance of authority given by the articles. The same principle applies also in the case of a manager of a limited company. (Sec. 286)
- (iv) **Investigation in the Affairs of a Company:** Where the central government is of the opinion that it is necessary to investigate into the affairs of a company:
- (a) On the receipt of a report of the registrar or inspector under sec. 208.
 - (b) On information of a special resolution passed by a company that the affairs of the company ought to be investigated.
 - (c) In public interest it may order its investigation into its affairs of the company. If an inspector is appointed under section 210 or 212 or 213 of the Companies Act to investigate the affairs of the company, he has the power to also investigate the affairs of any related company in the same management or group (sec. 219). This is in complete disregard to the separate entities of the companies.



4. Fraudulent Conduct of Business: (Sec. 339) if in the course of winding up of a company, it appears that any business of the company has been carried on in the intention to defraud creditors of the company or any other persons, the tribunal may declare that any persons who were knowingly parties to the carrying on the business in the fraudulent manner, shall be personally responsible without any limitation of liability for all or any of the debts or other liabilities of the company.

5. Failure to Return the Application Money: (Sec. 39) No allotment of any shares 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 have been paid to and received by the company.

If the amount of minimum subscription is not received within 30 days from the date of issue of prospectus or such other period as may be specified by SEBI, the amount shall be returned within such time 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 Rs. 1000 for every day of default or Rs. 100000 whichever is less.

6. Misrepresentation in Prospectus: (Secs. 34, 35) In case there is misstatement in prospectus, every director, promoter, expert and any other person who was involved in the issue of prospectus shall be liable to compensate for loss or damage to every person who subscribed to shares on believing the untrue statement published in the prospectus.

7. Mis-description of Name: The name of the company is very important. It shows the identification so every detail regarding the spelling and pronunciation of the name of the company should be paid attention. The company's name lets the company enter into contracts and legally bind it. The name requires prior approval as under sec. 4 and printed under sec. 12 of the Companies Act. Thus, if any representative of the company collects bills or signs on the behalf of the company



and enters in incorrect particulars of the company then is personally liable.

Case law: Hendon v. Adelman, signatory directors were held personally liable for stating the company's name and signed as "L R Agencies Ltd." while the original name was "L&R Agencies Ltd."

- 8. Pre-incorporation Contract:** Promoters will be personally liable for all those contracts which are made before incorporation of the company, and which are not adopted after the incorporation of the company.
- 9. Ultra Vires Acts:** Every company is bound to perform in compliances of its memorandum of association, articles of association, and the Companies Act, 2013. Any action done outside purview of either is said to be "*Ultra vires*" or improper or beyond the legitimate scope. Such operations of the company can be subjected to penalty. The doctrine of *ultra vires* acts against companies was evolved in the case *Ashbury Railway Carriage and Iron Company Ltd. vs. Hector Riche* where a company entered into contract for financing construction of railways lines, and this operation was not mentioned in the memorandum. The house of lords held this action as *ultra vires* and contract, *null* and *void*.
- 10. Liability under Other Statutes:** There are many other provisions of the company law where directors of a company are personally liable for the default in complying with those provisions. Some of these are non-maintenance of proper books of account; default in holding of annual general meetings, default in filing the annual returns; default in paying dividends after declarations; false declaration of solvency; non-cooperation with the company auditors or with the liquidators (in the event of the winding up of the company); non-compliance with the regulation of the Securities and Exchange Board of India (SEBI). Beside these, directors may be held liable under pollution laws, social security laws (Minimum Wages Act, ESI, EPF, Gratuity), Competition Act, Foreign Exchange Management Act (FEMA), taxation laws.



IN-TEXT QUESTIONS

7. In the famous case of Salomon vs. Salomon & Co. Ltd., it was held that:
 - (a) Company is at law a different person
 - (b) Company is at law a different person from its directors
 - (c) Company is at law a different from its members
 - (d) All of the above
8. Corporate veil can be lifted:
 - (a) As per the Companies Act
 - (b) As per judgment of court
 - (c) Both of the above
 - (d) None of the above
9. In which of the following events, lifting of the Corporate Veil may be allowed by court?
 - (a) When a company is formed to protect revenue
 - (b) When a company is formed for improper conduct or fraud
 - (c) Both of the above
 - (d) None of the above
10. Corporate veil is lifted in two ways in case of Companies Act or judicial interpretation. (True/False)
11. Due to effect of corporate veil the company is itself liable for its acts. (True/False)
12. Indian Companies Act, 2013 contain 470 sections, 7 schedules and 29 chapters. (True/False)
13. The corporate veil definition is a legal concept which separates the actions of members to its _____.
14. Sir Dinshaw Maneckji Petit case based to protect _____.
15. Reduction in number of memberships in case of private company is _____ and in case of public company is _____.



1.6 Summary

A Company is a voluntary association of persons recognised by law, having a distinctive name, a common seal, formed to carry on business for profit, with capital divisible into transferable shares, limited liability, a corporate body and perpetual succession. Corporate veil is a legal concept that separates the personality of a corporation from the personalities of its shareholders and protects them from being personally liable for the company's debts and other obligations. In some circumstances, The court will pierce the corporate veil or will ignore the corporate veil to reach the person behind the veil or to reveal the true form and character of the concerned company.

1.7 Answers to In-Text Questions

1. (c) 2(20)
2. (d) All of the above
3. False
4. False
5. 12th Sep. 2013
6. Saloman vs. Saloman and Co. Ltd.
7. (d) All of the above
8. (c) Both of the above
9. (c) Both of the above
10. True
11. True
12. True
13. Company
14. Revenue
15. 2, 7



1.8 Self-Assessment Questions

1. What is the meaning of company? Define its characteristics.
2. What is the meaning of corporate veil? In which case it is lifted?

1.9 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Administration of Company Law: National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT), Special Courts

Author: Dr. R C Garg

Revised by: Ms. Chandani Aswal

STRUCTURE

- 2.1 *Learning Objectives*
- 2.2 *Introduction*
- 2.3 *Meaning of a Company*
- 2.4 *Constitution of NCLT and NCLAT*
- 2.5 *Selection of Members [Section 412]*
- 2.6 *Terms of Office*
- 2.7 *Advantages of NCLT and NCLAT*
- 2.8 *Powers of NCLT and NCLAT*
- 2.9 *Special Courts and Company Law Board (CLB)*
- 2.10 *Summary*
- 2.11 *Answers to In-Text Questions*
- 2.12 *Self-Assessment Questions*
- 2.13 *Suggested Readings*



2.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ What is the NCLT, its powers, working scenario and its constitution.
- ◆ What is the NCLAT, its powers, working scenario and its constitution.
- ◆ What are the special courts and CLB, its powers, working scenario and its constitution.

2.2 Introduction

The National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) was established under the Companies Act, 2013 and was constituted on 1st June 2016. Companies (Amendment) Act, 2002 was passed to provide for their establishment. It is a quasi-judicial body to regulate and resolve civil corporate disputes. The power derived from Article 245 of the Constitution of India. NCLAT is the higher forum where appeals from NCLT are dealt with. Both Tribunal and Appellate Tribunal follow the Code of Civil Procedure and are subject to any rules formed by the Central Government. Company Law Board (CLB), The Board for Industrial and Financial Reconstruction (BIFR), The Appellate Authority for Industrial and Financial Reconstruction and company related matters of High Court are now governed by NCLT. Any person aggrieved by the order NCLT then appeal any order on question of Law and Fact within 45 days to NCLAT and any person aggrieved by the order NCLAT then appeal order on question of Law within 60 days to Supreme Court.

2.3 Meaning of a Company

NCLT: The NCLT or Tribunal is a quasi-judicial authority created under the Companies Act, 2013, to handle corporate civil disputes arising under the act as we know. It is conceptualized by the Eradi Committee. The NCLT is obliged to objectively determine facts. decide case in accordance with principles of natural justice and draw conclusions from them in the form of orders. Such orders can be remedy a situation, correct a wrong or impose legal penalties/costs and may affect the legal rights, duties or privileges of the specific parties. The Tribunal is not bound by the



strict judicial rules of evidence and procedure. It can decide case by the following the principles of natural justice.

NCLAT: NCLAT or Appellate Tribunal is an authority provided for dealing with appeals arising out of the decisions of the Tribunal. It is formed for correcting the errors made by the Tribunal. It is an intermediate or mediator appellate forum where the appeals lie after order of the Tribunal. The order can be challenged to the Supreme Court. Any aggrieved or dissatisfied party by any order of the Tribunal may apply to Appellate Tribunal. The Appellate reviews the decision of the tribunal and power to set aside, modify or confirm it.

Difference between the NCLT and NCLAT:

Basis of	NCLT	NCLAT
1. Jurisdiction	It holds primary jurisdictions on cases of insolvency, bankruptcy and corporate disputes.	It holds appellate jurisdictions over the cases judged by NCLT.
2. Evidence	It accepts and analyses the evidence from creditors/debtors for taking decisions.	It accepts and analyses the decision made by NCLT.
3. Facts	It collects all the facts.	It analyses the facts.

2.4 Constitution of NCLT and NCLAT

Constitution of National Company Law Tribunal (NCLT): Section 408

The Central Government shall by notification, constitute, with effect from such date as may be specified therein, a tribunal to be known as National Company Law Tribunal consisting of a President and such Judicial and Technical members, as the Central Government may deem necessary, to be appointed by its notification, to exercise and discharge such powers and functions as are, or may be, conferred on it by or under this Act or any other Law for the time being in force.

As per section 409, qualification of President and Members of Tribunal are as under:

- 1. The President shall be a person who is or has been a**
 - (a) Judge of a High Court at least five years

**2. Judicial Member:**

- (a) Judge of a High Court.
- (b) District Judge for at least five years.
- (c) Has for at least 10 years been an advocate of a court or held a judicial office or as a member of a Tribunal.

3. Technical Member:

- (a) Has for at a least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Services out of which at least three years as joint secretary or above; or
- (b) Is or has been in practice as a chartered accountant for at least fifteen years;
- (c) Is or has been in practice as a cost accountant for at least fifteen years;
- (d) Is or has been in practice as a company secretary for at least fifteen years;
- (e) Is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related management, conduct of affairs, revival, rehabilitation and winding up of the companies; or
- (f) Is or has been, for at least five years, a Presiding Officer of a labour court, Tribunal or National Tribunal Constituted under the Industrial Disputes Act, 1947.

The National Company Law Tribunal consists of a President and such number of Judicial and Technical Members not exceeding sixty-two, as Central Govt. deems fit. The President and every other member of the Tribunal shall hold office for a term of five years from the date on which he enters upon his office but shall be eligible for re-appointment.

***Constitution of National Company Law Appellate Tribunal (NCLAT):
Section 410***

The Central Government shall, by notification, constitute with effect from such date as may be specified therein, an Appellate Tribunal to



be known as the national Company Law Appellate Tribunal consisting of a chairperson and such number of Judicial and Technical Members, not exceeding eleven, as the Central Government may deem fit, to be appointed by it by notification, for hearing appeals against–

- (a) The orders of the Tribunal or of the National Financial Reporting Authority under this act [Amended by the Companies (Amendment) Act, 2017].
- (b) Any direction, decision or order referred to in section 53N of the Competition Act, 2002 in accordance with the provision of that Act.

As per section 411, qualification of President and Members of Appellate Tribunal are as under:

1. **The chairperson shall be who** is or has been a judge of the Supreme Court or the Chief Justice of a High Court.
2. **A judicial Member** shall be a person who is or has been a judge of a High Court or is a Judicial Member of the Tribunal for Five Years.
3. **A Technical Member shall be a person of proven ability, integrity and standing having special knowledge and experience.**
 - (a) **Of not less than twenty-five years** in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies.

2.5 Selection of Members [Section 412]

In case of both NCLT and NCLAT - President of the Tribunal and Chairperson and Judicial Members of the Appellate Tribunal, shall be appointed after consultation with the **Chief Justice of India**.

The members of the Tribunal and the Technical Members of Appellate Tribunal shall be appointed on the recommendation of a selection committee consisting of –

- (a) Chief Justice of India or his nominee - Chairperson.
- (b) A senior Judge of the Supreme Court or a Chief Justice of the High Court – member.



Notes

- (c) Secretary in the Ministry of Corporate Affairs – members.
- (d) Secretary in the Ministry of Law and Justice – members.
- (e) Secretary in the Department of Financial Services in the Ministry of Finance – members.

The Secretary, Ministry of Corporate Affairs shall be the Convener of the Selection committee.

2.6 Terms of Office

NCLT

The President and every other member of the Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office but shall be eligible for reappointment for another term of five years.

A member of the tribunal shall hold office as such until he attains:

- (a) In the case of the president, the age of sixty-seven years.
- (b) In the case of any other member, the age of sixty-five years.

A person who has not completed fifty years of age shall not be eligible for appointment as member.

The Member may retain his lien with his parents' cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

NCLAT

The chairperson or a member of the Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office but shall be eligible for re-appointment for another five years.

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

- (a) In the case of the Chairperson, the age of seventy years.
- (b) In the case of any other member, the age of sixty-seven years.

A person who has not completed fifty years of age shall not be eligible for appointment as member.



The Member may retain his lien with his parents' cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

IN-TEXT QUESTIONS

1. _____ means a member of the Tribunal or the Appellate Tribunal appointed as such and includes the President or the Chairperson, as the case may be:
 - (a) Chairperson
 - (b) Judicial Member
 - (c) President
 - (d) Member
2. What is the maximum number of judicial and technical members in NCLAT?
 - (a) 3
 - (b) 11
 - (c) 6
 - (d) 10
3. NCLT shall consist of a _____.
4. Selection committee of NCLT recommends the appointment of _____ of Tribunal.

2.7 Advantages of NCLT and NCLAT

- (a) NCLT is a specialized court only for corporations, *i.e.*, companies registered in India.
- (b) This will be no more than a Tribunal for the corporate members.
- (c) NCLT will reduce the multiplicity of litigation before different forums and courts.
- (d) NCLT has multiple branches and is able to provide justice at a close range.
- (e) NCLT consists of both judicial and technical members while deciding on matters.



Notes

- (f) The time taken to wind up a company will be reduced from 20-25 years to 2 years.
- (g) Speedy disposal of cases will help reduce the number of cases.
- (h) NCLT and NCLAT have exclusive jurisdiction.
- (i) There will be a mixture of judicial and equitable jurisdiction while deciding matters.
- (j) The Tribunal shall comprise technical experts who will provide more concrete and precise decisions.

2.8 Powers of NCLT and NCLAT

1. The powers of the tribunal may be exercised by Benches, constituted by the President of the Tribunal, out of which one shall be a judicial Member, and another shall be a technical member.
2. The Tribunal may, after giving an opportunity of being heard to the parties to any proceedings before, it passes such orders thereon as it thinks fit.
3. The tribunal shall have powers to review its own orders.
4. Any person aggrieved by an order or decision of the Tribunal may prefer an appeal to Appellate Tribunal.
5. The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice. Subject to other provisions of this Act and of any rules made by the Central Government, Tribunal and the Appellate Tribunal shall have power to regulate their own procedures.
6. The tribunal and the appellate tribunal shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters:
 - (a) Summoning and enforcing the attendance of any person and examining him on oath.
 - (b) Requiring the discovery and production of documents.
 - (c) Receiving evidence on affidavits.



- (d) Subject to the provisions of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office.
 - (e) Issuing commissions for the examination of witnesses or documents.
 - (f) Reviewing its decisions.
 - (g) Dismissing a representation for default or deciding it *ex parte*.
7. Any order made by the Tribunal, or the Appellate Tribunal may be enforced by that tribunal in the same manner as if it were a decree made by a court in a suit pending therein.
 8. All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the Indian Penal Code.
 9. No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine by or under this act and no injunction shall be granted by any court or other authority in respect of any action taken in pursuance of any power conferred by or under this act.
 10. Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such decision or order.

The NCLT has the power under the Companies Act to adjudicate proceedings:

1. Initiated before the Company Law Board under the previous Act (Companies Act, 1956);
2. Pending before the Board for Industrial and Financial Reconstruction (BIFR), including those pending under the Sick Industrial Companies (Special Provisions) Act, 1985;
3. Pending before the Appellate Authority for Industrial and Financial Reconstruction; and
4. Pertaining to claims of oppression and mismanagement of a company, winding up of companies and all other powers prescribed under the Companies Act.



Power Vested in NCLT

1. Class Action: Protection of the interest of various stakeholders, especially non-promoter shareholder and depositors, has always been the concern of company law, there were several frauds and impropriety that were noticed where the key losers were the shareholders and depositors. The shareholders who invested in listed companies saw their investments and savings drying up when the companies that they invested in were cheated by the investors.

The Companies Act, 2013 has provided a very good combination of remedies where the offender will be punished and the people who are involved (whether it is the company or directors or auditor or experts or consultants) will be liable even for a civil action, wherein they have to compensate the shareholders and depositors for the losses caused to them on account of the fraudulent practices or impropriety.

A class action is a procedural device that permits one or more plaintiffs to file and prosecute a lawsuit on behalf of a larger group or class. It is in the nature of a representative suit where the interest of a class is represented by a few of them. A huge number of geographically dispersed shareholders /depositors are affected by the wrongdoings. It is a useful tool where a few may sue for the benefit of the whole or where the parties form a part of voluntary association for public or private purposes and may be fairly supposed to represent the rights and interest of the whole.

Section 245 has been introduced in the new company law to provide relief to the investors against a large set of wrongful actions committed by the company management to other consultants and advisors who are associated with the company.

Class action can be filed against any type of companies, whether in the public sector or in the private sector . It can be filed against any company which is incorporated under the Companies Act, 2013, or any previous Companies Act. The Act provides only one exemption: banking companies.

2. Deregistration of Companies: The procedural errors at the time of registration can now be questioned at any time. The tribunal is empowered to take several steps, including cancellation of registration and dissolving the company. The Tribunal can even declare the liability of members unlimited. Sec. 7(7) provides this new way for de-registration of companies



in certain circumstances when registration of companies is obtained in an illegal or wrongful manner. Deregistration is a remedy that is distinct from the winding up and striking off.

3. Oppression and mismanagement: The remedy of oppression and mismanagement is retained in the 2013 Act. The nature of this remedy has however changed to a certain extent, and it needs to be seen in light of the change made to the Companies Act, 2013. The Act 2013 has reset the bar for oppression to a little lower level and has set the bar of mismanagement a little higher by applying the test “winding up on just and equitable grounds” even to mismanagement matters. The Act permits dilution of the eligibility criteria with the permission of the Tribunal, where a member below the eligibility criteria can apply in deserving cases.

4. Refusal to Transfer shares: The power to hear grievances of refusal of companies to transfer securities and rectification of register members under sections 58 and 59 of the new Act were already notified and were being taken up by CLB. Now, the same are transferred to NCLT. The remedy for refusal to transfer on transmission were restricted only to shares and debentures under 1956 Act. The provisions for refusal to transfer and transmit under Companies Act, 2013, Act extends to all securities. These sections give express recognition to contracts or arrangements for transfer of securities entered into between two or more persons with respect of shares of a public company and thus clears any doubts about the enforceability of these contracts.

5. Deposits: Chapter 5 dealing with deposits was notified in phases in 2014 and powers to deal with the cases under it were assigned in CLB. Now the said powers will be vested in NCLT. The law on deposits is quite distinct under the Companies Act, 2013 as compared to the Companies Act, 1956. The provisions for deposits under the 2013 Act were already notified. Aggrieved depositors also have the remedy of class actions for seeking redressal for the acts/omissions of the company which hurt their right as depositors.

6. Reopening of Accounts and revision of financial statement: Several instances of falsification of books of account were noticed under the Companies Act, 2013. One such measure is the insertion of sections 130 and 131 read with sections 447, 448 in the new Act. Section 130 read with section 131 are newly inserted provisions that prohibit the company



from *suo motu* opening its accounts or revising its financial statement. This can be done only in the manner provided in the Act. Section 130 read with Section 131 provides the instances where financial statements can be revised/reopened. Section 130 is mandatory, where the Tribunal or court may direct the company to reopen its accounts when certain circumstances are shown. Section 131 allows a company to revise its financial statement but does not permit reopening of accounts. The company can itself approach the Tribunal under Section 131, through its director for revision of its financial statement.

7. Tribunal Ordered investigations: Chapter XIV provides several powers to the Tribunal in connection with investigation. The most important powers that are conferred to the tribunal are:

- (a) **Power to impose restriction on securities:** The restriction earlier could be imposed only on shares. Now the Tribunal can impose restrictions on any security of the company.
- (b) Power to investigate the ownership of the company.
- (c) **Power to impose restriction on securities:** The Restriction earlier could be imposed only on shares. Now, the Tribunal can impose restrictions on any security of the company.
- (d) **Power to investigate into the ownership of the company:** The Tribunal is given the power to freeze assets of the company which can not only be used when the company is under investigation but can also be initiated at. The insistence of a wide variety of persons in certain situations.

8. Conversion of public company into private company: Sections 13, 14, 15 and 18 of the Companies Act, 2013 read with rules regulating the conversion of public limited company into private limited company. It requires approval from NCLT. Approval of the Tribunal is required for such conversion. The Tribunal may at its discretion impose certain conditions subject to which approvals may be granted (Sec. 459).

9. Tribunal convened AGM: General meetings are required to assess the opinion of shareholders from time to time. The Act mandatorily requires one meeting to be called, which is termed as the “annual general meeting” or “AGM”. Any other general meeting is termed as “extraordinary general meeting” or “AGM”. Any other general meeting is termed as “extraordinary



general” or “EOGM”. If the AGM or EOGM cannot be held called or convened in the manner provided under the Act or the Rules by the board or the member due to certain extraordinary circumstances, then the Tribunal is empowered under sections 97 and 98 of 2013 Act to convene general meetings under the Companies Act, 2013. The provision for convening an annual general meeting and extraordinary general meeting in the Companies Act, 2013 are almost similar to provisions provided in the Companies Act, 1956. However, the draft rules have inserted an additional provision that require intimation of such cases to be require intimation of such cases to given to Registrar of company.

10. Compounding of offence: Provisions of compounding under the 2013 Act were notified before the constitution of NCLT and were assigned to CLB. This power will now be vested with NCLT, and all compounding matters which are above the prescribed monetary limit will be approved by NCLT.

11. Change in Financial Year: Section 2(41) also has been already notified on 1 April 2014. The Act requires that every company or body corporate, new existing, must have a uniform financial year ending on 31st march. It provides an exception where certain companies can apply to the Tribunal to have a different financial year. A company or a body corporate can make an application to the Tribunal. As the Tribunal was not notified at the time when this section was notified, the power to alter the financial year on application was granted to the CLB. The same has been notified on the site of CLB *vide* order date 28 January 2015. All the applications that are not disposed of at the time when NCLT provisions are notified, will also be transferred to the Tribunal.

12. Power to freeze Assets of the company.

Company Law Board (CLB).

The concept of Company Law Board was introduced through an amendment to Companies Act, 1956 in the year 1988. It was constituted in its present form on May 31, 1991. Under section 10E of the Companies Act, 1956 replacing the erstwhile Company law Board which was primarily as a delegate of Central Government since 1st Feb. 1964. The Company law board has framed Company Law Board Regulations, 1991 wherein all the procedures for filing the application/petition before the Company law board has been prescribed. The Central Government has also prescribed the fee



for making applications/petitions before the Company Law Board (Fees on Applications and Petitions Rules, 1991). The Company Law Board will be succeeded over by the NCLT which will govern all companies under Companies Act, 2013. The Board has its Regional Benches at Mumbai, Calcutta, Chennai and New Delhi besides the Principal Bench at New Delhi and another Principal branch for Southern states at Chennai.

2.9 Special Courts and Company Law Board (CLB)

Special Courts

Establishment of Special Courts (Section 435)

Sections 435 to 446 of the Companies Act, 2013 contains provisions on the Special Court.

As per section 435(1) of the Companies Act, 2013, the Central Government may establish or designate as many special courts as may be necessary to provide speedy trial of offences punishable under the Companies Act, 2013 with imprisonment of two years or more.

The Central Government, by notification, establish or designate as many Special Court as may be necessary:

The Special Courts shall consist of:

- (a) A single judge holding office as Session's Judge or Additional Sessions Judge in case of offences punishable under this Act with imprisonment of two years or more.
- (b) A Metropolitan magistrate or a judicial magistrate of the first class, in the case of other offences.

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

Section 446A: It specifies that the court or the Special Court, while deciding the amount of fine or imprisonment under this Act, shall have due regard of the following factors, namely:

- (a) Size of the company.
- (b) Nature of business carried on by the company.
- (c) Injury to public interest.



(d) Nature of the default.

(e) Repetition of the default.

In case of OPC (one person company) or small company fails to comply with the provision of sub-section (5) of section 92, sub-section (2) of section 117 or sub-section (3) of section 137, such company and officer in default of such company shall be punishable with fine or imprisonment or fine and imprisonment, as the case may be, which shall not be more than one half years of the fine.

Offences triable by Special Courts:

As per the provisions of the Companies Act, 2013, following offences are triable by Special Courts:

1. Offences for which the Companies Act, 2013, provides for imprisonment of 2 years or more.
2. Cases forwarded by a Magistrate (where he thinks detention is unnecessary) for any offence committed under the Companies Act, 2013. This provision will come into play when a person is arrested and detained in custody, and it appears that the investigation cannot be completed within the period of 24 hours as required under the Code of Criminal Procedure, 1973 (CrPC) and there are grounds for believing that accusation or information is well – founded, and detention is authorized by Magistrate for a period not exceeding 15 days (if ordered by Judicial Magistrate) or 7 days (if ordered by Executive Magistrate), as the case may be. In such cases, the Special Court has the same power as the Magistrate having jurisdiction to try such cases.
3. Take cognizance of an offence under the Companies Act, 2013, without the accused being committed to it for trial upon:
 - (a) perusal of the police report of the facts constituting such offence.
 - (b) if a complaint has been filed in that behalf.
4. Try at the same trial on offence for which an accused may be charged under CrPC in addition to an offence under the Companies Act, 2013.
5. If the Special Court thinks fit, it may try in a summary way, any offence under the Companies Act, 2013, which is punishable with



imprisonment for a term not exceeding 3 years, provided that in the case of any conviction in such trial, a person cannot be sentenced for imprisonment for a term exceeding 1 years.

Mediation and Conciliation Panel (Section 442)

1. The Central Government shall maintain a panel of experts to be called Mediation and Conciliation Panel Consisting of such number of experts having such qualifications as may be prescribed for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under this Act.
2. Any of the parties to the proceedings may, at any time during the proceedings before the Central Government or the Tribunal or the Appellate Tribunal, apply to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in such form along with such fees as may be prescribed, for referring the matter pertaining to such proceedings to the Mediation and Conciliation Panel and the Central Government or Tribunal or the Appellate Tribunal, as the case may be shall appoint one or more experts from the panel referred to in sub-section (1).
3. 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 number of experts from the Mediation and Conciliation Panel as the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, deems fit.
4. The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as may be prescribed.
5. The Mediation and Conciliation Panel shall follow such procedure as may be prescribed and dispose of the matter referred to it within a period of three months from the date of such reference and forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.
6. Any party aggrieved by the recommendation of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

**IN-TEXT QUESTIONS**

5. The President of NCLT shall be a person who is or has been judge of High Court _____ years.
 - (a) 5 years
 - (b) 2 years
 - (c) 7 years
 - (d) 1 year
6. The President of the Tribunal shall be appointed after consultation with the _____.
 - (a) President of India
 - (b) Prime Minister of India
 - (c) Home Minister of India
 - (d) Chief Justice of India
7. Mr. Dev wants to be a member of Tribunal in the year 2020. His age is 49 years in 2020. would he be eligible for appointment as member of the Tribunal?
 - (a) Yes
 - (b) No
 - (c) Not applicable
8. The President/Chairperson and Members of Tribunal/Appellate Tribunal shall hold office for a term of _____ years from the date on which he enters upon his office.
9. The principal Bench of the Tribunal shall be at _____.
10. What is the time limit from the date of receipt of the order to file Appeal to the Supreme Court _____?

2.10 Summary

NCLAT was constituted under section 410 of the Companies Act, 2013 for hearing appeals against the orders of NCLT with effect from 1st June 2016. NCLT is a quasi-judicial body in India that adjudicates issues relating to Indian Companies. The Central Government has NCLT under section

**Notes**

408 of the Companies Act, 2013. The Central Government may for the purpose of providing speedy trial of offences punishable under this act with imprisonment of two years or more, by notification, establish or designate as many Special Courts as may be necessary. The Company Law Board (CLB) is a quasi-judicial body, exercising equitable jurisdiction, which was earlier being exercised by the High Court or the Central Government. The Board has powers to regulate its own procedures. The Company Law Board has framed “Company Law Board Regulations, 1991” prescribing the procedures for filing the application/petition before it.

2.11 Answer to In-Text Questions

1. (b) Judicial Member
2. (b) 11
3. President, Technical Members and Judicial Members
4. Members
5. (a) 5 years
6. (d) Chief Justice of India
7. (b) No
8. 5 Years + 5 Years
9. New Delhi
10. 60 Days

2.12 Self-Assessment Questions

1. Write a short notes NCLT.
2. Write the difference between CLB and NCLT.

2.13 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur. H. (2022). Company Law, Delhi: Kitab Mahal.



- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Types of Companies: On Basis of Incorporation and on the Basis of Members

Author: Dr. R C Garg

Revised by: Ms. Chandani Aswal

STRUCTURE

- 3.1 *Learning Objectives*
- 3.2 *Introduction*
- 3.3 *Distinction Between Company and Partnership*
- 3.4 *Classification of Companies on the Basis of Mode of Incorporation - Chartered Company, Registered Company, Statutory Company*
- 3.5 *Classification of Companies on the Basis of Number of Members - Public Company, Private Company, Small Company, One Person Company*
- 3.6 *Difference Between Private and Public Company*
- 3.7 *Summary*
- 3.8 *Answers to In-Text Questions*
- 3.9 *Self-Assessment Questions*
- 3.10 *Suggested Readings*

3.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Types of companies on the basis of incorporation, difference between companies and its function.
- ◆ Advantages and disadvantages of types of Companies.
- ◆ Difference between partnership and Company.



- ◆ Conversion of companies from one to another type. Like Private to public and *vice versa*.

3.2 Introduction

A company is a body corporate or an incorporated business organisation registered under the Companies Act. The Companies Act, 2013 provides types of companies that can be promoted and registered under the Act. We know about public and private company as these companies types are common but there are so many company such as Statutory company, registered company, companies limited by shares, unlimited. Companies, Government company, foreign company etc. We study types of companies in detail.

3.3 Distinction Between Company and Partnership

Basis	Company	Partnership
1. Mode of creation	By Registration and by statute	By agreement.
2. Legal Statue	Legal entity distinct from members, perpetual succession, common seal.	Firm and partners.
3. Liability	Limited liability of members.	Unlimited joint and several liability of partners.
4. Authority	Divorce between ownership and management, Representative management.	Right to share management, common ownership and management, mutual agency-implied authority.
5. Transfer of shares	Public Co-freely transferable and transferee gets all the rights of the transferor.	Ordinarily no rights of transfer of share by a partner –limited rights.
6. Number of members.	Private Co- minimum 2 member and maximum- 200-member, public company minimum 7 member and maximum – unlimited.	Minimum 2 members Maximum 100 members.
7. Resources	Large and unlimited resources especially in the case of public companies as funds can be raised from the public.	Limited resources. Dependent on partners' personal resources.



Notes

Basis	Company	Partnership
8. Legal formalities	Statutory books have to be maintained. Audit of Accounts is compulsory. Documents and required information to be filed. Publication of Accounts required. Lots of legal formalities.	No legal formalities. Registration is not compulsory. Audit is not compulsory. No publication of accounts.
9. Conduct of Affairs	Affairs of company are conducted as per the Companies Act. A company has to operate within the objects laid down by the Memorandum of Association.	Partners may carry any business as they decide, so long it is not illegal. They are free to make whatever arrangements they wish to run the affairs of the firm.
10. General powers.	Memorandum defines and confines the scope of the company.	Easy to change the agreement and so also the powers of the partners.
11. Dissolution	May be dissolved only according to the provision of law. Usually by an order of the court. Death of members does not dissolve the company.	Dissolution by agreement by notice, or by court death of partner dissolves the partnership.

3.4 Classification of Companies on the Basis of Mode of Incorporation - Chartered Company, Registered Company, Statutory Company

According to the modes of incorporation, companies may be classified into three categories:

- (a) Registered Companies.
- (b) Statutory Companies.
- (c) Chartered Companies.

Registered companies

Companies registered under the Indian company's act are known as Registered companies. It is officially set up and registered with the Registrar of Companies and get Certificate of incorporation issued by Roc. Example- Google India private Ltd.



Registered Companies further divided into 3 parts:

- (a) Companies limited by shares.
- (b) Companies limited by guarantee.
- (c) Unlimited Companies.

(a) Companies limited by shares: Section 2(22) of Indian Companies Act, 2013 defines “Company limited by shares” as a company having the liability of its members limited by the Memorandum of Association to the amount (if any) unpaid on the shares held by them, such a company is known as a company limited by shares. The liability can be enforced during the existence of the Company and also during the winding up of the company. If the shares are fully paid, the liability of the members holding such shares are nil. For example: If a XY Ltd. has a share capital of 20,000 shares of Rs. 20 each, and A has purchased 200 shares on which he has paid so far Rs. 12 shares, the maximum liability of A is only Rs. 8 per share (the unpaid amount). Companies limited by shares are the most common and also known as “Limited Liability Company”. A company Limited by shares may be a public company or private company.

(b) Companies limited by guarantee: According to section 2(21) of the Companies Act, 2013, where the liability of the members of a company is limited by its Memorandum of Association to such amount as the members may respectively undertake to contribute to the assets of the company in the event of it being wound up. Company limited by guarantee also called Guarantee company. The amount guaranteed by each member in the nature of a reserve capital. It cannot be called up except in case of winding up of the affairs of the Company. The articles of association of such a company shall state the number of members with which the company is to be registered. These companies may or may not have share capital. If it has a share capital, liability of members shall be two fold, firstly liable to pay the amount which remains unpaid on their shares plus the amount payable under the guarantee. The objective of these companies, not to earn profit, are non-trading companies. These companies are usually formed for the promotion of educational or scientific research, science, religion, social or charitable purposes.



Example - sports club, trade association NGOs are usually registered as guaranteed companies.

- (c) **Companies with unlimited Liability:** According to section 2(92) of the Indian Companies Act, 2013 defines that unlimited company as a company not having any limit on the liability of its members. In case of an unlimited company, every member is liable for the debts of the company to an unlimited extent. An unlimited company may or may not have share capital. In case it has any share capital, it can increase or reduce its share capital without any restriction. If it has a share capital, it may be a public company or a private company. It must have its own Article of Association.

Statutory Companies

There are the Companies which are created by a special Act of the central and state legislature called Statutory Company. Statutory companies governed by the provisions of their special Acts. Some examples of these types of companies are - the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation, etc. These are mostly concerned with public utilities and the objective is not to earn profit but to serve people, e.g., railways, tramways, gas and electricity companies and enterprises of national importance. The provisions of the Companies Act, 2013 apply to them, if they are not inconsistent with the provisions of the Special Acts under which they formed. The liability of the members of such companies is limited. But in most of the cases, they may not be required to use the word “Limited” as part of their names. Annual Report on the working of each such company is required to be placed on the table of the Legislature (Parliament or State Legislative Assembly as the case may be). The audit of such Companies is conducted under the supervision, control and guidance of the Comptroller and Auditor General of India.

Chartered Companies

A Company which is formed by the grant of the Charter by the crown, and which is regulated by that charter is called a chartered company. These are the companies which are created under a special charter issued by the king or queen of the country of Monarchy. Example – East India of India, Bank of England.

**Difference between Unlimited company and Partnership Firm:**

Although the members of unlimited companies are fully liable for all the debt incurred by the Company like partners of a partnership firm, unlimited company is different from partnership firms:

- (1) The creditors of unlimited companies cannot sue the members directly on account of the separate legal personality of the company. In case the company fails to pay, the creditors will have to resort to the winding up of the company. The liquidators will call upon the members to contribute towards the assets of the company so as to enable him to meet the debts and the costs of winding up of the company.
- (2) An unlimited company is registered under the Companies Act and is a legal person with perpetual succession and common seal. A partnership firm on the other hand has no existence as a legal entity.

IN-TEXT QUESTIONS

1. Minimum number of directors in public company as per Indian Companies Act, 2013 are:
 - (a) 5
 - (b) 6
 - (c) 7
 - (d) 3
2. Minimum paid up capital in private company as per Indian Companies Act, 2013 is:
 - (a) 2 lakhs
 - (b) 5 lakhs
 - (c) 1 lakh
 - (d) 7 lakhs
3. Minimum paid up share capital of public company is _____ .
4. Companies with limited liability are mentioned in section 5. (True/False)



3.5 Classification of Companies on the Basis of Number of Members - Public Company, Private Company, Small Company, One Person Company

According to basis of the number of members, Companies may be classified into Four categories:

- (a) Public Company.
- (b) Private Company.
- (c) Small Company.
- (d) One-person Company.

Public Company

According to section 2(71) of the Companies Act, 2013, public company is a company which:—

- (A) is not a private company,
- (B) has minimum paid-up share capital Rs. 5,00,000 or such higher paid-up capital as may prescribed,
- (C) has seven or more members.

The Company can invite the public for Subscription of shares and debentures. The term public limited is added to its name at the time of incorporation.

There is no restriction on the maximum number of members.

As per the provision of Companies Act, 2013, a company which is a subsidiary of a company (not being a private company) shall be deemed to be a public company even where such subsidiary company continues to be a private company in Article of Association (AoA).

The Companies (Amendment) Bill, 2019 was introduced in Lok Sabha on July 25, 2019 by the Minister of Finance, Ms Nirmala Sitharaman. It amends the Companies Act, 2013. Issuance of dematerialised shares: Under the Act, certain classes of public Companies are required to issue shares in dematerialised form only.



Private Company

According to section 2(68) of the Companies Act, 2013, private company means a company having a minimum paid-up share capital as may be defined and which by its Article—

- (a) Restricts the right to transfer its shares. This restriction is basically to preserve the private character of the company.
- (b) Maximum number of members 200 (except in case one person company).
- (c) Prohibits any invitation to the public to subscribe for any securities of the Company.

Minimum number of members are two (2) and where two more persons hold one or more shares in a company jointly, they shall, for purposes of this clause, be treated as a single member. In counting this number, the following persons are excluded:

1. Employee of the company, and
2. Persons who were former employees of the company, while in that employment and have continued to be members after the employment ceased.

The requirement of Rs. 1,00,000 or more as minimum paid up share capital for private companies has been omitted by the Companies (Amendment) Act, 2015.

Exemption enjoyed by a Private Company in India:

1. **Members:** A private company can form with only two people. (Sec. 3)
2. **Prospectus:** A private company doesn't need to issue a prospectus. So, private companies are exempted from complying with the provisions of the Act regarding the issue of the prospectus [Sec. 23(1)].
3. **Exemption regarding share capital:** A Private can give financial assistance for the purchase of subscription of its own shares or its holding company [Sec. 67(2)]. Restrictions applicable to public companies regarding kinds of share capital, voting rights, issue of shares with disproportionate voting rights and termination of disproportionate excessive rights do not apply to private companies.



- 4. Exemptions regarding to directors:** A private company have enjoys following exemptions regarding directors–
- (a) A private company may have two directors.
 - (b) A private company is not required to appoint an independent.
 - (c) Directors of private companies need not retire by rotation.
 - (d) Persons holding an office of profit can be appointed as directors of a company without passing a special resolution. [Sec. 149(e)(i)].
 - (e) The provision excluding an interested director from participating in voting at board proceedings does not apply to a private company.
- 5. Exemption regarding number of directors:** The restrictions as to the maximum number of companies of which a person may be appointed as director is 20 in case of private company and 10 in a public company [Sec. 165(1)].
- 6. Exemption regarding managerial remuneration:** The provisions of the Act regarding fixing or increasing the remuneration of managerial personnel of a company are not applicable to private companies. [Sec. 197].
- 7. Audit committee:** A private company is not required to constitute an audit committee of the Board. [Sec. 177].

Conversion of Companies already registered (Section 18)

According to Indian Companies Act, 2013 [sec. 18] allows an existing company an existing Company of another class by altering its memorandum of association in the manner prescribed in chapter II of the Companies Act, 2013. Section 13 provides alteration of Memorandum of Association and Section 14 provides for Alteration of Articles of Association.

Conversion of a Private Limited Company into Public Company:

Section 14 of Companies Act, 2013 plays an important role during conversion of a Private Company into Public Company. Conversion of a private Company into a Public Company involves alteration of articles of association of Private company under section 14 which cannot be



completed without passing special resolution of Shareholders in the General meeting.

Three modes:

1. **Conversion by Default:** Where a private company makes default in complying essential statutory requirement on the Companies Act, 2013 then company ceases to enjoy the privileges and exemptions conferred on a private company.
2. **Conversion by Operation of Law or Private Company to be deemed Public Company.**
3. **Conversion by choice:** Alteration of articles of association required and special resolution of members passed at a general meeting.

Procedures are:

1. **Calling of Board meeting:** notice shall be issued with provision of section 173(3) of the Companies Act, 2013. Agenda of this board meeting are:
 - A. Pass a board resolution to get approval of Directors for conversion of a Private Company into Public company by altering AOA.
 - B. To get Approval of shareholders, time, date and place should be fixed to holding Extraordinary General Meeting (EGM), by way of Special resolution.
 - C. According to section 102(1) of Companies Act, 2013 - to approve notice of EGM along with Agenda and Explanatory statement to be annexed to the notice of General meeting.
2. **Issue of EGM Notice:** Notice issued of the Extraordinary General Meeting (EGM) to all members - Directors, and Auditors of the company in accordance with the provisions of section 101 of the Companies Act, 2013.
3. **Holding of extraordinary General Meeting**
4. **ROC Form filling:** Few E-forms will be filed with the concerned Registrar of Companies at different stages.
 - (a) E-Form MGT.14 - For filing special resolution with ROC, passed for the conversion of Private company to public company. MGT.14 filed with concerned ROC within 30 days of passing



special resolution in the EGM. First, we have to file MGT-14 as SRN No. of Form MGT-14 will be used in Form INC-27.

5. Attachments of e-Forms MGT-14:

- (a) Notice of EGM with explanatory statement under section 102 of Companies Act, 2013.
- (b) Certified true copy of special Resolution.
- (c) Altered MOA and AOA.

6. E-Form INC-27 - As per Rule 33 of Companies (Incorporation) Rules, 2014, for effecting the conversion the application shall be filed in ROC with Form No. INC-27 with prescribed fee.

Then scrutiny or verification of documents done then some post conversion formalities follow:-

Intimate all the concerned authorities like Excise and sales tax etc, arrange new Pan card and update all bank details, new stationery with new name of the company and board contained name with "Ltd". then newly adopted AOA and MOA and raise paid up capital for 500000 and increase No. of director to 3.

Conversion of a Public Company into private company:

Section 13 of Indian Companies Act, 2013 says about Alteration of memorandum with terms of sec. 61 (Power of Ltd. company to alter its share capital) of the act. This section explained about the changes in alteration of memorandum for that purpose prior permission of Central Government.

Section 14 of Companies Act says about the alteration of articles.

Steps for conversion of Public Company into Private Company: According to secs. 13, 14 and 18 of the Act need to be read with section 41 of the Companies Incorporation (4th Amendment) Rules, 2018. Rule 41 defines procedures/steps for the conversion of Public Company into Private Company.

Steps:

1. **Board meeting:** Meeting held for conversion decisions. The Board approves the conversion procedure. The minutes of the meeting should be made.



2. **Representative:** The Company shall authorize any representative to act on behalf of the company for conversion procedure. One true copy of resolution required on behalf of the Company in favour of any professional to represent the Company before the Regional director.
3. **General meeting:** Decision on conversion of the company shall take place in the general meeting.
4. **E-form:** The necessary e-form should be filed regarding the decision of conversion of the company. According to section 117 of the Companies Act, it is important to file certain documents at the time of said filing.
5. **Application:** The necessary application for conversion shall be drafted and submitted before the Regional Director and the application has to file within 60 days after passing the resolution. Documents and declarations as mentioned in rule 41 need to be submitted before the regional Director with the Application. Particulars which are mentioned in rule 41(2) shall also need to be submitted.
6. **List of creditors and debenture holders need to be annexed with the application:** Due amount claims, liabilities, uncertain debt details required.
7. **Form No. INC-25A:** The company has to file Form No. INC-25A. After Submission RD may seek some more details or additional information, the same details need to be submitted in the period of 15 days in **e-Form No. RD GNL-5**. RD may reject the application within a period of 30 days after the submission of the application and the applicant cannot file more than two submissions of the application.
8. **Order of Approval:** If no Order of approval, or rejection or resubmission has been passed by the RD shall conduct hearing within 30 days upon the receipt of the said objection.

Conversion shall not pass if there is any case pending against the company and the conversion order has to file in Form No. INC 28 within 15 days upon receipt of order.

**Number of Members Falling below Requirement:**

Section 3A has been included by the Companies (Amendment) Act, 2017, regarding liability of members in case when number is reduced from statutory minimum.

In both case – public companies below seven, private company below 2. And the company carries business for more than 6 month, while the number of member is so reduced, every person who is a member of the company during the time that it so carries on business after those six month and is aware of the fact that they carrying business with less than 7 or 2 members, as the case may be, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefore.

Small company**Definition:**

Section 2(85) of the Companies Act, 2013 defines a small company as- “Small Company” means a company, other than a public Company:

1. Paid-up share capital of which does not exceed fifty lakh rupees, or such higher amount may be prescribed which shall not be more than Rs. ten crores.
2. Turnover of which as per 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:

Provided that nothing in this section shall be apply to:

1. Public Company.
2. A holding company or a subsidiary company.
3. A company registered under section 8; or
4. A company or body corporate governed by any Special Act.

“Turnover” here means the aggregate value of the realisation of amount from the sale, supply and distribution of goods or an account of services rendered, or both, by the company during a financial year. [Section 2(91)].

Salient features of the small company:

1. **Private company:** Only a private company can be classified as a small company.



2. **Types of the Companies:** Holding company or a subsidiary company, charitable company and company governed by any Special Act cannot be classified or mentioned as a small company.
3. **Status of the Company:** The status of a company may change from one year to another year. Thus, the benefits which are available during a particular year may stand withdrawn for next year and become available again in subsequent year.
4. **In case of Gradual growth of business:** When there is gradual growth in business, if a company crosses any of the thresholds provided, either paid up capital or turnover, then the company has to give its status of small company and all the benefits granted for such companies.
5. **Criteria for qualifying as a small company:** Previously, for qualifying as a small company, it's enough to fulfil one criterion which is mentioned in Definition in section 2(85). Later the word "or" in the sub-clause (i) of section 2(85) was substituted by word "and" by Companies (Removal of Difficulties) order dated 13.02.15.

Special Provision and exemption for small company:

1. **Signing of annual return:** Company Secretary can sign the annual return of a small company alone, but in case there is no company secretary then it is signed by a single director of the company.
2. **Board meeting:** Small companies may hold only two meetings. One Meeting may be held in the first 6 months of the calendar year and next in another 6-month, minimum gap between two meetings is 90 days.
3. **Financial statement:** Section 2(40) of the Companies Act, 2013, says financial statement includes cash flow statement for the financial year. However, this section specifically excludes the requirement of cash flow statements for small companies, one person company and dormant company. A small company need not include a cash flow statement as a part of its financial statement.
4. **Rotation of Auditor:** Provisions regarding mandatory rotation of auditor/maximum term of auditor being 5 years in case of an individual and 10 years in case of firm of auditors is not applicable to a small company as per section 139(2) of the Companies Act, 2013.



5. **Matters to be included in Board's Report:** Small companies are exempted from the matters to be included in the Board's report as per rule 8 of Companies (Accounts) Rules, 2014. But in case One Person Company (OPC) shall include the matter stated in Rule 8A of Companies (Accounts) Rules, 2014.
6. **Internal Financial Controls:** A small company is not required to report on the adequacy of the internal financial controls and its operating effectiveness in the auditor's report.
7. **Lesser penalties for small Companies under section 446B of the Companies Act, 2013:** If a small company fails to comply with the provisions of section 92(5), section 117(2) or section 137(3), such company and officer in default of such company shall be liable to a penalty which shall not be more than one half of the penalty specified in such sections.
8. **Fast Track Merger of Small Companies:** On fast track basis, merger process between two or more small companies to be approved. Such merger need to get approval from ROC, official liquidator, members holding at least 90% of total number of shares and majority of creditors representing 9/10th in value the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty –one days along with the scheme to its creditors for the purpose, or otherwise approved in writing.
9. **Professional Certification for e-forms to be filled with MCA:** As per rule 8(12) of Companies (Registration Offices and Fees) Rules, 2014 the e-forms filed by small companies are not required to be pre-certified by Chartered Accountant or the Company Secretary or as the case may be the Cost Accountant, the whole-time practice. To promote small companies all stringent provisions of Companies Act, 2013 which are impractical and suitable for administration and management of large organisations are exempted.

One Person Company

Definition:

Section 2(62) of the Companies Act, 2013 defines One-person company as a company which has only one person as a member.



Members of a company are subscribers to its memorandum of association, or its shareholders, so an OPC is effectively a company that has only one shareholder as its member. In OPC legal and financial Liability is limited to the company only not to that person. (Liability is limited).

These Companies are generally created when there is only one founder or promoter for business. Entrepreneurs whose business lie in the early stage prefer to create OPCs instead of sole proprietorship business because so many advantages OPCs offer.

The basic difference between OPCs and Sole Proprietorships:

Nature of Liability - In case of OPC is a separate legal entity distinguished from its promoter, it has its own assets and liabilities. The promoter is not personally liable to repay the debts of the company.

On other hand, sole proprietorships and their proprietors are the same persons. So, the law allows attachment promoter's own assets in case of non-fulfilment of the business 'liabilities'.

Feature of a One Person Company:

- 1. Private Company:** Section 3(1)(c) of the Companies Act says that a single person can form a company for any lawful purpose. It further describes OPCs. As a private company.
- 2. Single member:** OPCs can have only one member or shareholder, unlike other private companies.
- 3. Nominee:** A unique feature of OPCs that separates it from other kinds of companies in that the sole member of the company has to mention a nominee while registering the company.
- 4. No Perpetual Succession:** Since there is only one member in an OPC, his death will result in the nominee choosing or rejecting to become its sole member. This does not happen in other companies as they follow the concept of perpetual succession.
- 5. Minimum One Director:** OPCs need to have a minimum one person (the member) as director and maximum of 15 directors.
- 6. No Minimum Paid Up Share Capital:** Companies Act, 2013 has not prescribed any amount as minimum paid-up capital for OPCs.
- 7. Special Privileges:** OPCs enjoy several privileges and exemption under the Companies Act.



8. Name of the Company: The name of the One-person company shall include the word OPC 'One Person Company' within the bracket below the name of the company.

Exemption or advantage of OPCs:

1. They do not have annual general meetings.
2. The financial statement need not to include a cash flow statement.
3. A company Secretary is not required to sign annual returns; Directors can also sign in case of absence of Company Secretary.
4. Provisions relating to independent directors do not apply to them.
5. Their articles can provide for additional grounds for vacation of a director's office.
6. Several provisions relating to meetings and quorum do not apply to them.
7. They can pay more remuneration to directors compared to other companies.

Conversion of OPCs into other Companies:

The Ministry of Corporate Affairs, Government of India has issued the Companies (Incorporation) Rules, 2014 providing provisions regarding conversion of OPCs into a private or public company. The rules are as under:

1. Conversion by Operation of Law:

- (a) When the paid-up share capital of an OPC exceeds the limit of Rs. 50 lakh or its average annual turnover during the relevant period exceeds Rs. 2 crore, it will cease to be entitled to continue as an OPC.
- (b) Such OPC shall be required to convert itself within 6 months into either a private company with two members and two directors or a public company with seven members and three directors' according with section 18 of the Act.
- (c) It shall alter the memorandum of association and article of association by passing an ordinary or special resolution to give effect to the conversion and to make necessary changes.



(d) The OPC needs to give notice to ROC within 30 days and inform them that it has ceased to be OPC and that it is now required to convert itself into a private company or public company.

2. Conversion by Choice:

OPC can get itself converted into private company or public company by increasing No. of members and directors and by maintaining the minimum paid up capital as per requirements of the Act for such class of company and by making compliance of section 18 of the Act for conversion.

3.6 Difference Between Private and Public Company

Basis	Section	Private limited company	Public limited company
1. Meaning.	2	Minimum capital: Rs. 1,00,000, right to transfer the shares, Restricted	Not public company, Minimum share Capital: Rs. 5,00,000, Subsidiary of Public Company deemed to be a public Co. is deemed to be public Co.
2. Small company.	2	If paid-up share Capital does not exceed Rs. 50 Lakhs and Turnover as per Last Audited accounts does not exceed Rs. 2 crore	Not applicable.
3. Minimum Members Required.	3.	2(two), Maximum 200 (2 hundred)	7 (seven).
4. Name of the company.	4.	“Private Limited” as the last word. (Pvt. Ltd.)	“Public Limited” as “Last Word.” Ltd.
5. Provision of entrenchment in Articles.	5.	To be agreed and approved by all the members.	To be agreed and approved through a Special Resolution.



Notes

Basis	Section	Private limited company	Public limited company
6. Issue of Securities.	23	By way of Right issue or Bonus issue through Private Placement.	To Public through prospectus (“Public Offer”) By way of Right Issue or Bonus Issue through Private Placement.
7. Public Offer to be in Dematerialised Form.	29.	Not applicable	In case of public offer of securities, the securities have to be in Dematerialised form.
8. Securities in Public offer to be listed in Stock Exchanges.	40.	Not applicable	Securities offered in public offer, to be listed in Recognised Stock Exchanges.
9. Purchase/Loan for Purchase of Own Shares.	67	Not allowed to purchase its own Shares.	Not allowed to purchase its own Shares; No Financial assistance to be given to purchase its own shares.
10. Acceptance of Deposits.	73	Not allowed to accept deposits.	Allowed if paid up share capital is Rs. 100 Crore or more or turnover of Rs. 500 Crore or more.
11. Quorum of Meetings.	103	Two members personally present.	Five in case of members upto 1000; Fifteen in case of Members more than 1000 upto 5000; Thirty in case of Members exceed 5000.
12. Internal Audit.	138	Applicable in case of: 1. Turnover \geq Rs. 200 crore in preceding financial year or	Applicable in case of: 1. Paid up capital \geq Rs. 50 Crore in the preceding financial year, or 2. Turnover \geq Rs. 200 Crore in preceding financial year, or



Basis	Section	Private limited company	Public limited company
		2. Loans from bank or NBFCs \geq Rs. 100 Crore in preceding financial year.	3. Loans from Bank or NBFCs \geq Rs. 100 crores in preceding Financial year. 4. Public Deposit \geq Rs. 25 Crore in preceding financial year.
13. Annual Evaluation in the Board's Report.	134(3) (p)	Not applicable	If paid up share capital is Rs. 25 crore or more, the details of annual evaluation in the Board's Report.
14. Rotation of Auditor.	139(2)	Applicable in case of Paid-up capital is Rs. 20 Crore or more.	Applicable in case of paid-up Capital is Rs. 10 Crore.
15. No. of Directors and independent Directors.	149	2(Two); Not required to appoint an independent director.	3(three); and in case of listed Companies; at least One-third as independent directors.
16. Retirement by rotation – appointment of Directors.	152	Not applicable	At least two-third of the total number of directors are liable to retire by rotation and eligible to be re-appointed in AGM.
17. Contract of Employment with Managing Director /Whole Time Director.	190	Not required (optional)	Compulsory Required.
18. Restriction on Managerial Remuneration.	197	No restriction on the amount of managerial remuneration.	Managerial Remuneration is: Restricted to 11% of Net profit (subject to condition); or at least Rs. 30 lakh per annum depending upon paid up capital.



IN-TEXT QUESTIONS

5. OPC is defined under which section of Indian Companies Act, 2013:
 - (a) 2(62)
 - (b) 2(85)
 - (c) 2(95)
 - (d) 2(74)
6. According to Indian Companies Act, 2013, Small company turnover does not exceed from
 - (a) 5 crores
 - (b) 6 crores
 - (c) 1 crore
 - (d) 2 crores
7. RBI is which type of Company:
 - (a) Registered company
 - (b) Private company
 - (c) OPC
 - (d) Statutory Company
8. OPC was first recommended by the _____.
9. Private company is defined in section _____ of Companies Act, 2013.
10. Registered Companies which are formed and registered under the _____.
11. A holding company/subsidiary company is not a _____ company.
12. The words “One-Person Company” must be mentioned (in brackets) below the name of the company. (True/False)
13. Public companies have to limit its member to 300. (True/False)
14. A company or body corporate governed by any Special Act is not a small company. (True/False)



15. The Requirement of Rs. 1,00,000 or more as minimum paid up share capital for private companies has been omitted by the Companies (Amendment) Act, 2015. (True/False)

3.7 Summary

Companies can be classified into 5 categories – on the basis of formation, on the basis of members, on the basis of control, on the basis of nationality. Private companies are those companies whose articles restrict transferability of shares and prevent the public at large from subscribing them. Public company is a company that has limited liability and may offer shares to the general public by Initial Public Offer (IPO). Where the company is listed, and any individual can purchase or acquire the shares of such company via stock market. Small companies are basically the small start-ups with limited amounts of capital or investment by the promoter. OPC as a company which has only one person as a member. There are different companies with different advantages, members, directors, paid up capital and all the companies have to follow the compliances and provisions mentioned in the Indian Companies Act, 2013.

3.8 Answers to In-Text Questions

1. (d) 3
2. (c) 1 lakh
3. 5 lakhs
4. False
5. (a) 2(62)
6. (d) 2 crores
7. (d) Statutory Company
8. Jamshed J. Irani Expert Committee
9. 2(68)
10. Indian Companies Act, 2013
11. Small



Notes

12. True
13. False
14. True
15. True

3.9 Self-Assessment Questions

1. Write the difference between Private company and public company.
2. Write the difference between OPC and a small company.

3.10 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Types of Companies: On the Basis of Control, Government Companies, Foreign Companies, Dormant Companies, Association Not-for-Profit and Illegal Association

Author: Dr. R C Garg

Revised by: Ms. Chandani Aswal

STRUCTURE

- 4.1 *Learning Objectives*
- 4.2 *Introduction*
- 4.3 *Classification of Company on the Basis of Control - Holding Companies, Subsidiary Companies and Associate Company*
- 4.4 *Foreign Companies*
- 4.5 *Dormant Companies [Section 455]*
- 4.6 *Associations Not-for-Profit/formation of Companies with Charitable Objects [Section 8]*
- 4.7 *Illegal Association (Section 464) [Prohibition of Association of Partnership of Persons Exceeding Certain Number (Section 8)]*
- 4.8 *Summary*
- 4.9 *Answers to In-Text Questions*
- 4.10 *Self-Assessment Questions*
- 4.11 *Suggested Readings*



4.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ What are the types of companies on the basis of control, difference between companies and its function.
- ◆ Advantages and disadvantages, types of Companies.
- ◆ What is Government company, foreign company and Dormant Company?

4.2 Introduction

A company is a legal entity formed by a group of individuals to engage in and operate a business-commercial or industrial. A company may be structured in various ways for tax and financial liability purposes depending upon the corporate law and its jurisdiction. There are different types of companies like, Government companies, dormant companies, NPO etc. With different ownership structure, regulation and financial reporting requirements. A company has many legal requirements and rights as a person as a person, like the ability to enter into contracts, the right to sue (or to be sued), borrow money, pay taxes, own assets and hire employees.

4.3 Classification of Company on the Basis of Control - Holding Companies, Subsidiary Companies and Associate Company

1. According to the modes of incorporation, companies may be classified into three categories:

- (a) Holding Companies.
- (b) Subsidiary Companies.
- (c) Associate Company.

Holding Companies: Section 2(46).

According to section 2(46) of Indian Companies Act “holding company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies. A company which holds, or controls another company is called a holding company. According to sec.



4(4), a company is “deemed to be the holding company of another if, but only if, that other is its subsidiary.”

As per the Companies (Amendment) Act, 2017, for the purpose of holding company the expression ‘company’ includes anybody corporate.

The company is called a holding company if that particular company holds/owns at least 50% of the other companies and has the authority to make management decisions, influence and control the company’s board of directors.

The term “body corporate” is defined in section 2(11) of the Companies Act, 2013. This includes or contains a private company, public company, one person company, small company, limited liability partnership, foreign company etc. “body corporate” or “corporation” also includes a company incorporated outside India.

However, body corporate does not include–

- (1) A co-operative society registered under any law relating to co-operative societies.
- (2) Any other body corporate (not being a company as defined in the Companies Act, 2013), which the Central Government may, by notification, specify on this behalf.

Subsidiary Companies: Section 2(87)

According to Indian Companies Act, 2013, Subsidiary company, in relation to any other company (that is to say the holding company—

1. Controls the composition of the Board of Directors; or
2. Exercises or controls more than half of the total voting power [amended by the Companies (Amendment) Act, 2017.]

1. **Company Controlling Composition of Board of Meeting:** If one company controls the majority composition of the board of directors of another company. The composition of another company’s board of directors shall be deemed to be controlled if it can, at its direction, appoint or remove the holders of all or a majority of the directorships.

Example: The board of directors of a company (Company A) consists of seven directors. Any other company (Company B), which has authority to appoint four directors is deemed to be the holding



company of the former (Company A) which is called the subsidiary companies.

- 2. Holding of Majority of Shares:** If it exercises or controls more than one-half of the total voting power (aggregate of paid-up equity share capital and convertible preference share capital) either at its own or together with one or more of its subsidiary companies.

Example: Where Company B controls more than half of total share capital of Company A either by itself or together with one or more subsidiary companies. In this case share capital may be controlled either by the holding company or by the holding company.

- 3. Subsidiary of Another Subsidiary:** A company shall be deemed to be the holding company of another company if another company is a subsidiary of the another mentioned company's subsidiary (Subsidiary of the subsidiary).

Example: Company B is subsidiary of Company A, Company C is subsidiary of Company B and Company D is Subsidiary Company C, then in this case Company A is holding company of all three Companies B, C and D.

- 4.** A private company which is a subsidiary of a public company is regarded as the public company.
- 5.** A Subsidiary company cannot be a member of its holding company and all allotment or transfer of shares in the holding company to its subsidiary will be void.

Associate Company: Section 2(6)

According to Indian Companies Act, 2013 “Associate company”, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company of having such influence and includes a joint venture company:

- The expression “Significant influence” means control of at least **twenty per cent (20%)** of total voting power or control of or participation in business decisions under an arrangement.
- The expression “joint venture” means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.



Thus, a company will be treated or taken as an associate company and not a subsidiary company if it holds 20% or more but less than 50% of the share capital of another company.

Example: If Company A holds 23% of shares of Company B, then Company B is an associate company of company A not a subsidiary company.

Government Companies: Section 2(45)

According to section 2(45) of Indian Companies Act, 2013 “Any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any state Government or Governments, or partly by the Central Government and partly by one or more state Governments and includes a company which is a subsidiary company of such a Government company.”

Some points:

1. Public sector undertakings/enterprises in India are also included in this definition.
2. A “subsidiary company” or “subsidiary” of a government company would also be categorised as a Government Company provided the Government Company:
 - (a) Controls the composition of the Board of Directors; or
 - (b) Exercises or controls more than one-half of the total voting rights [till January 2018 the word share capital was used instead of voting rights] either at its own or together with one or more of its other subsidiary companies.
3. Municipal and other local authorities or statutory corporations (which are the government bodies) holding the shares are not to be taken into consideration for this purpose.

Example of Government Company: Steel Authority of India, Hindustan Steel Limited.

Annual Reports of Government Companies [Sec. 394/Sec. 395].

1. **Annual Reports to be Placed Before Parliament:** Where the Central Government is a member of a Government company, the Central Government shall cause an annual report on the working and affairs of that company to be:



- (a) Prepared within three months of its annual general meeting before which the comments given by the Comptroller and Auditor-General of India and the audit report is placed under provision to section 143(6).
- (b) After preparation, a report is laid before both houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

Where in addition to the Central Government, any state Government is also a member of a Government company, the state Government shall submit a copy of the annual report prepared and laid before the House or both Houses of the State legislature together with a copy of the audit report and comments upon or supplement to the audit report.

In cases where only the state government or every state Government which is a member, shall cause the above documents to be prepared within the specified time and laid before the House or both Houses of the State Legislature.

The provision of both sections 394 and 395 shall, so far as may be, apply to a Government company in liquidation as they apply to any other company.

2. Appointment of Auditor and Audit Reports: (Sec. 139)

Within a period 180 days from the commencement of the financial year, the auditor of a Government company shall, in respect of a financial year, be appointed or reappointed by the Comptroller and Auditor-General of India. Such an auditor shall hold office till the conclusion of the next annual general meeting.

Once a Government company is registered then within 60 days the first auditor of a government company shall be appointed by Comptroller and Auditor-General of India.

Within said period if Comptroller and Auditor-General of India does not appoint such auditor then within the next 30 days the Board of Directors of the company shall appoint such auditor.

And in case if the Board of Directors of the company fails to appoint the auditor within the 30 days, then this information shall be given



to members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting.

The comptroller and Auditor-general shall have the power to instruct the way the company's accounts shall be audited by the auditor. He shall also have power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise on this behalf.

The provisions of section 143(5)/(6)/(7) of the Indian Companies Act, 2013 which deal with audit shall apply.

3. Audit reports to be submitted to the Comptroller and Auditor General of India:

The auditor of a Government company shall submit an audit report copy to the Comptroller and Auditor-General of India, who shall have right to comment upon, or supplement, the audit report shall be shown before the annual general meeting of the company.

4. Certain provision of the Companies Acts not to apply:

The Central Government may, by notification in the Official Gazette, direct that any of the provision of the Companies Act, specified in the notification—

- (a) Shall not apply to any Government company; or
- (b) Shall apply to any Government company; with such expectations, modifications, and adaptations, as may be specified in the notification.

Every notification copy proposed to be issued shall be mentioned in draft before each house of Parliament while it is in the session of 30 days which may be composed in one or two more successive sessions. If both houses (Rajya Sabha and Lok Sabha) agree in disapproving the issue of the notification, the notification shall not be issued. If they agree in making any kind of modification in the notification, the notification shall be issued in the modified form.

There is exemption notification dated 5th June 2015 accordingly has exempted government companies from some provisions of the Companies Act.



4.4 Foreign Companies

According to section 2(42) of Indian Companies Act, 2013, foreign company means any company or body corporate incorporated outside India which has a place of business in India whether by itself or through an agent, physically or through **electronic media**; and, conducts any business activity in India in any such manner. The expression “electronic media” means that cover all those companies which are operating online on a virtual platform **such as Amazon, Flipkart**.

Application of the Act to Foreign Companies:

1. Sections 380 to 386 and sections 392 and 393 shall apply to all foreign companies : said that the Central government may, by order published in the Official Gazette, exempt any class of Foreign Companies, specified in the order, from any of the provisions of sections 380 to 386 and sections 392 and 393 and a copy of every such Order shall, as soon as may after it is made, be laid before both Houses of Parliament [Sub-section (1) and provision inserted by the Companies (Amendment) Act, 2017].
2. Where not less than 50%, of the paid-up share capital, whether equity or preference partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, whether single or in the aggregate, such company shall comply with the provisions of the Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

Documents, etc., to be Delivered to Registrar by Foreign Companies/Obligations of a Foreign company (Sec. 380)

1. Within 30 days of the establishment of its place of business in India by Foreign company it has to deliver some documents to the Registrar for registration, these documents are:
 - (a) A certified copy of the charter, statutes or MOA and AOA of the company or other instrument constituting and defining or elaborating the constitution of the company and, if the instrument is not in the English language, then a certified translation thereof in the English language.



- (b) The registered or principal office of the company's full address required.
 - (c) Prescribed list of directors and secretary of the company, which contains name and address or the names and addresses of one or more person's resident in India and who are authorised to accept on behalf of the process of the company's service and any notices or other documents required to be served for the company.
 - (d) The full address of the company in India which is deemed to be its principal place of business in India.
 - (e) Particulars of opening and closing of a place of business in India or on earlier occasions or occasions.
 - (f) Declaration regarding to 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
 - (g) Any other information as may be prescribed.
2. Section 592(1) of the Companies Act, 1956 - Every Foreign company existing at the commencement of this act shall, if it has not delivered to the Registrar before such commencement the documents and particulars specified in section, continue to be subject to the obligation or responsibilities to deliver those documents in accordance with that Act.
 3. If any alteration is made or occurs in the document which is delivered to the Registrar under this section, the foreign company shall, within thirty days of such alteration or changes, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form.

Accounts of Foreign company (Section 381)

1. Every Foreign company shall, in every calendar year—
 - A. Make out a balance sheet and profit and loss account in such form, which contains such particulars and including or having annexed or attached thereto such document as may be prescribed.



B. Need to deliver a copy of those documents to the Registrar:

Provided that the central government may, by notification, direct that, in case of any foreign company or class of foreign companies, the requirement of clause (a) shall not apply or shall apply subject to such exceptions and modifications as may be specified in that notification.

2. If any such document as is mentioned in sub-section (1) is not in the English language, there shall be annexed to its a certified translation thereof in the English language.
3. Every Foreign company shall send to the Registrar along with the documents required to be delivered to him under sub-section (1), a copy of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in sub-section (1) is made out.

Display of Name, etc., of Foreign Company (Sec. 382)

Every foreign company shall—

- (a) Conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and in the characters of the language or one of the languages in general use in the locality in which the office or place is situated.
- (b) Cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill-heads and letter paper, and in all notices, and other official publications of the company; and
- (c) If the liability of the members of the company is limited, cause notice of that fact—
 1. To be stated in every such prospectus issued and in all business letters, bill heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and



2. To be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the language or one of the languages in general use in the locality in which the office or place is situated.

Service of notice on Foreign Company (Sec. 383)

Any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served if addressed to any person whose name and address have been delivered to the Registrar under section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

Debentures, Annual Return, Registration of Charges, Books of Account and their Inspection (Sec. 384)

1. The provisions of section 71 shall apply *mutatis mutandis* to foreign companies.
2. The provisions of section 92 shall, subject to such exceptions, modify adaptations as may be made therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.
3. The provisions of section 128 shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India, the book account referred to in that section, with respect to monies received and spent, sales and purchases made, and asset and liabilities, in the course of or in relation to its business in India.
4. The provisions of Chapter VI shall apply *mutatis mutandis* to charges on properties which are created or acquired by any foreign company.
5. The provision of Chapter XIV shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

Fee for Registration of Documents (Section 385)

There shall be paid to the Registrar for registering any document required by the provisions of this chapter to be registered by him, such fee, as may be prescribed.



Interpretation (Section 386)

For the purpose of the foregoing provisions of this chapter:

- (a) The expression “certified” means certified in the prescribed manner to be a true copy or a correct translation.
- (b) The expression “director”, in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act; and
- (c) The expression “place of business” includes a share transfer or registration office.

Punishment for contravention (Section 392)

If a foreign company contravenes the provisions of this chapter, the foreign company shall be punishable with fine which shall not be less than one lakh rupees (Rs. 100000) but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees (Rs. 50000) for every day after the first during which the contraventions continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to five lakh rupees (Rs. 500000), or with both.

Examples of Foreign Companies in India are: Gillette (India) Ltd., Nestle India Ltd.

4.5 Dormant Companies [Section 455]

Dormant means “inactive or inoperative”, it’s good to start a company for future perspective, holding projects and holding an asset/intellectual property without significant accounting transactions. It is new initiative taken by Ministry of Corporate Affairs to introduce Dormant company:

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



Explanation.—For the purpose of this section,

- A. “Inactive company” means a company which has not been carrying on any business or operation or has not made any significant accounting transaction during the last two financial years.
- B. “Significant accounting transaction” means any transaction other than –
- (a) Payment of fees by a company to the Registrar.
 - (b) Payments made by it to fulfil the requirements of this act or any other law.
 - (c) Allotment of shares to fulfil the requirements of this act; and
 - (d) Payments for maintenance of its office and records.
2. The Registrar on consideration of the application shall grant the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect.
 3. The Registrar shall maintain a register of dormant companies in such form as may be prescribed.
 4. In case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.
 5. A dormant shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Register to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed.
 6. The registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.



Procedural formalities to get the status of a Dormant company:

File form MSC 1 + fees + consent of 3/4th of the shareholders (in value) either by special resolution in the meeting or issuing notice to the shareholder.



Registrar to issue certificates in Form MSC-2.



The Registrar shall maintain the register of dormant companies. The same is maintained on WWW.MCA.GOV.IN or any other specified website.

Example of Dormant company: NCORE Technology Pvt. Ltd., Good Leaf Traders Pvt. Ltd.

4.6 Associations Not-for-Profit/Formation of Companies with Charitable Objects [Section 8]

Section 8 of Indian Companies Act, 2013 which deals with the Central Government who give permission to charitable companies, or which have charitable objects to be registered as limited companies under this section without addition of Word Ltd. or Pvt. Ltd.

License Grants with these Conditions: The Central Government may grant license to an association of peoples only when Central government get satisfied or proved by such an association –

- (a) 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;
- (b) Intends to apply its profits, if any, or other income in promoting its objects; and
- (c) Intends to prohibit the payment of any dividend to its member, the Central Government may, by license issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the



word “Limited” or as the case may be, the words “Private Limited”, and there upon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section:

1. The Company registered under this section shall enjoy all the privileges and be subject to all the obligations of limited companies.
2. A firm may be a member of the company registered under this section.
3. (i) A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.
(ii) A company registered under this section may convert itself into a company of any other kind only after complying with such conditions as may be prescribed.
4. Where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified in clause (a) of sub-section (1) and with the restrictions and prohibition as mentioned respectively in clauses (b) and (c) of that sub-section, it may, by license, allow the company to be registered under this section subject to such conditions as the Central Government deems fit and to change its name by omitting the word “Limited”, or as the case may be, the words “Private Limited” from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company.
5. The Central Government may, by order, revoke the license granted to a company registered under this section if the company contravenes any of the requirements of this section or any of the condition subject to which a license is issued or the affairs of the company are conducted fraudulently or in a manner violate of the objects of the company or prejudicial to public interest, and without prejudice to any other action against



Notes

the company under this Act, direct the company to convert its status and change its name to add the word “Limited” or the words “Private Limited”, as the case may be, to its name and thereupon the Registrar shall, without prejudice to any action that may be taken under sub-section (7), on application, in the prescribed form, register the company accordingly:

Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.

License can be revoked:

6. Where a license is revoked under sub-section (6), the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound under this Act or amalgamated with another company registered under this section:

Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.

7. Where a license is revoked under sub-section (6) and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligation as may be specified in the order.
8. If on the winding up or dissolution of a company registered under this section, there remains, after the satisfaction of its debts and liabilities, any asset they may be transferred to another company registered under this section and having similar objects, subject to such conditions as the Tribunal may impose, or may be sold and proceeds thereof credited to the Rehabilitation and Insolvency Fund formed under section 269.



9. A company registered under this section shall amalgamate only with another company registered under this section and having similar objects.
10. If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees (Rs. 1000000) but which may be extend to one crore rupees (Rs. 10000000) and the directors 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 twenty five thousand rupees (Rs. 25000) but which may be extend to twenty-five lakh rupees, or with both:

Provided that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action of section 447.

Example of NPO is: Shiksha (NGO), Federation of Indian Chambers of Commerce and Industry (FICCI).

Nidhi company (Section 406).

“Nidhi” means a company which has been incorporated as a Nidhi with the object of:

- (a) Cultivating the habit of thrift and savings amongst its members.
- (b) Receiving deposits from, and lending to, its members only, for their mutual benefit.
- (c) And which complies with such rules as are prescribed by the central Government for regulation of such class of companies.

Nidhi companies have different names - Permanent Fund, Benefit Fund, Mutual Benefit Funds and Mutual Benefit Company.

Nidhi's are most popular in South India and localized single office institutions. Nidhi's are not much when compared to the organised banking sector. It comes under NBFCs. RBI is empowered to issue directions to them in matters relating to deposit acceptance activities. Whereas RBI



exempted the notified Nidhi's from the core provisions of the RBI Act and other direction applicable to NBFCs.

4.7 Illegal Association (Section 464) [Prohibition of Association of Partnership of Persons Exceeding Certain Number (Section 8)]

No association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual member thereof, unless it is registered as a company under this Act or is formed under any other law for the time being force:

Provided that the number of persons which may be prescribed under this sub-section shall not exceed one hundred (100).

1. Nothing in sub-section (1) shall apply to –
 - (a) A Hindu undivided family carrying on any business; or
 - (b) An association or partnership, if it is formed by professionals who are governed by special Acts.
2. Every member of an association or partnership carrying on business in **contravention** of sub-section (1) shall be punishable with fine which may extend to one lakh rupees (Rs. 100000) and shall also be personally liable for all liabilities incurred in such business.
3. No legal existence: An illegal association cannot:
 1. Enter into binding contracts.
 2. Cannot file a case or sue any member or an outsider.

IN-TEXT QUESTIONS

1. Government company means any company in which not less than how much paid-up share capital:
 - (a) 25%
 - (b) 35%
 - (c) 51%
 - (d) 60%



2. In which of the following conditions, a company will be reckoned a foreign company?
 - (a) If the company is established outside India and has a place of business in India
 - (b) A company incorporated outside India having shareholders who are all Indian citizens and having its business outside India
 - (c) A company is incorporated in India but having all foreign shareholders
 - (d) Both (a) and (b)
3. The company nationality is decided by its:
 - (a) Shareholders
 - (b) Registered Office
 - (c) Place at books of account is kept
 - (d) None of the above
4. Association not for profit defined in section of Indian Companies Act, 2013:
 - (a) Section 2(74)
 - (b) Section 2(54)
 - (c) Section 2(36)
 - (d) Section 8
5. According to section 455 of Indian Companies Act which company defined:
 - (a) Illegal association
 - (b) Dormant company
 - (c) Producer company
 - (d) Nidhi company

4.8 Summary

Government company is a company or an organisation with at least 51% of paid up share capital with Central government and state government

**Notes**

or both and defined in section 2(45) of Indian Companies Act, 2013. A foreign company is a company who main branch or head office is outside India but has place of business in India either in physical form or an electronic mode [section 2(42)]. Dormant company is a company which is for future project perspective without any significant accounting transaction for more than two years [section 455]. There is producer, Nidhi Company and Association not for profit with different companies' provision as well as illegal association in case of number exceeds in partnership.

4.9 Answers to In-Text Questions

1. (c) 51%
2. (a) If the company is established outside India and has a place of business in India
3. (b) Registered Office
4. (d) Section 8
5. (b) Dormant Company

4.10 Self-Assessment Questions

1. What is the Difference between Government Company and Foreign Company?
2. Dormant Company is an inactive company. Explain how?
3. Write short notes on:
 - (a) Illegal Association.
 - (b) Nidhi Company.
 - (c) Producer Company.

4.11 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur. H. (2022). Company Law, Delhi: Kitab Mahal.



- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2015). Elements of Corporate Laws. Himalaya, Publishing House Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2019). Company Law. Himalaya Publishing House, Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.

UNIT - II



Formation of the Company, Promoters and Online Registration of a Company

Author: Dr. R C Garg

Revised by: Ms. Sheetal Chauhan

STRUCTURE

- 1.1 *Learning Objectives*
- 1.2 *Introduction*
- 1.3 *Formation of Company [Section 3]*
- 1.4 *Promoter [Section 2(69)]*
- 1.5 *Preliminary or Pre-incorporation Contract*
- 1.6 *Online Registration of a Company*
- 1.7 *Summary*
- 1.8 *Answers to In-Text Questions*
- 1.9 *Self-Assessment Questions*
- 1.10 *Suggested Readings*

1.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ How is the company incorporated and what are the various modes?
- ◆ Who is the promoter and what are his legal compliances and position?
- ◆ What are pre-incorporation contracts/ preliminary contracts and provisional contracts?
- ◆ How is a company incorporated by online mode?



1.2 Introduction

Company can be formed after completing a few formalities and following a few regulations which are mentioned under Companies Act, 2013. It is important or mandatory to get a company registered, then after that its operation will be started. There are long procedures or various stages involved in the formation of a company. But before all that, first we need to decide what kind of company we want to start, like a public company, private company or we are going to take an already established concern. All these decisions are taken by certain persons known as “Promoters”. They do all the necessary preliminary work for the formation of a company. In case of Public Company, promotion, incorporation, capital subscription stage and certificate of commencement required but in case of private company only two stages required – promotion and incorporation.

1.3 Formation of Company [Section 3]

Section 3(1) A company may be formed for any lawful purpose by:

- (a) Seven or more persons, where the company to be formed is to be a **public company**;
- (b) Two or more persons, where the company to be formed is to be a **private company**; or
- (c) One person, where the company to be formed is to be **one person company** that is to say, a private company.

By subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

A company so formed may be one of the following:

1. A company limited by shares, or
2. A company limited by guarantee, or
3. An unlimited company.

Incorporation of Company: (Section 7)

1. There shall be filed with the Registrar within whose **jurisdiction** the registered office of a company is proposed to be suited, the following documents and information for registration, namely:



- (a) the **memorandum and articles** of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;
- (b) a declaration in the prescribed form by **an advocate, a chartered accountant, cost accountant, or company secretary in practice**, who is engaged in the formation of the company, and by a person named in the articles **as a director, manager or secretary of the company**, that all the requirements of this act and rules made there under in respect of registration and matters precedent or incidental thereto have been complied with;
- (c) **an affidavit** 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 document 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;
- (d) the **address for correspondence** till its registered office is established;
- (e) the particulars of name, **including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity**, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;
- (f) the particulars of the persons mentioned in the articles as the **first directors the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality** and such other particulars including proof of identify as may be prescribed; and
- (g) 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.

2. The Registrar on **the basis of documents and information** filed under sub-section (1) shall register all the documents and information referred to in that sub-section in the register and issue a **certificate of incorporation** in the prescribed form to the effect that the proposal company is incorporated under this Act.
3. On and from the date mentioned in **the certificate of incorporation** is issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be, distinct identity for the company and which shall also be included in the certificate.
4. The company shall maintain and preserve at its **registered office copies of all documents and information** as originally filed under sub-section (1) till its dissolution under this Act.
5. If any person furnishes any **false or incorrect** particulars of any information suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action **under section 447**.
6. Without prejudice to the provisions of sub-section (5) where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any **false or incorrect information** or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporation such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under clause (b) of sub-section (1) shall each be liable for action under **section 447**.

Certificate of Incorporation: Section 7(2)

When all important or requisite documents are filed with the registrar, the Registrar shall satisfy himself that all the statutory requirements regarding the registration have been duly complied with. If the Registrar is satisfied with compliance to the statutory requirements, then he registers the MOA



and AOA and all other important documents filed with him and issues a “certificate of incorporation”.

A Certificate of incorporation is a legal document/license relating to the formation of a company or corporation. It is a kind of license to form a corporation and it is issued by the Registrar of companies in accordance with the State Government.

Conclusiveness of Certificate of Incorporation:

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

Three cases:

1. **Barned’s Banking Co.; Re Peel’s Case, (1867) known as Peel’s case.**
2. **Jubilee Cotton Mills Ltd. v. Lewis (1924).**
3. **T.V. Krishna v. Andhra Prabha Pvt. Ltd. (1960).**

The certificate of incorporation has been held to be conclusive on the following points:

1. That requirements of the Act in respect of registration of matters precedent and incidental thereto have been complied with.
2. That the association is a company authorised to be registered under the Act and has been duly registered.
3. That the date borne by the certificate of incorporation is the date of birth of the company, the date on which the company comes into existence.

If a company got incorporated with by furnishing any false and incorrect information or representation by suppressing any material fact or information in any of the documents and declarations filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, 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 MOA and AOA, in the public interest or in the interest of the company and its member 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:

Provided that before making any order under this sub-section –

1. The company shall be given a reasonable opportunity of being heard in the matter; and
2. The Tribunal shall take into consideration the transactions entered by the company, including the obligation, if any, contracted or payment of any liability.

Thus, in view of the above section and deletion of sections 34 and 35 of the Companies Act, 1956 the certificate of Incorporation is not conclusive anymore.

Effects of Registration (Section 9)

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 to be sued, by the said name.

When a company is registered and a certificate of incorporation is issued by the Registrar, three important consequences follow:

1. ***The company becomes a distinct legal entity:*** Its life commences from the date mentioned in the certificate of incorporation.
2. ***The company acquires a perpetual succession:*** The members may come and go, but it goes on forever, unless it is wound up.
3. ***The company's property is not the property of the shareholders:*** The shareholders have a right to share in the profits of the company when realised and divided. Likewise, any liability of the company is not the liability of the individual shareholders.



A private limited company can commence business immediately after its incorporation. A public company has to obtain a certificate to commence business first.

1.4 Promoter [Section 2(69)]

Definition:

Section 2(69) of the Companies Act, 2013, a ‘promoter’ means a person:

- (a) Who has been named as such in a prospectus or is identified by the company in the annual return in section 92; or
- (b) A person who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) A person who is in agreement with whose advice, directions or instructions the Board of Directors of the company is accustomed to Act.

Palmer’s definition:

“a person who originates a scheme for the formation of the company, has the Memorandum and Articles prepared, executed and registered, and finds the first directors, settles the terms of preliminary contracts prospectus (if any) and makes arrangements for advertising and circulating the prospectus and placing the Capital.”

Meaning of Promoter:

A promoter may be an individual, a firm or a company, association of people or even the government who performs all basic and preliminary work and duties which are necessary to bring a company into existence. He conceives the idea, develops it and finds and induces or influences others to join the company. He is a “father of the company”.

The promoters prepare the scheme and ideas for the formation of the company, find and bring together the subscribers to the memorandum, prepare the memorandum and articles and get it executed and registered, finds the bankers, brokers and legal advisors, find the first directors and make arrangement for the advertisement and circulation of the prospectus and arranges the capital.

A person cannot be considered as a promoter because he merely signed at foot of the Memorandum or that he has provided money for the payment



of formation expenses [**Case - G. Tiruvengadachariar v. Velu Mudaliar (1938)**] A signatory to the Memorandum, who has not performed the functions of the promoter of a company, may not be liable as a promoter.

Functions of Promoter:

1. **Discovering the business opportunities and generate idea:** Promoter generate idea of the business and are called the father of the company and influence others towards the business as well as explore all possibilities. This is the first step towards formation of a company.
2. **Detailed investigation:** The promoter, after getting an idea of business then makes a detailed investigation of the prospects of the business. Undertake detailed technical, economic and commercial feasibility of the business proposition such as sources of supply, nature of demand, extent of competition, capital requirements of the present and future etc. He can also take help from experts.
3. **Verification:** The promoter should also verify whether the advises or comments or reports made by the expert are free from bias. He should also consult with others regarding whether the idea is commercially viable or not.
4. **Negotiation:** To conduct negotiations for the purchase of a business in case its intended to purchase an existing business.
5. **Requisite number of persons:** To collect right and requisite number of people, 2 in case of private company and 7 in case of public company, and who can sign MOA and AOA of the company and also agree to act as the first directors of the company.
6. **Decisions made towards the following:** (a) The nature of the company, (b) The location of its registered office, (c) The amount and form of its capital, (d) The underwriters or brokers for capital issue, if necessary, (e) Bankers, (f) The legal advisors.
7. **Preparation of documents:** To get the MOA and AOA drafted and printed, to arrange for the preparation of prospectus, its filing, advertisement and issue of capital.
8. **Preliminary contracts:** To enter into preliminary contracts with vendors, under-writers etc.
9. **Preliminary expenses.**



Legal Position of Promoter:

1. Legal status of a promoter: Case – Wigpool Iron Ore Co. Bird, (1866),

“Although not an agent for the company, nor trustee for it before its formation, the old familiar principles of the 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 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 the trust had really existed between him and the company when the money was obtained.”

2. Quasi-trustee: A promoter is neither an agent nor a trustee of the company under incorporation, but certain fiduciary duties have been imposed on him or he is liable for some duties. He is not an agent because there is no cestui que trust in existence. Hence, he occupies the peculiar position of a quasi –trustee (Vali P. Rao v. Sri Ramanuja Ginning and Rice Factory Pvt. Ltd. (1986).

3. Fiduciary position of a promoter: A promoter stands in a fiduciary relation (relation requiring confidence or trust) to the company which he promotes. In Erlanger v. new sombrero phosphate Co. (1878). Lord Cairns:

“In equity the promoters of a company stand in a Fiduciary relation to it and those persons who they induce to become shareholders in it and cannot in equity bind the company by any contract with themselves as promoters without fully disclosing to the company all material facts which the company ought to know.”

The fiduciary position of a promoter may be summed up as follows:

- A. Not to make any profit at the expense of the company:** The promoter must not make, either directly or indirectly, any profit at the expense of the company which is being promoted. If any secret profit is made in violation of this rule, the company may, on discovering it, compel him to account for and surrender such profit [Cape Breton Co. Re, (1885)].
- B. To give benefit of negotiation to the company:** The promoter must, when once he has begun to act in promotion of a company,



give to the company the benefit of any negotiations or contracts into which he enters in respect of the company. Thus, when he purchases some property for the company, he cannot rightfully sell that property to the company at a price higher than he gave for it. If he does so, the company may, on discovering it, rescind the contract and recover the purchase money.

Erlanger v. New Sombrero Phosphate Co. (1878): A syndicate, of which E was the head, purchased an island said to contain valuable minerals. E, as promoter, sold the island to a company newly formed for the purpose of buying it. A contract was entered into between X, a nominee of the syndicate, and the company for purchase at double the price actually paid by E. Held, as there had been no disclosure by the promoters of the profit they were making, the company was entitled to rescind the contract and to recover the purchase money from E and the other members of the syndicate.

- C. To make a full disclosure of interest or profit:** The company may sue in case if promoter fails to make a full disclosure of all the relevant facts, including any profit and his personal interest in transaction with the company, damages for breach of his fiduciary duty and recovery of any secret profit made even though rescission is not asked for or is impossible. In the case of full disclosure of profit then that is permissible. The disclosure must be made to an independent Boards of Directors. Where in case there is no independent board, disclosure must be made to the intended shareholders.
- D. Not to make unfair use of position:** The promoter must not make an unfair or irrelevant use of his position and must take care to avoid anything which has the appearance of undue influence or fraud.

Further, a promoter cannot relieve himself from the liability by making provisions to that effect in the Articles of the company [Omnium Electric Palaces Ltd. v. Baines (1914)].

Remuneration of a promoter:

A promoter has no right to get compensation from the company for his services in promoting the company unless there is a contract regarding remuneration. If there is no contract, he is not entitled to get any



compensation in respect of any payment made by him in connection with the formation of the company. Promoters take remuneration for his services in one of the following ways:

1. He may sell his own property to the company after making full disclosure about profit to the boards of directors or to intended shareholders.
2. He may have an option to purchase or buy a certain number of shares in the company at par.
3. He may take commission on shares sold.
4. He may be paid a lump sum amount by the company according to the contract made.

Liabilities of Promoter:

1. Non-disclosure of Secret Profit.
2. Non-adoption of Preliminary Contract.
3. Fraud in the promotion of the company. (Sections 447, 282, 452)
4. Omission in the Prospectus. (Section 26)
5. Misrepresentation in the prospectus. (Sections 34, 35)

1.5 Preliminary or Pre-incorporation Contract

Meaning: Pre-incorporation contracts are those contracts which are made before the company is incorporated. Promoters entered a preliminary contract on the behalf of the company as an agent.

The legal position is that “in case when two consenting parties are necessary to a contract whereas the company, before incorporation, is a non-entity.” [Kelner v. Baxter (1866)].

Adoption of preliminary contract:

A company may adopt preliminary contracts by either of the two ways:

1. The company may adopt these contracts by entering into new contracts with the third parties on the same terms as were embodied in the original contract. Such a new agreement of adoption may not be expressly made but may be implied by the acts of the company.



2. The company may adopt these contracts under the Specific Relief Act, 1963. Sections 15(h) and 19(e) of the Act provide that a contract entered into by the promoters on behalf of the company before its incorporation can be enforced by or against the company, if the following two conditions are satisfied:
 - A. The contract is entered into, for the purposes of the company and such contract is warranted by the terms of incorporation. The term “for the purposes of the company” implies that the contract should be for the working purpose of the company.
 - B. The company accepts the contract after its incorporation and communicates such acceptance to the other party to the contract.

Case: *Imperial Ice Mfg. Co. v. Manchershaw.*

Position of Promoters as Regards Pre-Incorporation Contracts:

1. **Company is not bounded by the pre-incorporation contract:** A company does not have legal existence before incorporation and so it cannot enter any contracts before incorporation. However, so many financial commitments are made, and tasks executed to bring a company into existence. Promoters entered into such contracts but with understanding that the liability will be incurred by the company when it comes into existence. These contracts are the arrangements with legal and financial consultants for the formation of the company. In such cases, the important question arises- what is the liability of the company in respect to these contracts. A company, when it comes into existence is not bound by a pre-incorporation contract even where it takes the benefit of the contract entered into on its behalf.

Case: *English and Colonial Produce Co. Ltd. Re (1906).*

2. **Company cannot enforce pre-incorporation contract:** A company cannot, after incorporation, enforce a contract made before its incorporation. It's all upto the company whether those pre contracts will be accepted by the company or not.

Case: *Natal Land and Colonisation Co. Ltd. v. Pauline Colliery and Development Syndicate Ltd. (1904).*



- 3. Promoters personally liable:** The promoters remain personally liable for the pre-incorporation contract which is made on behalf of a company which does not yet exist. These contracts are deemed to have been entered into personally by the promoters.

Case: *Kelner v. Baxter (1866)*.

Provisional contracts

Provisional contracts refer to those contracts in which only a public company entered after its incorporation but before getting the certificate to commence business.

Any contract which is made by a company before the date on which it is entitled to commence business is a provisional contract only and it will not bind the company until that date, and on that date it shall become binding. In case when a company is unable to get or obtain a certificate to commence business, the provisional contracts automatically lapse. But in case when certificates are obtained by the company then those provisional contracts are automatically binding to the company.

The words “**shall become binding**” **does not** mean that the company is bound to recognise all contracts made between the date of incorporation and the date of commencement of business. If a contract is oppressive, fraudulent and voidable for any reason in that case the company may not accept those provisional contracts by taking appropriate proceedings.

Difference between preliminary contract and provisional contract:

Basis	Preliminary contract	Provisional contract
1. Meaning	Preliminary contract are the contracts, which are made before the formation of the company.	Provisional contracts which are entered by a company after incorporation but before getting certificate.
2. Enforcement of contract	Neither the company can sue, nor can it be sued to enforce the preliminary contracts.	Can be enforced only on receiving certificate of Commencement of business
3. Applicable for	Both private company and public company.	Only public company.



IN-TEXT QUESTIONS

1. When a public company said to be registered:
 - (a) When it files the memorandum of association with the registrar of companies
 - (b) When it gets the certificate of incorporation
 - (c) When it starts its business
 - (d) None of the above
2. Contracts which are entered into by agents or trustee on behalf of a prospective company before it has come into existence are called:
 - (a) Provisional contracts
 - (b) Pre-incorporation contracts
 - (c) Both provisional and pre-incorporation contract
 - (d) None of the above
3. Every company shall have its registered office within _____ of its incorporation.
 - (a) 15 days
 - (b) 30 days
 - (c) 45 days
 - (d) 60 days
4. A change in the name of a company requires:
 - (a) An ordinary resolution and approval of the Central Government
 - (b) A special resolution and approval of the Central Government
 - (c) A special resolution and approval of the tribunal
 - (d) An ordinary resolution and approval of the tribunal
5. INC 33 is filed for:
 - (a) MOA
 - (b) AOA
 - (c) Prospectus
 - (d) None of the above



1.6 Online Registration of a Company

The MCA 21 project of the Ministry of Corporate Affairs enables online registration of the company:

1. Integrated Process.
2. Non-Integrated Process.

RUN – Reserve Unique Name is a web service used for reserving a name for a new company or for changing its existing name. It verifies that the name is unique or is not.

The Central Registration Centre (CRC) may, based on information and documents provided, reserve the name for a period of:

- (a) 20 days from the date of approval if in case the name is being reserved for a new company.
- (b) 60 days from the date of approval if in case it includes a change in the name of an existing company.

Before the Run web - form was introduced, all applications concerning company names were to be made in the Form INC 1.

Simplified Process for Incorporating Company Electronically (SPICE).

The SPICE method for incorporating the company is notified by the Government. The company, it is notified by the Government in Oct 2016, aims to ensure ease in doing business and reduce the time in incorporation of the Company:

- (a) **INC 32:** File an application as per integrated form INC 32 for reservations of name, incorporations of company, appointments of proposed company's Directors, etc. OPC, Private company, public company etc.
- (b) Only one name in e-form No. **INC 32**.
- (c) **INC 33, INC 34** - MOA filed in Form 33, AOA filed in Form 34.
- (d) **Maximum 3 directors:** The particulars of a maximum of three directors shall be allowed to be filled in INC 32 in case when proposed directors do not have Director Identification number.
- (e) **Promoter:** The applicant shall sign and witness digitally, the Memorandum of Association and Articles of Association prepared



in e-forms INC 33 and 34 and both forms has attached them to e-form INC 32.

- (f) **As per section 12(2):** A company verification of registered office, all the documents required to be filled and attached in **INC 22** in case the correspondence address is different.
- (g) **Registrar:** The Registrar in whose jurisdiction the office of the proposed company will be suited, will process allotment of DIN and INC 32. Also inform about deficiencies, if any, and removal of the same.
- (h) **Reject:** The application of the proposed company may be rejected by the Registrar if deficiency is not removed.

ON Line Incorporation of company: Non-integrated process.

1. **Digital Signature Certificate (DSC):** Obtain the DSC for all proposed Directors because MCA 21, E-governance requires the use of digital signatures by all those persons who are authorised to sign the Documents. A licensed Certifying Authority (CA) issues the digital signature.
2. **Directors' Identification Number (DIN):** Apply for DIN in proper format to be digitally signed by CA/CS/Cost Accountant etc. and uploaded by MCA portal after payment of fees electronically. Upload, successful, payment, then Provisional DIN is generated.
3. **Validate the signature:** Implement a role check in the MCA application to validate the signature Director as well as that of a professional. who certified the documents. Only after that the e-form will be uploaded in the portal.
4. **Names (Prevention of Improper Use) Act, 1950:** To select, in order of preference, at least one name and maximum of six names, consistent with the main objects of the company. Also ensure that the name does not resemble the name of any already – registered company and that it does not violate the provisions of Emblems and Names (Prevention of Improper) Act, 1950. If the proposed name is not available, then in that case a fresh name on the same application.
5. **Name Approved:** After the name approval, the applicant can apply for registration of a new company by filing all the required documents



for incorporating a company other than OPC within 60 days of the name approved. The application for incorporation of a company shall be attached with following documents:

- (a) **MOA** is signed by the subscribers and witnessed. Therefore, the name of the subscribers, Father's name, address, occupation and the number of shares taken must be given along with similar details of the witness.
 - (b) **AOA** also needs to be signed by the subscribers to the MOA and witnessed.
 - (c) **Declaration:** A declaration by a professional (practising CA, CS, ICWA) and director, manager or company secretary that all requirements related to incorporation have been compiled with.
 - (d) **Affidavit:** An affidavit from each subscriber and first director stating that in the past five years, he has not been convicted of an offence in connection with promotion, formation or management of a company, nor found guilty of fraud/misfeasance/breach of duty, and all documents contain true and complete information to the best of his knowledge.
6. **Section 12:** A company furnishes to the register, verification of its registered office, within 30 days of its incorporation, in such may be prescribed, accompanied by any prescribed document. A title registered documents in the name of company. Notarised copy of lease/ rent agreement with name of company with copy of rent paid.
 7. **Appointment of Directors:** File particulars of appointment of directors and key managerial personnel with the Registrar within 30 days from the date of appointment of every director and key personnel.
 8. **E-payment:** Make payment, MCA 21 portal provide facility of e-payment of requisite filing and registration fee.
 9. **Receiving E-mail:** Receiving email on approval of application, then Registrar generated incorporation certificate which consist Corporate Identity Number (CIN) in **INC 11** within a few days. Consist of PAN (Permanent Account Number) of the company. Consist of TAN



(Tax deduction account). NO hard copy of certificate issued; only digital certificate issued.

1.7 Summary

The incorporation of a company is a legal process which is used to form a legal entity. It was a long process earlier but now the initiative taken by MCA of online registration called SPICE. ROC plays an important role in the whole registration process; it defines all documents and steps required in incorporation of the company. After all verification by the ROC, the company is registered and ready to do business. Promoters play a vital and important role to make it possible and convenient to get a company registered. He does all preliminary work, incur preliminary expenses as well entered in pre-incorporation contract and provisional contract.

1.8 Answers to In-Text Questions

1. (b) When it gets the certificate of incorporation
2. (b) Pre-incorporation contracts
3. (b) 30 days
4. (b) A special resolution and approval of the Central Government
5. (a) MOA

1.9 Self-Assessment Questions

1. What is the process of incorporation of the company according to Indian Companies Act, 2013?
2. Who is Promoter and what is the meaning of fiduciary position regarding to promoter?
3. How company get registered online?

1.10 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.



- ◆ Kaur. H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Memorandum of Association

Author: Dr. R C Garg

Revised by: Dr. Sonika Nagpal

STRUCTURE

- 2.1 *Learning Objectives*
- 2.2 *Introduction*
- 2.3 *Contents of Memorandum [Section 4]*
- 2.4 *Alteration of Memorandum of Association*
- 2.5 *Summary*
- 2.6 *Answers to In-Text Questions*
- 2.7 *Self-Assessment Questions*
- 2.8 *Suggested Readings*

2.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Explain the meaning of the memorandum of association.
- ◆ List different clauses of memorandum of association.
- ◆ Discuss the provisions of the Companies act for alteration of clauses of memorandum.

2.2 Introduction

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are:

1. Memorandum of Association.
2. Articles of Association.



The preparation of a memorandum of association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which the company is allowed to be formed. It is the unalterable charter or constitution of the company.

According to section 2(56) of the Companies Act, 2013, “Memorandum means Memorandum 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”.

This definition does not provide any idea of the nature and importance of this document. Lord Macmillan defined a memorandum as a document which governs the relationship of the company with the outside world. It enables shareholders, creditors and all those who deal with the company to know the scope of activities of the company. It enables these parties to know the purpose, for which their money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. According to Palmer, Memorandum specifies the objects for which the company is formed and enables outsiders dealing with the company to know whether the contractual relation in which they intend to enter with the company is within the objects of the company. Any act which is beyond the powers of the company is “*ultra vires*” and hence void.

Form of Memorandum (Sec. 4)

According to Sec. 4 of the Act, Memorandum of a company shall be drawn in such form and manner as given in the following Tables of Schedule I of the Companies Act, 2013.

Table A contains a form of Memorandum of a company limited by shares.

Table B contains a form of Memorandum of a company limited by guarantee and not having share capital.

Table C contains a form of Memorandum of a company limited by guarantee and having share capital.

Table D contains a form of Memorandum of an unlimited company.

Table E contains a form of Memorandum of an unlimited company and having share capital.



The memorandum of Association of accompany shall be:

- (a) printed,
- (b) divided into Paragraphs,
- (c) numbered consecutively, and
- (d) signed by a prescribed number of subscribers (at least 7 in case of public company, two in case of private company and one in case of One Person Company). Each subscriber must sign and mention his/her address, description and occupation in the presence of at least one witness who shall attest the signatures and shall provide his particulars.

2.3 Contents of Memorandum [Section 4]

1. Name clause

Since a company is a distinct legal entity it must have its own name. The name of a public company must end with the words 'Limited' and that of a private company with the words 'Private Limited' and 'One Person company' in case of OPC. **A company can be registered with any name subject to the following restrictions:**

- (i) The name of the company must **not be undesirable**. Also, it should **not be similar** to or identical to the name of an existing company or LLP. If it is so, it is considered to be undesirable by the Central government and the government may order the company to change its name. However, the government may order a change of name if the resemblance results in confusion as to the existence of some association between the two companies and it is likely to deceive the customers.

For e.g., in the case of *Ewing v. Buttercup Margarine Co. Ltd.* was carrying on business under the name of Buttercup Dairy Company. He filed a suit against Buttercup Margarine Co. Ltd., a newly formed company, restraining it from continuing business under the existing name as it may create confusion amongst the customers that both the companies are associated



in some way. The court passed an injunction order against the defendant company.

However, the name shall not be considered undesirable if just a few words are common. This can be illustrated in the case *Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Ltd.* the plaintiff brought a suit against the defendant company to prevent it from using the existing name. The court rejected the contention on the ground that plaintiff was a trade protection society whereas defendant was an insurance company. The resemblance is not such so as to deceive the customers and hence it is not undesirable.

- (ii) The name of the company **must indicate its principal objects**. The words included in the name must connote the objects with which the company is formed.
- (iii) The name should not indicate that the company is connected with or is **having patronage** of the Central Government or State government or any local authority, unless prior approval of the Central Government has been obtained.
- (iv) The name should not violate the provisions of the **Emblems and Names (Prevention of Improper Use) Act, 1950**. It should not use the official seal or emblems of the government and various national and international organizations such as WHO, UNO etc.
- (v) The company should not include any words in its name so as to **offend any section** of society.
- (vi) The words **banking, insurance, co-operative, trust, investment** etc. should not be included; it is justified.
- (vii) The name of a company should not include the name of an **enemy country**.

Reservation of Name

According to sec. 4(4) of the Act, a person may reserve the name of a proposed company by making an application to the Registrar along with the required information and documents. After receipt of the application, the registrar shall reserve the name for a period of



60 days from the date of approval of the name. After reservation of the name if it is found that the information furnished by the person was wrong then—

- (i) If the company is not incorporated, then the reserved name shall be cancelled and the person making such application shall be liable to a penalty upto Rs. 1 lakh.
- (ii) If the company has been incorporated, then the Registrar shall provide the company an opportunity of being heard and then direct it,
 - (a) To pass an ordinary resolution and **change the name** within 3 months, or
 - (b) To take action for **striking off the name** from the Register of companies, or
 - (c) To make a **petition for winding up**.

Publication of Name

Sec. 12 of the Companies Act, 2013 requires every company to affix or paint its name, outside its registered office and at every place where it carries business, in conspicuous position, in legible letters and in one of the local languages. The name shall also be engraved on its seal.

It should also get its name, address, telephone number, fax number, e-mail id, website address and its Corporate Identity Number (CIN) printed on all its bill heads, business letters, notices, invoices, negotiable instruments etc.

In case of a One Person Company, OPC should be mentioned along with its name.

If a company defaults in complying with the provisions of this section, the company and every officer in default shall be punishable with a fine ranging from Rs. 1,000 to Rs. 1,00,000 per day till the default continues.

2. Registered Office/Domicile/Situation Clause

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated Sec. 4(1). This is important for two reasons:



- (i) It will fix **the domicile of the company** which determines the jurisdiction of the High court of the State in which the registered office is situated.
- (ii) It is at the registered office where the statutory books and other documents of the company shall be kept.

Every company must have its registered office within 15 days of its incorporation. Further, the company must get its registered office verified by the registrar by filing Form INC 22 within 30 days of its incorporation. The form must be submitted along with the prescribed fees and documents such as Title deed of the premises, Notarised copy of lease agreement or electricity bills in the name of the company.

The notice of change in the registered office after incorporation shall be furnished to the registrar within 15 days of such change.

3. *Object Clause*

This is the most important clause in the memorandum because it not only shows the objects for which the company is formed but also determines the extent of the powers which the company can exercise in order to achieve those objects. Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. This is because of the following reasons:

- (i) It provides **protection to shareholders and investors** as they know the purposes for which their money is being employed. Further it ensures that their investment is not being used for any other venture.
- (ii) It provides **protection to the creditors** by ensuring that the funds of the company are not being used in unauthorized activities.
- (iii) It **serves public interest** as it limits the activities of the company within the boundaries set by the object clause. This prevents diversification in business fields which are not closely connected to the one for which the company was established.



Notes

A company can choose any object provided:

- ◆ It must not be Illegal,
- ◆ It must not be Immoral or against public policy,
- ◆ It must not contain anything which is against the provisions of the Companies Act, 2013,
- ◆ It must not contain ambiguous statements,
- ◆ It must contain the main objects and any other matter necessary for furtherance of the main objects.

A. Doctrine of *Ultra Vires*

A company is bound by its Memorandum of association, and it cannot do anything which is beyond the powers conferred upon it by the memorandum and the Companies Act. The object clause of the memorandum delimits the scope of corporate activities and anything which is outside the object clause of the company is '*ultra vires*'. **Ultra** means beyond and **vires** means powers. These transactions cannot be ratified or legitimized even though the whole body of shareholders gives their consent to it as they are *void-ab-initio*. This rule is known as the Doctrine of **Ultra Vires**.

The leading case through which this doctrine was enunciated is ***Ashbury Railway Carriage and Iron company Limited vs. Riche (1875)***. In this case the plaintiff company was formed with the following objects:

- (a) To make, sell or lend railway carriages and wagons.
- (b) To carry on business as mechanical engineers and general contractors.
- (c) To purchase, lease, sell and work mines.
- (d) To purchase and sell as merchants or agents of coal, metals, timber etc.

The directors of the plaintiff company entered into contract with Riche for financing construction of a railway line in Belgium. This act of directors was ratified by the shareholders



in the general meeting. The company repudiated the contract on the contention of being *ultra vires*. The court held that the term 'general contractors' must be understood in relation to the main business of the company *i.e.*, 'mechanical engineers' and the word 'general' must not be interpreted in literal sense. Hence, the contract was *null* and *void* as it was beyond the scope of the object clause.

So, the rationale behind this doctrine is that since the company is an artificial legal person, the directors cannot bind the company by such acts which are not within the scope of activities of the company. If they do so, then it will lead to the following **consequences**. In other words, the **effects** of such acts are as follows:

- ◆ These acts are **not binding on the company**.
- ◆ The **company cannot sue or be sued** by the third parties for these contract.
- ◆ The **members can obtain an injunction order** and restrain the company from doing *ultra vires* acts.
- ◆ The **directors are personally liable** for such acts. However, acts which are within the powers of the company but beyond the powers of directors can be ratified at the general meeting.
- ◆ In case of **ultra vires acquired property**, if the property is transferred following the legal procedure, then **it is duly vested in the company** *i.e.*, the company can enjoy the rights of owning and disposing of such property without any restriction.
- ◆ In case of **ultra vires contracts**, since these acts are void-ab-initio so they cannot be enforced. However, the following two points must be noted in this respect:
- ◆ If the money or property obtained under *ultra vires* contract is used to pay debts of the company, then by virtue of principle of subordination, the creditors can to that extent stand in the shoes of those creditors who have been paid off.



Notes

- ◆ If the property handed over to the company by virtue of an *ultra vires* contract exists in specie or it can be traced the person who has handed it over can get it back.
- ◆ In case of ***ultra vires* lending by the company**, the company can file a suit and recover it.
- ◆ In case of ***ultra vires* torts** (civil wrong) done by its employees, the company cannot be held liable unless it is proved that the **acts are done in the course of *intra vires* activities and within the course of their employment.**

4. Capital Clause

As per Sec. 4(1), in case of company limited by shares, the memorandum must state:—

- (i) The amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount. The capital with which the company is registered is called the authorized or nominal share capital.
- (ii) The number of shares which each subscriber intends to take, which shall not be less than one.
- (iii) In the case of OPC which shall become the member of the company in case of death of the subscriber.

5. Liability Clause

The liability clause states the nature of liability of the members of the company Sec. 4(1).

In the case of a company *limited by shares*, the liability of members is limited to the amount unpaid, if any, on the shares held by them.

In the case of a *company limited by guarantee*, the liability of members is limited to—

- ◆ The amount that each member has undertaken to contribute to the assets of the company in the event of winding up while he is a member or within one year after he ceases to be a member, for payment of debts and liabilities of the company; and



- ◆ The amount of cost and expenses of winding up and for adjustment of rights of the contributories among themselves.

6. Association or Subscription Clause

As per sec. 3 of the Companies Act, 2013, the memorandum of every company must end with an Association or Subscription clause. It contains the declaration by the subscribers that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by attested even persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall mention his address, description and occupation, if any. This clause generally runs in this form: “we, the several persons whose names, addresses and occupations are subscribed, are desirous of being formed into a company in pursuance of the number of shares in the capital of the company, set opposite of our respective names”.

IN-TEXT QUESTIONS

1. The memorandum of association is the Constitution of the company. (True/False)
2. It delimits the scope of company's activities. (True/False)
3. The clauses of the memorandum of association can be altered by the sweet will of the members of the company. (True/False)
4. The memorandum of a company contains 5 clauses. (True/False)
5. The name of the company can be changed by passing a _____ resolution in the general meeting.
6. The _____ shall issue a new certificate of incorporation after incorporating necessary change in the memorandum.



2.4 Alteration of Memorandum of Association

Alteration of Memorandum can be done by complying with the provisions of sec. 13 of the act and by passing a special resolution in the general meeting. An alteration shall have effect only when it is registered with the registrar.

Alteration of Name Clause

1. Change of Name by Special Resolution

- (i) A company may change its name by passing a special resolution in the general meeting and by getting the approval of the Central Government signified in writing.
- (ii) However, no such approval shall be required where the change in the name of the company is the just addition or deletion of the word “Private” on the conversion of a public company into a private company or of a private company into a public company (Sec. 13).

2. Change of Name Not Allowed

Rule 29 of the Companies (Incorporation) Rules, 2014 provides that the change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any other document due for filing with the Registrar or which has defaulted in the repayment of matured deposits or debentures or interest on deposits and debentures.

3. Change of Name by Ordinary Resolution

- (a) ***Company registered with identical name:*** If through inadvertence or otherwise, a company is registered by a name which, In the opinion of the Central Government, is identical with or too nearly resembles the name of an existing company, it shall change its name by passing an ordinary resolution, within three months of issuing such directions [Sec. 16(1)].
- (b) ***Company registered with name identical to registered trademark:*** If a proprietor of a registered trademark applies to the Central Government that the name of the company closely resembles with the registered trademark, within 3 years of incorporation of the company and the Central Government



is of the same opinion, then it may direct the company to change its name. In such a case the company shall change its name within a period of 6 months from the issue of such directions, by passing an ordinary resolution [Sec. 16(1)].

- (c) **Default:** If a company defaults in complying with the directions of the Central Government, then the company shall be punishable with fine of Rs. 1,000 per day, till the default continues and every officer in default shall be fined ranging from Rs. 5,000 to Rs. 1,00,000 [Sec. 16(3)].
- (d) **Issuance of New Certificate of Incorporation:** When a company changes its name then it shall give a notice to the Registrar along with the order of Central Government, within 15 days of such change. The company shall apply to the Registrar in Form No. INC 24 and request him to make the necessary changes in the certificate of incorporation and the memorandum. After making the changes, the registrar shall issue a new certificate of incorporation in Form No. INC 25.
- (e) **Rights and Obligations Remain Unaffected:** The change of name shall not affect the rights and obligations of the company or render the legal proceedings, by or against the company, defective.

Alteration of Registered Office/Domicile Clause

The company may alter its domicile clause in the following cases:

- (i) Change of premise of the registered office within the same city, town or village.
- (ii) Change of registered office from one town to another town, within the same state.
- (iii) Change of registered office from one state to another.

In the first two cases the memorandum need not be altered as it is the name of the State which is mentioned in the registered office clause and not the town, village or the address of the company. There is alteration in the memorandum only when the shift is from one state to another. The requirements of the companies act in all the cases are given below:



- (i) **Change of registered office from one place to another place in the same city, town or village [Sec. 12(5)]:** In this case a special resolution is to be passed and the registrar is to be informed about such change within 15 days of the change.
- (ii) **Change of registered office from one town, city or village to another in the same State.** In this case, the procedure to be followed is as under:
- (a) **Special Resolution:** A special resolution is to be passed in the general meeting.
- (b) **Confirmation of Regional Director:** Sec. 12(5) provides that when the company changes its registered office from one town, village or city to another, the confirmation of regional director is to be obtained on an application made in this behalf by the company in the prescribed manner. This is so as the change is from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar. At present, only Tamil Nadu and Maharashtra have more than one Registrar, namely at Chennai and Coimbatore, and Mumbai and Pune respectively. According to the Companies (Incorporation) Rules, 2014, the company shall apply in Form No. INC 23 along with the prescribed fees to obtain the approval of the Regional Director. Rule 28 of the Companies (Incorporation) Rules, 2014 provides that at least one month before filing any application to the regional director for the change of registered office, the company shall:
- ◆ Publish a notice about the change of registered office, in one English and one vernacular newspaper, circulating in the district of the registered office.
 - ◆ Send individual notices to the creditors, debenture holders and depositors of the company asking them whether their interest is affected by the change in registered office. If it is so, then shall intimate the regional director within 21 days of the notice. If the Regional director does not receive any such intimation within the given period, then



it is presumed that the concerned parties have given their consent for the change.

- ◆ The company shall not be allowed to change its registered office if any inquiry or any suit is pending against the company.

If the company complies with all the above provisions, the regional director shall send his confirmation within 30 days of receiving the application.

(c) Confirmation of Regional Director to be Filed with the Registrar: The company shall file a copy of the confirmation letter of the regional director along with a copy of the altered memorandum with the ROC within 60 days of receiving the confirmation. The registrar shall issue a certificate within 30 days from date of filing of confirmation and this certificate shall be conclusive evidence of the fact that all the company has complied with all the provisions of the Companies Act pertaining to the change in registered office.

(d) Notice of change to be given to the registrar: The company shall intimate the registrar about the new address of the company within 15 days of the change.

(iii) Change of Registered Office From One State to Another State:

For changing the place of registered office from one state or union territory to another, the company has to comply with the following provisions:

- (a) Special Resolution:** A special resolution is to be passed at the general meeting; a copy of the same is to be filed with the registrar within 30 days.
- (b) Confirmation by Central Government:** The company shall file an application to the Central government seeking approval for change in the registered office from one state to another. As per rule 30 of Companies (Incorporation) Rules, 2014, the company shall attach the following documents along with the application which shall be made in Form No. INC 23:
 - ◆ A copy of MOA with the proposed alterations.



Notes

- ◆ A copy of minutes of the general meeting in which the resolution authorizing such alteration was passed, giving details of the number of votes cast in favour and against the resolution.
- ◆ A copy of a special resolution passed to approve the change.
- ◆ The list of creditors and debenture holders specifying their names, addresses and amounts due to them.
- ◆ An affidavit signed by the Company Secretary and not less than two directors, one of whom should be Managing Director, stating that they have made full inquiry into the affairs of the company, and they are of the opinion that the list of creditors and the estimated number of claims and debts mentioned in the list are correct and there are no other debts or claims against the company.
- ◆ An affidavit signed by the directors mentioning that no employee shall be retrenched due to change in the registered office from one state to another. This affidavit is to be submitted to the Chief Secretary of the State.
- ◆ A copy of acknowledgement given by the Registrar and Chief secretary of the state where the registered office is situated at the time of filing application.

At least 30 days before filing the application to the central Government in Form No. INC 23, the company shall:

- ◆ Advertise the application in one English and one vernacular newspaper, circulating in the district of the registered office.
- ◆ Send by registered post with acknowledgement due, individual notices to the creditors and debenture holders along with the Registrar, SEBI in case of listed company and any other regulatory body in case the company is regulated by any special act at that time in force.
- ◆ In case if any objection is received by any of the parties whose interest is likely to be affected by the proposed



change, the objection shall be filed with the Central Government on or before the date of hearing.

- ◆ Where no such objection is received, the company shall put up the application for orders without hearing.
- ◆ Before confirming the alteration, the Central Government shall ensure that either the consent of all the creditors and debenture holders is received, or their debt has been discharged or has been secured to the satisfaction of the Central government.
- ◆ The company shall not be allowed to shift its registered office if any inquiry or any suit is pending against the company.

The Central Government may confirm the alterations on such terms and conditions as it may deem fit and shall dispose of any application filed for change of registered office from one state to another, within 60 days.

- (c) ***A copy of Central Government's order to be filed with the Registrar:*** The company shall file a copy of the Central Government's order approving change in Form No. INC 28 along with the prescribed fees, to the Registrar of each state within 30 days of the receipt of such order, who shall register the same. The registrar of state where the registered office is shifted shall issue a fresh certificate of incorporation incorporating the alterations.

Alteration of Object Clause

Sec. 13 of the Act provides that the object clause of a company can be altered through the following procedure:

- (i) **Special Resolution:** The company shall pass a special resolution at the general meeting. Rule 22 of the Companies (Management and Administration) Rules, 2014 further provides that the object clause can be altered by passing a special resolution through postal ballot. However, this provision does not apply to One Person Company and Companies having up to 200 members.



(ii) Registration of Changes: A copy of the resolution along with a copy of the altered memorandum is to be filed with the Registrar within one month of passing it.

(iii) Certification of Registration: The Registrar will register the changes and issue a new certificate of incorporation which will be conclusive evidence of the fact that all the requirements of sec. 13 of the act have been complied with.

In case of **companies where the money has been raised through prospectus** and some amount so raised is still unutilized, the object clause can be altered only if the following requirements are met:

(i) Special Resolution: According to sec. 13(8), a special resolution is to be passed by the company and a copy of the same is to be filed with the Registrar within 30 days.

Rule 32 of Companies (Incorporation) Rules, 2014 provides that the special resolution to be passed should be through the mode of postal ballot and a notice for the proposed resolution containing the following particulars should be sent:

- ◆ The total money received
- ◆ The total money utilized
- ◆ The unutilized amount
- ◆ The particulars of the proposed alteration in the objects
- ◆ The justification for alteration
- ◆ The estimated financial impact of the proposed alterations on the earnings of the company
- ◆ Other necessary information required for making an informed decision
- ◆ The place from where a copy of the notice can be obtained

(ii) Publication in Newspaper: Along with sending the postal ballot notices to the shareholders, the company shall also get the resolution published in one English and one vernacular newspaper, circulated at the place of registered office. The notice shall also be placed on the website of the company [Sec. 13(8)].



(iii) Dissenting Shareholders: The promoters and shareholders shall provide an opportunity to the dissenting shareholders to exit from the company in case they don't agree with the proposed alterations in the objects of the company [Sec. 13(8)].

(iv) Registration of Alterations: The company shall get the alterations in the object clause registered with the ROC and he shall certify the alterations within 30 days of the special resolution. Unless the alterations are registered with the registrar in accordance with the provisions of the Companies Act, they shall have no effect [Sec. 13(9)].

Alteration of Capital Clause

The capital clause can be altered in any of the following ways:

1. Alteration of share capital (Sec. 61)
2. Reduction of share capital (Sec. 66)
3. Variation of rights of shareholders (Sec. 48)
4. Alteration of share capital (Sec. 61)

A limited company, if authorized by its articles, may alter its capital in any of the following ways, by passing an ordinary resolution:

- (a) Increase its authorized share capital by such amount as it may deem expedient.
- (b) Consolidation of shares into shares of higher denomination.
- (c) Sub-division of shares into shares of lower denomination.
- (d) Conversion of fully paid-up shares into stock or conversion of stock into shares.
- (e) Cancellation of unissued shares.
- (f) Issue of new shares

If the articles of the company authorize, then the company may alter its capital clause in any of the above ways by passing an **ordinary resolution**. However, if articles do not permit then a **special resolution** is to be passed to alter the articles.

Sec. 64(1) provides that a notice regarding the alteration in the capital clause, along with the altered memorandum, is to be filed with the Registrar within 30 days of such alteration. Further sec. 64(2) provides that if a



company and any officer contravene any of the aforesaid provisions, they shall be liable to fine which may extend to Rs. 1,000 per day till the default continues, or Rs. 5,00,000 whichever is less.

Reduction of Share Capital (Sec. 66)

A company may reduce its share capital by any of the following ways:

- (a) It may reduce or extinguish the liability of its shareholders in respect of share capital not paid up or uncalled capital [Sec. 66(1)(a)]; or
- (b) It may cancel any paid-up share capital which is lost or is not represented by the available assets [Sec. 66(1)(b)(i)]; or
- (c) It may pay off any paid-up share capital which is in excess of the requirements [Sec. 66(1)(b)(ii)].

Sec. 66 of the Companies Act and NCLT (Procedure for Reduction of Share Capital) Rules, 2016 prescribe the following procedure for reduction of share capital:

- (i) The **articles must authorize** such reduction of share capital. If they do not contain such provision, then articles may be altered to include the provision.
- (ii) The company shall pass a **special resolution** at the general meeting.
- (iii) For confirmation of reduction, the company shall **file a petition with the National Company Law Tribunal** along with:—
 - ◆ The list of creditors
 - ◆ Verification of list of creditors by auditor
 - ◆ Declaration by a director and certificate by the auditor that no arrears in repayment of deposits are there on the date of filing of application
- (iv) Within 15 days of filing of application, **the Tribunal shall give notice** of such application to:
 - ◆ The Central Government,
 - ◆ The Registrar,
 - ◆ SEBI (in case of listed companies), and
 - ◆ The Creditors of the company.



The **Tribunal shall consider the representations** made by the Central Government, Registrar, SEBI and Creditors **within 3 months** of receipt of such notice.

- (v) The **Tribunal shall confirm the reduction** if no representation is received from any of the concerned parties and it shall presume that they have no objection to the reduction. But if any creditor objects, then the Tribunal shall either obtain his consent or satisfy his claim or make his payment secured.

Once all the parties are satisfied, the Tribunal shall **make an order confirming reduction** on such terms as it may deem fit. However, the Tribunal shall not give its consent unless the accounting treatment proposed by the company for such reduction is in conformity with the accounting standard specified in sec. 133 and the auditor files a certificate regarding this with the Tribunal.

It may also direct the company that for a specified period it shall **add the words ‘And reduced’** to its name.

- (vi) After obtaining confirmation from the Tribunal, the **company shall publish Tribunal’s order** in such a manner as Tribunal may direct. In case of failure of a company to do so, it shall be fined from Rs. 5 lakhs which may extend to Rs. 25 lakhs.
- (vii) The company shall register the Tribunal’s order along with the minutes approved by the Tribunal with ROC within 30 days of receiving such order. The reduction shall take effect from the date of registration of the confirmation order. The minutes shall include:
- (a) The amount of share capital.
 - (b) The number of shares into which it is divided.
 - (c) The amount of each share; and
 - (d) The amount if any, paid-up on each share at the date of registration.

Within 30 days of submission of the Tribunal’s order, the registrar shall issue a certificate to that effect in Form RSC-7.

- (viii) **After reduction, members are not liable** for the calls on the amount by which the nominal value of their shares has been reduced.



(ix) **If any creditor entitled to object to the reduction of capital is unintentionally missed** by the company, then all members at the time of registration of the order and minutes, shall be liable to contribute for discharge of debts.

(x) **If any officer of the company:**

- ◆ knowingly conceals the name of a creditor who is entitled to object to reduction; or
- ◆ knowingly misrepresents the nature or amount of debt of any creditor; or
- ◆ abets or is party to any such concealment or misrepresentation, then he shall be liable under sec. 447 *i.e.*, he shall be liable to imprisonment with a term ranging from 6 months to 10 years. In addition to this, he shall be liable to fine which shall not be less than the amount involved in the fraud and may extend to three times the amount involved in fraud.

Tribunal’s Sanction not required

In the following cases, the sanction of tribunal shall not be required:

- (a) Forfeiture of shares
- (b) Surrender of shares
- (c) Diminution of capital *i.e.*, cancelling shares which are not subscribed
- (d) Redemption of Preference shares (Sec. 55)
- (e) Buy-back of shares in accordance with the provisions of Sec. 68.

Difference between Reduction of Capital and Diminution of Capital

Basis	Reduction of Capital	Diminution of Capital
1. Definition	Reduction of capital is extinguishment of paid-up or subscribed capital.	Diminution of capital is reduction of unsubscribed part of the issued capital.
2. Resolution	It requires special resolution.	It requires ordinary resolution.
3. Confirmation by Tribunal	Confirmation by the Tribunal is required in reduction.	Confirmation by Tribunal is not required in case of diminution.
4. Adding words after name	In this case the Tribunal orders the company to add words ‘and reduced’ after its name.	No such order is passed by the Tribunal in case of diminution.



Basis	Reduction of Capital	Diminution of Capital
5. Procedure	It requires an elaborate procedure before reduction is registered with and certified by the registrar.	The company has to notify the registrar within 30 days of diminution.

Variation of rights of shareholders (Sec. 48)

Where the company has issued different classes of shares the rights attached to the shares of any class may be varied by following the procedure specified in Sec. 48 which is given as under:

- (i) The **memorandum and articles of the company must authorize** such variation. Such variation should not be prohibited by the terms of issue.
- (ii) A **special resolution** is to be passed in the meeting of holders of those shares whose rights are being varied.
- (iii) If variation in the rights of one class of shareholders is affecting the rights of another class of shareholders, then the company must **obtain the consent of at least 3/4th of such class of shareholders** whose rights are being.
- (iv) If the rights of a class of shareholders are to be varied and some shareholders of that class **do not give their consent** to the variation, then **not less than 10 per cent of such dissenting shareholders** can appeal to the Tribunal and obtain cancellation order within 21 days of passing of the resolution. Until the Tribunal gives its consent, the variation shall not have effect.
- (v) The company shall **send the copy of resolution** along with the **Tribunal's order to the Registrar** within 30 days.

In case of default in complying with any of the above provisions, a fine ranging from Rs. 25,000 to Rs. 5,00,000 shall be imposed on the company and every defaulting officer shall be liable to imprisonment up to 6 months or a fine ranging from Rs. 25,000 to Rs. 5,00,000 or both.

Alteration of Liability Clause

The liability clause cannot be altered so as to increase or make the liability of members unlimited unless the written consent of such member is obtained either prior or subsequent to the alteration. However, in case of a club or any other not-for-profit association, the memorandum may



Notes

be altered so as to increase the subscription of members, even without their written consent.

A company, if authorized by its articles, may alter its memorandum to make the liability of its directors or manager unlimited by passing a special resolution. Such alteration will not have effect unless they have accorded their consent in writing.

IN-TEXT QUESTIONS

- 7. It can be altered only by following the procedure prescribed in the Companies Act. (True/False)
- 8. Change of registered office from one city to another requires confirmation of _____.
- 9. Change of registered office from one state to another requires confirmation of _____.
- 10. The capital clause can be altered in _____ ways.
- 11. Mix and Match (A) with (B):

S. No.	(A)	(B)
1.	Any Act which is beyond the scope of its memorandum and Companies Act is not binding on the company	(a) Memorandum of Association
2.	It establishes jurisdiction of High court of the state in which registered office is situated	(b) Doctrine of <i>ultra vires</i>
3.	Reduction of unsubscribed part of issued capital	(c) Domicile clause
4.	Principal document of the company	(d) Diminution of capital

2.5 Summary

The process of formation of a company involves four stages and the company is required to submit various documents with the registrar for successful completion of this process. One such document is Memorandum of Association. A memorandum is the principal document of the company



as it states the reason for existence of the company and defines the relationship of the company with the outsiders. It contains six clauses viz. Name clause, Domicile clause, Object clause, Capital clause, Liability clause and Association clause. The company can alter these clauses only as per the provisions of the Companies Act. The company is also required to intimate the registrar about such alterations within the stipulated time period. Any alteration done in contravention of any of the provisions of the Companies Act, makes the company and every defaulting officer liable to pay fine of the prescribed amount.

2.6 Answers to In-Text Questions

1. True
2. True
3. False
4. False
5. Special
6. Registrar
7. True
8. Regional Director
9. Central Government
10. Three
11. 1. (b), 2. (c), 3. (d), 4. (a)

2.7 Self-Assessment Questions

1. Define Memorandum of Association? Discuss its clauses.
2. State the procedure for alteration of Registered office clause of Memorandum of Association.
3. Explain the Doctrine of *ultra vires*?
4. State the provisions of Sec. 66 regarding Reduction of Share Capital?
5. Differentiate between Reduction of capital and Diminution of capital.



2.8 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S.K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Articles of Association

Author: Dr. R C Garg

Revised by: Dr. Sonika Nagpal

STRUCTURE

- 3.1 *Learning Objectives*
- 3.2 *Introduction*
- 3.3 *Contents and Form of Articles*
- 3.4 *Entrenchment Clause*
- 3.5 *Relationship Between Memorandum and Articles*
- 3.6 *Difference Between Memorandum and Articles of Association*
- 3.7 *Alteration of Articles of Association Articles*
- 3.8 *Doctrine of Constructive Notice*
- 3.9 *Doctrine of Indoor Management*
- 3.10 *Summary*
- 3.11 *Answers to In-Text Questions*
- 3.12 *Self-Assessment Questions*
- 3.13 *Suggested Readings*

3.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Explain the meaning of articles of association.
- ◆ State the contents of articles of association.
- ◆ Explain the relationship between memorandum and articles.
- ◆ State the differences between memorandum and articles.
- ◆ State the provisions of Companies act for alteration of articles.
- ◆ Explain the Doctrine of Constructive notice and Doctrine of Indoor management.



3.2 Introduction

Every company is required to file Articles of Association along with the other documents to the Registrar at the time of its registration. Section 2(5) of the Companies Act defines Articles of association as “Articles means articles of association of a company as originally framed, or as altered from time to time or applied in pursuance of any previous company law or of this act”.

Articles of Association are the rules, regulations and by e-laws for governing the internal affairs of the company. They define the powers of its officers and establish a contract between the company and its members and the members inter-se (Naresh Chandra Sanyal vs. Calcutta Stock Exchange Association Ltd. 1971). They lay down the mode and the manner in which the business of the company is to be conducted. While framing the articles the company must ensure that the regulations framed do not go beyond the powers of the company as contemplated by the Memorandum of Association nor should they violate any of the provisions of the companies Act.

3.3 Contents and Form of Articles

Articles contain rules regarding the following matters:

- ◆ Share capital and variations of rights,
- ◆ Lien on shares,
- ◆ Calls and forfeiture of shares,
- ◆ Alteration of share capital,
- ◆ Transfer and transmission of shares,
- ◆ Capitalisation of profits,
- ◆ Buy-back of shares,
- ◆ Procedure of general meetings,
- ◆ Voting rights,
- ◆ Proxy,
- ◆ Board of directors,
- ◆ Proceedings of the board,



- ◆ Chief Executive Officer, Manager, Company Secretary or Chief Financial Officer,
- ◆ Seal of the company,
- ◆ Dividends and Reserves,
- ◆ Books of Account,
- ◆ Winding up,
- ◆ Indemnity.

Form of Articles

The Articles of a company registered under this act shall be drawn in the form specified in various Tables (as applicable) contained in Schedule I to the Act.

Table F contains Articles of association of a Company Limited by Shares.

Table G contains Articles of association of a Company Limited by Guarantee and having Share Capital.

Table H contains Articles of association of a Company Limited by Guarantee and not having Share Capital.

Table I contains Articles of association of Unlimited Companies and having Share Capital.

Table J contains Articles of association of Unlimited Companies and not having Share Capital.

As per section 5(7) and Rule 11 of the Companies (Incorporation) Rules, 2014, the company may adopt the model form of articles given in Schedule I either in totality or otherwise.

Articles of Association must be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation if any. Each subscriber shall sign in the presence of at least one witness who shall at test the signatures and also mention his own address, description and occupation.

3.4 Entrenchment Clause

Section 5(3) of the act provides that articles of a company may contain an Entrenchment clause whereby specified provisions of the articles can



Notes

be altered only if more restrictive procedures or conditions than those applicable in case of special resolution have been met or complied with.

The company may include such clauses either at the time of formation of the company or by way of amendment to the articles, agreed upon by all the members in case of private company and by a special resolution in case of a public company.

If Articles of a company contains an entrenchment clause, it shall inform the registrar by giving a notice in case of Form No. INC 2, in case of an OPC or in Form No. INC 7, in case of any other company.

IN-TEXT QUESTIONS

1. Articles of Association of a company define the scope of its operations. (True/False)
2. Articles of association of a company are subordinate to the memorandum and the Companies Act. (True/False)
3. The company may alter its articles of association anytime by following the procedure as prescribed in the _____.
4. The company may insert _____ clause in its articles.
5. Any act of the company which is *ultra vires* the articles can be confirmed by the shareholders if it is *intra vires* the _____.

3.5 Relationship Between Memorandum and Articles**◆ The articles are subordinate to and controlled by the memorandum**

Lord Cairns in *Ashbury Railway Carriage and Iron Co. Ltd. vs. Riche* (1875) explained the relationship between articles and memorandum as: “the articles play a part subsidiary to the memorandum of association. They accept the memorandum as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, the rights and the powers of the governing body as between themselves and the company at large, and the mode and form in which business is to be carried on, and the mode and form in which changes in the internal regulations of the company may vary from time to time be made”.



The memorandum is the constitution of the company and contains fundamental conditions upon which alone the company is allowed to be incorporated. The articles are subsidiary to the memorandum. The articles should not contain any provision which is against the companies act or the memorandum or the law of land. In case of any conflict between the articles and the memorandum, then the provisions of the memorandum shall prevail.

The memorandum can be altered only under certain circumstances provided by the act. The articles can be altered by passing a special resolution as they govern the internal affairs of the company and the members may include or exclude any provision which they think fit, remaining within the limitations of the act. An act beyond the scope of memorandum is *ultra vires* and hence void. It cannot be ratified even by the unanimous consent of the shareholders. However, an act which contravenes the provisions of the articles is irregular and hence can be regularized and confirmed by the shareholders.

◆ **The memorandum and articles must be read together**

The memorandum and articles must be read together so as to avoid any ambiguity and to supplement each other in case any of the documents is silent on any matter. However, a memorandum should prevail in case of a conflict between the two documents.

3.6 Difference Between Memorandum and Articles of Association

Basis	Memorandum of Association	Articles of Association
1. Meaning	Memorandum of association is the charter of the company which contains the fundamental conditions upon which the company is allowed to be incorporated.	The Articles lay down the rules and regulations for the internal management of the company.
2. Objectives	It defines and limits the scope of activities of the company.	The articles are the rules for carrying out the objects set out in the Memorandum.



Basis	Memorandum of Association	Articles of Association
3. Relationship	Memorandum defines the relationship of the company with the outside world.	Articles define the relationship between the company and its members and the members inter-se.
4. Alteration	Memorandum can be altered in the manner provided in the act. It requires approval.	Articles can be altered by passing a special resolution. It requires approval of the Regional Director or Tribunal, in certain cases.
5. Subordinate	Memorandum is subordinate to the Companies Act.	Articles are subordinate to memorandum as well as the Companies Act.
6. Ratification	Any act of the company which is <i>ultra vires</i> the Memorandum is wholly void and cannot be ratified even by the whole body of shareholders.	Any act of the company which is <i>ultra vires</i> the articles can be confirmed by the shareholders if it is <i>intra vires</i> the memorandum.
7. Compulsory	Memorandum is to be compulsorily filed with the registrar by every company.	A company limited by Shares need not have Articles of its own. In such a case it has to adopt Table F.

3.7 Alteration of Articles of Association Articles

Section 14 of the Companies Act grants power to every company to alter its articles and add or remove any provision whenever it desires, subject to the provisions of memorandum and the Companies Act. For altering its articles, the company has to follow certain procedures. First, it has to take approval from the Board of Directors. After approval from the Board, a shareholder's meeting is convened in which the resolution for amendment of the articles is passed. A copy of the resolution is to be filed with the Registrar within 30 days.

Where a public company is to be converted into a private company, the company shall take approval of the Tribunal within three months of passing of the special resolution. A copy of the altered articles is to be filed with the Registrar within 15 days of the order of approval.



The company has to comply with the following provisions to alter its articles:

- ◆ **Special resolution:** Subject to the provisions of memorandum and companies act, a company may alter its articles by passing a special resolution Section 14(1).
- ◆ **Alteration must be *bona fide*:** Company must alter its articles only if it is for the benefit of the company.
- ◆ **Statutory power:** The power to alter its articles is a statutory power available to a company. It cannot enter into any contract which takes away this power from it.
- ◆ **Entrenchment clause:** In case the articles contain entrenchment clauses then the conditions of such clause are to be met before making any alteration.
- ◆ **Convert Private Company into Public Company:** If the company alters its articles to remove such restrictions which are applicable to a private company, then from the date of alteration, the company ceases to be a private company.
- ◆ **Convert Public Company into Private Company:** Any alteration made to convert Public company into Private company shall not have effect, unless it is approved by the Tribunal. The company has to submit a printed copy of the altered articles with the Registrar within 15 days of the approval order.
- ◆ **Notice to provide full information:** The notice of the meeting for alteration of the articles should contain full facts about the proposed amendments.
- ◆ **Breach of contract:** If the alteration is for the benefit of the company but it results in breach of contract with the other party, then the company can make such alteration. However, it is liable to pay damages to the other party.

Restrictions on Alteration

A company can alter its articles subject to following restrictions/limitations:

- ◆ The alteration must not be in conflict with the **provisions of the Companies Act** or any other law in force.



Case: Where the articles were altered to expel a member and register transfer of his shares without any transfer instrument, was considered to be invalid as it was against the provisions of section 56 of the Companies Act (*Madhava Ramachandra v. Canara Banking Corporation*).

- ◆ The alteration must not be inconsistent with the **provisions of the Memorandum** or must not exceed the authority of the memorandum.
- ◆ Alteration should not be against the **Tribunal's order**.
- ◆ Alteration must not be done to include any provision which is **illegal or opposed to public policy**.
- ◆ The company must take **Tribunal's approval** before alteration where such approval is required. For e.g. to convert a Public company into Private company, such approval is required.
- ◆ Alteration must be *bona fide* and for the benefit of the company as a whole. The benefit of the company is taken care of by the members. In case of an alteration which is against the interest of the company or which has the effect of causing discrimination against the minority shareholders or for causing fraud or oppression against any party, the Tribunal shall interfere.

Case: In the case of *Rights and Issues Investment Trust Ltd. v. Stylo Shoes Ltd.*, the issued capital of Stylo Shoes Ltd. comprising 36,00,000 Equity shares and 4,00,000 management shares. The articles provided for 8 votes for each management share. The shareholders sought to alter its articles so as to double the votes of each management share. An EGM was called and a special resolution was passed so as to refrain the holders of management shares from voting. Held, the alteration was valid as it was for the benefit of the company.

- ◆ Alteration may be made **with retrospective effect**, for the benefit of the company as a whole.

Case: In *Allen v. Gold Reefs of West Africa Ltd. (1900)*, the articles empowered the company to exercise lien on all the shares which were 'not fully paid-up'. All the shareholders owned partly paid shares except 'A' who had fully paid shares. He also held some partly paid shares. 'A' died and the company altered its articles to



remove the words 'not fully paid-up' and thus giving it the right of lien on all the shares. The legal representatives of 'A' challenged the alteration as it was done from retrospective effect. It was held that the alteration was valid as it was done for the benefit of the company.

- ◆ The alteration should not constitute a **fraud on minorities**. **If an alteration to the articles is unfair and results in oppression of minority shareholders by the majority shareholders, the Tribunal may interfere and stop it from being carried on.**

Case 1: In the case of *Menier v. Hooper's Telegraph Works*, the shareholders of the company P were also the shareholders of company Q. They passed a resolution which was favourable to company Q but unfavourable to company P. The minority shareholders of company P brought an action against the majority shareholders. It was held that the resolution was invalid.

Case 2: In *Brown v. British Abrasive Wheel Co.*, two shareholders held 98% of the shares of the company. They passed a resolution to amend the articles giving power to the holders of 9/10th of the issued share to purchase the shares of other shareholders of the company. It was held that the alteration was invalid as it was for the benefit of majority shareholders alone and not for the benefit of the company.

- ◆ An alteration which is done by the Board of Directors to **expel a member** is illegal and void.
- ◆ An alteration which **increases the shareholder's liability** to take more shares or contribute to the share capital, without his written consent, is invalid. However, where a company is a club or a not-for-profit association, it can alter its articles and ask for a higher subscription, but with the consent of all the members.
- ◆ An alteration **cannot justify a breach of contract** *i.e.* by altering its articles a company cannot avoid its contractual liability towards the third party. The company may repudiate the contract by altering its articles but it shall be liable to pay damages to the third party.

Case 1: In *Southern Foundries Ltd. v. Shirlaw*, the articles of a company provided that the directors could appoint a managing



director from among themselves *i.e.* only a director can be appointed as a managing director and if he ceases to be a director, he cannot continue as a managing director. The company appointed 'S' as a managing director for 10 years. But before completion of his term, the company was taken over by company 'F' and its articles were altered giving power to company F to remove any director of the appellant company. 'S' was removed from directorship and as a consequence he had to vacate the office of managing director. It was held that his removal amounted to breach of contract with 'S' and the company was liable to pay damages to him.

Case 2: In *Chitambaram Chettiar v. Krishana Iyenger*, 'C' was appointed as Secretary of a company on the basis of terms of the articles and on a salary specified in the articles. Subsequently, the company altered its articles and reduced the salary of a company Secretary to half. It was held that the alteration did not amount to a breach of contract and hence it was valid as a person dealing with the company has to take the risk of its articles being altered.

3.8 Doctrine of Constructive Notice

According to Section 399 of the Act, the Memorandum and Articles of a company are registered with the Registrar and on registration they become public documents open for public inspection. Any person can inspect these documents electronically or get a copy of these documents on payment of prescribed fees. Every person contracting with the company must acquaint himself with the contents of these documents and must ensure that his contract is in accordance with these documents otherwise he cannot sue the company. Every person who deals with the company is deemed to have read and understood the proper meaning of the contents of these documents. This is known as the doctrine of constructive notice.

Where a person enters into a contract which is beyond the powers of the company or the directors, as per the memorandum or articles, he does not acquire any right under the contract and hence shall be personally liable to bear the consequences of such dealings.

Case: In the case of *Kotla Venkataswamy v. Chinta Ramamurthy* a mortgage deed was executed by the secretary and the working director



of the company. However, the articles required that all the documents of the company must be signed by the managing director, secretary and working director on behalf of the company. The company went into liquidation and the plaintiff gave the plea that the deed was valid and hence enforceable. It was held that since the deed was not signed by all the three signatories hence it was invalid, and the mortgagee should have consulted the articles before executing the deed.

The doctrine of constructive notice protects the company from the outsiders, but it is unreal and has proved to be inconvenient for the parties dealing with the companies. A company is known by its officers and directors and not through its documents. Hence this doctrine was abrogated, and the Doctrine of Indoor Management was enunciated as an exception to the doctrine of constructive notice.

3.9 Doctrine of Indoor Management

The doctrine of indoor management is based on the convenience and ease of doing business. As per this doctrine, the memorandum and articles are open to public inspection, but the outsiders are unaware of the details of internal proceedings of the company. It is difficult for them to find out whether the necessary approvals and sanctions required by the articles have been obtained or not. They can presume that all the requirements of the articles have been met by the officers of the company.

Thus, the doctrine of indoor management seeks to protect outsiders from the company, whereas the doctrine of constructive notice seeks to protect the company from the outsiders. The doctrine of indoor management lays down that when the officers of the company act on behalf of the company in a manner which seems to be in compliance with the provisions of the articles, then the parties dealing with the company are not affected by the irregularities in the internal management and proceedings of the company. This rule was laid down in the case of *Royal British Bank v. Turquand (1856)* and is known as **Turqu and rule**. In this case the directors of the defendant company borrowed a sum of money from the plaintiff bank on a bond. The articles required authorization by a resolution to be passed at the general meeting. The shareholders claimed that the company was not bound to repay the loan



as it was not authorized to borrow without their permission. It was held that the third party was entitled to presume that the company has observed all the preliminaries and taken all the approvals before taking the loan. Hence, the company was bound by the act of directors.

Exceptions to the Doctrine of Indoor Management

There are certain situations in which outsiders cannot bind the company. These can be termed as the limitations/exceptions to the doctrine which are explained as under:

- 1. Notice of irregularity:** This doctrine is not applicable in cases where the party dealing with the company had the knowledge of irregularity or the lack of authority of the person acting on behalf of the company. This point can be explained with the help of the following cases.

Case: In *Devi Ditta Mal v. Standard Bank of India*, two directors of a company executed a transfer of shares. Out of these two directors, one was not validly appointed and the other was transferee himself *i.e.*, the shares were transferred in his name. The transferor had the knowledge of these facts and hence the transfer was invalid.

Case: In *Howard v. Patent Ivory Co.*, the articles of a company P empowered its directors to borrow up to £1000 without shareholders' approval. However, to borrow beyond that amount a resolution in the general meeting was required. The company borrowed a sum of £3500 from one of the directors without the consent of shareholders. Held the loan was valid only up to £1000 as the director had knowledge of the irregularity.

Case: *Moriss v. Kanssen*. A director of a company was allotted shares by the other directors in a meeting in which the allottee himself was present. He knew that none of the directors appointing him were validly in office. So, he could not defend the allotment on the basis of this doctrine.

- 2. Negligence:** This doctrine does not defend a person who acted negligently while dealing with the officers of the company. If in case the circumstances are suspicious and invite enquiry and still the person enters into contract without sufficient enquiry, then he himself is responsible for the consequences. Generally, suspicion



arises when the person acting on behalf of the company is acting in a manner which apparently is beyond the scope of his authority. This point can be further explained through following cases:

Case: *Anand Behari Lal v. Dinshaw & Co.* An accountant of a company D transferred an immovable property in the name of A. The court declared the transfer to be void and A the plaintiff was not allowed to plead this doctrine as it was clear that the power of transferring property of a company was outside the apparent authority of an accountant.

Case: In *Houghton and Co. v. Nothard, Lowe and Wills Ltd.*, a person was a director in two companies. He used the money of one company to pay the debt of the other company. The court said that it was so unusual that an enquiry was done on the plaintiffs to ascertain whether the persons making the contract had any authority to make it.

- 3. Forgery:** The doctrine of indoor management does not apply to the cases involving forgery as the contracts entered through forgery are *void-ab-initio* and hence no person gets any right under forgery. The company cannot be held liable for forgery committed by its officers.

Case: *Ruben v. Great Fingall Consolidated.* The Secretary of a company forged the signatures of two directors on a share certificate and issued it to R. The court declared the certificate to be nullity and the plaintiff was not allowed to take advantage of this doctrine. The company refused to accept R as its shareholder.

Ostensible Authority

A company may be held liable for fraudulent acts of its officers acting within their ostensible authority. This may be elucidated in the case of ***British Thomson-Houston Company v. Federation European Bank Ltd.***; the articles of a company authorized its directors to decide the signatories of the documents and contracts of the company. A director describing himself as the chairman of the company, without being so authorized, gave guarantee to the plaintiffs on behalf of the company. The court said that a person dealing with a director need not enquire into his authority for acts in which the directors ordinarily have authority.



IN-TEXT QUESTIONS

- 6. Doctrine of Indoor Management is an exception to the Doctrine of Constructive notice. (True/False)
- 7. A _____ need not have Articles of its own. In such a case, Table A Applies.
- 8. An alteration may be made with _____ effect provided it is for the benefit of the company.
- 9. Match the following:

S. No.	(A)	(B)
1.	The doctrine seeks to protect the outsiders from the company	(a) Articles of Association
2.	Alteration of articles must not be inconsistent with	(b) Doctrine of Indoor Management
3.	Every person dealing with the company is presumed to have read memorandum and articles of association.	(c) Companies Act and Memorandum of association
4.	Articles may be altered by passing	(d) Doctrine of constructive notice
5.	The rules, regulation and by laws for governing the internal affairs of the company.	(e) Special resolution

3.10 Summary

The two important documents of a company are Memorandum of association and Articles of association. The Articles of Association of a company governs the internal management of the company. It is like a partnership agreement and defines the relationship of the company with its members and the members inter-se. The articles contain rules and regulations which are framed by the members. The members can alter its articles remaining within the ambit of the Companies Act and the Memorandum of association. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their right perspective. This presumption is known as



the Doctrine of Constructive Notice. This doctrine protects the company from the outsiders and hence creates a risk for the third parties while dealing with the company. To overcome the limitation of this doctrine, the Doctrine of Indoor Management was proposed. This doctrine provides that outsiders cannot and need not inquire into the internal management of the company. They can presume that the required sanctions and approvals have been taken by the officers of the company. This enables the outsiders to safely deal with the company.

3.11 Answers to In-Text Questions

1. False
2. True
3. Companies Act
4. Entrenchment clause
5. Memorandum
6. True
7. Company limited by Shares
8. Retrospective
9. 1. (b), 2. (c), 3. (d), 4. (e), 5. (a)

3.12 Self-Assessment Questions

1. The doctrine of Indoor management is an exception to the Doctrine of Constructive notice'. Comment.
2. Explain the Doctrine of Indoor Management. State its exceptions.
3. Define Articles of association. How can it be altered?
4. Distinguish between Memorandum of Association and Articles of Association.

3.13 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.



Notes

- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur. H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House, Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.

UNIT - III



Prospectus

Author: Dr. R C Garg

Revised by: Ms. Sheetal Chauhan

STRUCTURE

- 1.1 *Learning Objectives*
- 1.2 *Introduction*
- 1.3 *Definition of Prospectus*
- 1.4 *Objects of a Prospectus*
- 1.5 *Types of Prospectuses*
- 1.6 *Contents of Prospectus*
- 1.7 *Statutory Requirements Regarding Issue of a Prospectus*
- 1.8 *Misstatement in a Prospectus*
- 1.9 *Book Building*
- 1.10 *Summary*
- 1.11 *Answers to In-Text Questions*
- 1.12 *Self-Assessment Questions*
- 1.13 *Suggested Readings*

1.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Define a prospectus and explain the requirement regarding the issue of prospectus.
- ◆ Describe the contents of the prospectus.
- ◆ Explain the meaning of Shelf prospectus, Deemed prospectus, Red-Herring prospectus, and Abridged prospectus.
- ◆ Explain the civil and criminal liabilities for Misstatement in prospectus.
- ◆ Discuss the process of Book Building.



1.2 Introduction

The promoters of a public company are required to take necessary steps to raise the required capital for the company, after the Certificate of Incorporation is obtained. A private company is restricted from raising funds from inviting subscriptions from the general public. It can arrange the funds by way of private placement (*i.e.*, from its friends and relatives). Another way of raising required funds for a private company is through a Rights Issue or Bonus Issue.

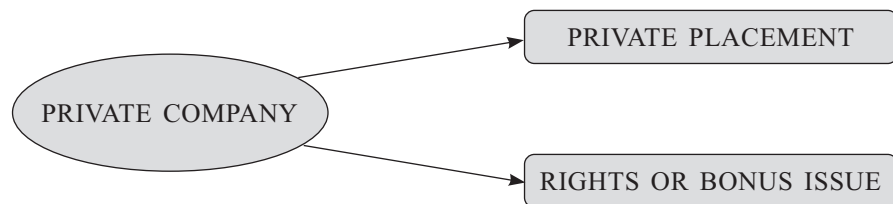


Figure 1.1: Issue of Securities of a Private Company

To get the necessary funds for its operations, a public company may also decide to not to invite the general public to subscribe to its shares or debentures. It may also raise funds through private placement or Rights or Bonus Issue. Section 23 of Companies Act, 2013, provides that a public company has the following options for issuing its securities: (i) through public issue, (ii) through private placement, (iii) through Rights or Bonus Issue.

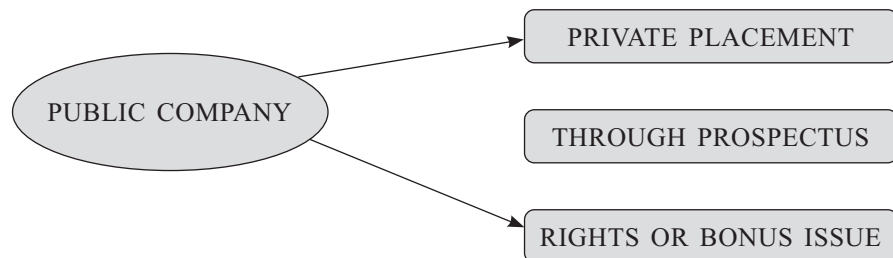


Figure 1.2: Issue of Securities of a Public Company

When a public company decides to raise funds from the general public then it is required to issue a document known as “Prospectus”. Where the promoters of a public company decide to not to invite the public to subscribe to its shares & debentures and are confident of raising the required capital privately from their friends or relatives, they need not issue a prospectus. In such a case, the company files a statement in lieu



of a prospectus with the Registrar. A private company is prohibited to issue a prospectus since it cannot invite the general public to subscribe to its shares and debentures. It is also not required to file a statement in lieu of a prospectus.

1.3 Definition of Prospectus

In simple words, a prospectus can be defined as an invitation to the public to subscribe to a company's securities. With the Amendment Act of 1974, any document that invites deposits from the public shall also come within the definition of prospectus. The word "Prospectus" means a document which invites deposits from the public or invites offers from the public to buy shares or debentures of the company. Thus, a document must satisfy the following conditions to be called as prospectus:

1. It must be issued on behalf of a public company and should invite deposits or invite subscription to shares & debentures of the company, and
2. The invitation must be made to the public.

A company releases prospectus to inform the public and investors about various securities that are available. The document informs about bonds, stocks, mutual funds and other types of investments offered by the company. A prospectus is usually accompanied by the financial information and other relevant facts in order to inform the general public about the prospects of the company and the purpose for which the capital is required. The aim of issuing a prospectus is arousing the interest of the proposed investors so that they subscribe to the shares & debentures of the company.

What constitutes an offer to the Public?

When directors of a company make an offer to a few of their friends, relatives or customers by sending them a copy of the prospectus marked "not for publication" then it is not considered as an offer to the public. The provisions of the Act relating to prospectus are not attracted unless it is issued to the public. An invitation of subscription to the public means an invitation to any section of the public yet selected. It means the word "public" here doesn't imply "Public at large". It is being used here as opposed to private communication. Whether the prospectus has been issued to the public or not is a matter of fact. Private communication



of an issue to friends & relatives doesn't mean an offer to the public. The leading case of this point is **Nash vs. Lynde (1929) A.C. 158**. In this case it was held that a document to be treated as a prospectus must be "issued to the public". Here the document was passed within a small circle of friends & relatives of the directors. The House of Lords held that since there had been no issue to the public, the document couldn't be treated as a prospectus.

In the case of **Re South of England Natural Gas and Petroleum Co. Ltd. (1911)**, the distribution of 3,000 copies of a prospectus among the members of certain gas companies was held to be an offer to the public because persons other than those who received the offer could also accept it.

1.4 Objects of a Prospectus

Prospectus is considered as an important document because of the following reasons:

- 1. Invitation:** It acts as an invitation by the company to the general public for subscribing to its shares, debentures or deposits.
- 2. Advertisement:** It serves as a medium of advertisement as it provides information to the public about the present operations and future prospects of the company.
- 3. Authentic Record:** It acts as an authentic record of the terms & conditions of issue & allotment of shares or debentures of the company.
- 4. Protection:** It protects the interests of the investors who invest their money on the faith of the information given in the prospectus by making the directors of the company responsible for the statement in the prospectus. Any misstatement in the prospectus attracts both criminal & civil liability of people who authorize the issue of the prospectus.

1.5 Types of Prospectuses

Following are the types of prospectuses:

- 1. Abridged Prospectus [Sec. 2(1)]:** No company can issue any form of application for shares or debentures of a company until & unless



it is accompanied by a memorandum having such salient features of prospectus as may be prescribed. An abridged prospectus is basically a summary of the prospectus containing all the details as may be prescribed by the SEBI. Since a prospectus is a very voluminous document containing all the details required to be given to the public for making sound judgment, one cannot be expected to read it fully and take decisions quickly. Everyone wants crisp & quick information that is relevant to take the required decision. An abridged prospectus is made to serve this purpose as it is short in length and contains all the relevant facts & information in bullets. However, a prospectus or abridged prospectus is not required to be issued under the following cases:

- (a) A private company is exempted from issuing a prospectus & thus an abridged prospectus.
- (b) A public company that is confident of raising funds through its personal contacts is also not required to issue a prospectus. Though, in this case, the company will be required to file a Statement in lieu of Prospectus.
- (c) Where a company makes issue to a person who is a *bona fide* invitee to enter into an underwriting agreement in respect of the shares or debentures offered.
- (d) When a company offers shares or debentures to its existing shareholders or debenture holders under Rights issue.
- (e) When the new issue is in uniformity in all respects and relates to the shares or debentures previously issued and traded on a Recognized Stock Exchange.
- (f) When the invitation to the public for subscription to the shares or debentures is given through newspaper advertisement.

2. Shelf Prospectus [Sec. 31]: It is a type of public offering under which companies are allowed to offer securities to the public without a separate prospectus for each issue of the same class. Companies are required to provide each and every relevant fact about the company in its prospectus before raising funds. In order to satisfy the SEBI guidelines, the prospectus of a company becomes highly informative and large. Every time a company comes out with an issue



of shares, bonds, debentures, or other securities, it needs to file a fresh prospectus which consumes a lot of time. In order to minimize the burden on companies going for public issues, the concept of 'Shelf Prospectus' was introduced for the first time in Companies Amendment Act, 2000. As per Sec. 31 of the Companies Act, 2013, the term '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". Shelf Prospectus is mainly introduced for public financial institutions, scheduled banks or public sector banks, whose main purpose is allowing finance to the infrastructural development of private industrial firms. Such institutions and banks are not required to file a separate prospectus every time they invite the public for the subscriptions of their securities. Shelf Prospectus remains valid for a period of one year that starts from the date of opening of the first offer of securities under that prospectus. During the period of validity of the prospectus, no new prospectus is required to be filed if the company comes out with a second or subsequent offer of such securities. Though the company is required to file an 'Information Memorandum' if any changes occur with respect to financial position or other relevant aspects, between the first offer of securities and succeeding offer of securities. This helps in reducing the burden of expenses required for preparation & issue of prospectus on the issuer, and also provides up to date information about the issuer to the general public.

- 3. Deemed Prospectus [Sec. 25(1)]:** Where a company allots or agrees to allot any of its securities to an intermediary for sale to the public then any document by which this offer of sale to the public is made, is termed as Deemed Prospectus. This document, inviting the public to subscribe to the securities is deemed to be a prospectus issued by the company and all the rules regarding the contents, liability for misstatements in the prospectus, etc. shall apply to it. Instead of offering its securities to the public, a company may allot them to an intermediary known as Issuing house. After this, the Issuing house invites the general public to subscribe to the securities by an advertisement or circular of its own. This circular or advertisement is called a deemed prospectus. The main reason for which a company



allots its securities to the Issuing house for sale to the public is that it saves underwriting expenses and also, the company enjoys the expertise of the Issuing house. The Issuing house allots the securities to the applicants, making them the allottee of the company.

- 4. Red Herring Prospectus [Sec. 32]:** The term Red Herring is included in the definition of a prospectus under the Companies Act, 2013. Section 32 of the Act states that “Red Herring” prospectus means a prospectus which doesn’t have complete particulars on the price of the securities and the quantum of the securities offered for subscription. In other words, it is a first or preliminary prospectus that is submitted by a company with reference to public offering. It has most of the details with respect to the company’s present operations and prospects but does not have the key information about the securities’ price or the quantum of shares. A company planning to make a public issue of securities is allowed to issue a Red Herring prospectus before the issue of a prospectus that contains all the details of price & quantum of securities offered. A Red Herring Prospectus is subjected to all the obligations as are applicable to a prospectus. If there are any variations in the red herring prospectus and a prospectus, then those should be highlighted as “variations in prospectus”.

1.6 Contents of Prospectus

Section 26 provides that every prospectus issued (a) by or on behalf of a company, or (b) by on behalf of any person engaged or interested in the formation of a company, shall include the matters and reports laid down by the provisions of the Section. The provisions of Sec. 26 ensure the fullest disclosure of all essential and relevant particulars so as to depict a true and fair insight about the soundness of the company. Through the amendment of Section 26 by the Companies (Amendment) Act, 2017 a prospectus is now required to provide such information and set out such reports about financial information as may be specified by SEBI in consultation with the Central Government. And till the time they may be specified, the regulations by SEBI under SEBI Act, 1992 must apply. Section 26(ii)(a), (b) and (d) are now deleted.



Notes

As per Sec. 26, every prospectus issued (a) by or on behalf of a company, or (b) by on behalf of any person engaged or interested in the formation of a company must be dated and signed and shall contain:

1. The matters specified in Part I of Schedule II, and
2. The reports specified in Part II or Schedule II, both Parts I and II shall have effect subject to the provisions contained in Part III of that Schedule II.

◆ **Part I of Schedule II**

1. The main objects of the company along with the names, descriptions, occupations and addresses of the signatories to the Memorandum of association, and the number of shares subscribed by each of them.
2. The number and classes of shares, and the nature and extent of the interests of the shareholders in the property and profits of the company.
3. The number of redeemable preference shares intended to be issued with particulars as regards their redemption.
4. The number of shares fixed by the Articles of Association of company as the qualification of a director.
5. The names, addresses, description and occupation of directors, managing director or manager or any of those proposed persons.
6. Any provisions in the articles or any contract relating to appointment, remuneration and compensation for loss of office of directors, managing director or manager.
7. The amount of minimum subscription.
8. The time of the opening of the subscription list cannot be earlier than the beginning of the fifth day after the publication of the prospectus.
9. The amount payable on application & allotment on each share must be stated. If any allotment was previously made within two preceding years, the details of the shares allotted and the amount; if any, paid thereon.
10. Particulars about any option or preferential right to be given to any person to subscribe for shares or debentures of the company.



11. The number, description and amount of shares and debentures which, within the last two years, have been issued or agreed to be issued as fully or partly paid up than in cash.
12. The amount paid or payable as a premium, if any, on such shares issued within two years preceding the date of the prospectus or is to be issued stating the necessary particulars.
13. The names of the underwriters of shares or debentures, if any, and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations.
14. The names or addresses description and occupations of the vendors from whom the property has been purchased or is to be purchased, and the amount paid or payable in cash, shares or debentures respectively.
15. The amount of underwriting commission paid within two preceding years or payable to any person for subscribing or procuring subscription for any shares or debentures of the company.
16. Any benefit given to any promoter or officer in preceding two years and the consideration for giving of the benefit.
17. Particulars as to the date, parties and general nature of every contract appointing or fixing the remuneration of managing director or manager, whenever entered into.
18. Particulars of every material contract not entered into in the ordinary course of business carried on or intended to be carried on by the company or a contract entered into more than two years prior the date of the prospectus.
19. Names and addresses of the auditors of the company.
20. Full particulars of the nature and extent of interest of the directors or promoter in the promotion of the company or in the property acquired by the company within 2 years of the issue of the prospectus.
21. If the share capital of the company is divided into different classes of shares, the rights of voting at meetings of the company and the rights in respect of capital and the dividends attached to several classes of shares respectively.



22. Where the articles of the company impose any restriction upon the members of the company in respect of the rights to attend, speak or vote at meetings of the company or the rights to transfer shares or on the directors of the company in respect of their powers of management, the nature and extent of these restrictions.
23. Where the company carries on business, the length of time during which it has been carried on. If the company proposes to acquire a business which has been carried on for less than three years, the length of time during which the business has been conducted.
24. If any reserves or profits of the company or any of its subsidiaries have been capitalized, particulars of the capitalization and particulars of the surplus arising from any revaluation on the assets of the company.
25. A reasonable time and place at which copies of all balance sheets and profits and loss accounts, if any, on which the report of the auditors under Part II below is based, may be inspected.

◆ Part II of Schedule II

I. General Information

1. Names and address of the Company Secretary, Legal Adviser, Lead Managers, Co-managers, Auditors, Bankers to the company, Bankers to the issue and Brokers to the issue.
2. Consent of Directors, Auditors, Solicitors/Advocates, Managers to issue, Registrar of Issue, Bankers to the company, and Bankers to the issue and Experts.
3. Expert's opinion obtained, if any.
4. Change, if any, in directors and auditors during the last 3 years, and reasons thereof.
5. Authority for the issue and details of resolution passed for the issue.
6. Procedure and time schedule for allotment and issue of certificates.

II. Financial Information

1. Report by the Auditors

A report by the auditors of the company as regards (a) its profits and losses and assets and liabilities of the company and (b) the rates of dividend, if paid by the company during the last five financial years.



If no accounts have been made up in respect of any part of the period of 5 years ending on a date 3 months before the issue of the prospectus, the report must, in addition, deal with either the combined profits and losses and assets and liabilities of its subsidiaries or each of the subsidiaries, as much they concern the members of the company.

2. Reports by the Accountants

- (a) A report by the accountants on the profits or losses of the business for the preceding 5 financial years, and on the assets and liabilities of the business on a date which shall not be more than 120 days before the date of the issue of the prospectus. This report is required to be given, if the proceeds of the issue of the shares or debentures are to be applied directly on the purchase of any business.
- (b) A similar report on the account of a body corporate by an accountant if the proceeds of the issue are to be applied in the purchase of shares of a body corporate so as to become a subsidiary of the acquiring company.
- (c) Principal terms of loans and assets charged as security against the loan.

3. Statutory and other Information

Statutory and other information minimum subscription, underwriting commission and brokerage; date of allotment, closing date, date of refund, option to subscribe, material contracts and inspection of documents, etc. are required to be set out in the prospectus.

◆ Part III of Schedule II

Part III of the Schedule consists of provisions that apply to Parts I and II of the said Schedule:

- A. Every person shall, for the purpose of this schedule, be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase of any property the company wants to acquire, in any case where (a) the purchase money is not paid in full at the date of the issue of the prospectus (b) the purchase money is to be paid, wholly or in part, out of the proceeds of the issue offered for subscription in the prospectus; (c) the contract depends on the result of that issue for its validity or fulfilment.



- B. In the case of a company which has been carrying on business for less than 5 financial years, reference to 5 financial years means reference to that number of financial years for which business was carried on.
- C. Reasonable time and place at which copies of all balance sheets and profit and loss accounts on which the report of the auditors is based, and material contracts and other documents may be respected.

Declaration

Declaration that all the relevant provisions of the Companies Act, 2013 and the guidelines issued by the Government have been duly complied with and no statement made in the prospectus is contrary to the provisions of the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992 and rules thereunder, **is required to be made.**

IN-TEXT QUESTIONS

1. A prospectus means any invitation issued to the public inviting it to deposit money with the company or to take share or debentures of the company. (True/False)
2. Section 55 states that every prospectus must be dated, and that date is deemed to be the date of publications of the prospectus. (True/False)

1.7 Statutory Requirements Regarding Issue of a Prospectus

The relevant requirements regarding issue of prospectus are given below:

1. Dating of Prospectus

A prospectus issued by a company shall be dated and that date shall be taken as the date of publication of the prospectus (**Section 26**). In some cases, the date of issue of the prospectus can be different from the date of its publication. Therefore, the date appearing on the prospectus is considered as the date of its publication.

2. Registration of Prospectus

As per section 26(4), a copy of every prospectus must be delivered to the Registrar for registration before it is issued to the public. Registration



is required to be made on or before the date of its publication. The copy sent for registration must be signed by every person whose name is appearing in the prospectus as a director or proposed director of the company or by his agent authorized in writing. Where the prospectus is issued in more than one language, a copy of it as issued in each language should be delivered to the registrar. This copy must be filed along with the following documents:

- (a) If the report of an expert is required to be published then his written consent for the same.
- (b) A copy of every contract which is related to the appointment and remuneration of managerial personnel.
- (c) A copy of every material contract entered into by the company unless it is entered in the ordinary course of business or two years before the date of the issue of prospectus.
- (d) A written statement relating to adjustments; if any, made by the auditors or accountants in their reports relating to profits and losses, assets and liabilities or the rates of dividends, etc.; and
- (e) A Written consent of auditors, legal advisers, attorney, solicitor, banker or broker of the company to act in such a capacity.

A copy of the prospectus along with specific documents must be filed with the Registrar. **The prospectus must be issued within 90 days of its delivery to the Registrar. A prospectus issued after the said period is considered invalid.**

Section 26(6) requires that on the face of every prospectus, it must be mentioned that a copy of the prospectus is delivered to the Registrar for its registration. If the prospectus is issued without its registration, the company shall be punishable with fine ranging from Rs. 5000 to Rs. 3 lakhs and every person who is involved in such an issue shall be punishable with imprisonment of 3 years, or fine of Rs. 5000 to Rs. 3 lakhs, or both.

3. Expert to be Unconnected with the Formation of the Company

A prospectus must not include a statement claimed by an expert such as an engineer, valuer, accountant etc. unless the expert is a person who has never been engaged or interested in the formation or promotion as in the management of the company [Section 26(5)].



A statement of an expert cannot be included in the prospectus without his written consent and this fact should be mentioned in the prospectus. Further, this consent should not be withdrawn before delivery of the prospectus to the Registrar for registration.

4. Variation in Objects given in the Prospectus or Terms of contracts

Section 27 states that a company is allowed to make changes in the terms of any contract or objects stated in the prospectus or statement in lieu of prospectus, if and only if it has passed a special resolution in the general meeting. This section provides that the company can do so if it has raised money from the public and is still left with unutilized money out of the money raised. The company is required to issue a notice in Form No. PAS 1 with regard to such resolution to the shareholders of the company and must also publish that notice in newspapers.

A company is allowed only once to make any variations in the object for which the prospectus was issued.

5. Prohibition of Allotment of Shares in Fictitious Names

Section 38 of the Companies Act, 2013 states that the provisions, consequences of applying for shares in fictitious names to be prominently displayed in every prospectus and every application form issued by the company to any person.

A person who makes an application to a company for acquiring shares or subscribing to or registering any transfer of securities to him or to some other person in a fictitious name; shall be liable for the action under section 447. This section deals with the punishment of fraud. The person involved in the fraud shall be liable for an imprisonment of a term ranging from 6 months to 10 years and a fine of not less than the amount involved in the fraud which may extend to 3 times the amount of fraud.

6. Issue of Securities only in Dematerialized Form

Section 29 of the Act states that every company making a public offer is required to issue securities only in dematerialized form which must comply with the provisions of the Depositories Act, 1996. The Ministry of Corporate Affairs has mandated for all unlisted public limited companies shares to be held only in electronic form, by introducing **Rule 9A in the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018.** All the existing shares in physical form in



such companies need to be dematerialized and new shares can only be allotted in dematerialized form.

1.8 Misstatements in a Prospectus

A prospectus is an invitation to the public to subscribe to the securities of a company. Every person authorizing the issue of prospectus has the most important responsibility to see that the prospectus contains information that shows the true state of affairs of the company and does not give any fraudulent picture to the public. People invest in the company on the basis of the information given & published in the prospectus. They should be safeguarded against all wrongs or false statements in the prospectus. Hence, a prospectus must give a full, accurate and a fair picture of material facts without concealing or omitting any relevant facts & information. This is known as the 'Golden Rule' for framing prospectus as laid down in **New Brunswick and Canada Railway & Land Company vs. Muggeridge [(1860) 3 LT 651]**. The true nature of the company's venture should be disclosed. The statements which do not qualify to the particulars mentioned in the prospectus or any information that is intentionally and wilfully concealed by the directors of the company is to be considered as misstatement.

Thus, the term 'venture statement' as 'misstatement' is used in a broader sense. It includes not only false statements which produce an impression of actual facts, but concealment of a material fact also comes within the category of misstatement.

A statement included in a prospectus is deemed to be untrue, if:

- ◆ The statement is misleading in the form and context in which it is included in the prospectus; and
- ◆ The omission of any information from a prospectus of any matter is calculated to mislead.

If there is any misstatement of a material fact in a prospectus which is misleading, this may arise—

1. Civil Liability.
2. Criminal Liability.



1. Civil Liability

A person who has induced to subscribe for shares (or debentures) on the faith of a misleading prospectus has remedies against:

- (i) The company; and
- (ii) The directors, promoters, and experts:

1. Remedies against the Company

Any person who invested in the securities of a company by relying on the faith of a prospectus that contains misstatement or omit any relevant facts may:

(a) *Rescission of the Contract for Misrepresentation*

Avoiding the contract is rescinded. Any person can apply to the court for recession of the contract if the statements on which he has taken the shares are false or caused by misrepresentation whether innocent or fraudulent.

The contract can be rescinded if the following conditions are satisfied:

1. The prospectus was issued by or on behalf of the company.
2. The statement was a misrepresentation of fact and not of law.
3. The statement must be a material misrepresentation of fact.
4. It must have induced the shareholder to take the shares.
5. The deceived shareholder is an allottee and he must have relied on the statement in the prospectus.
6. The omission of material fact must be misleading before recession is granted.
7. The proceedings for recession must be started as soon as the allottee comes to know of a misleading statement.

However, the investor loses the right to rescind the contract if:

- ◆ The subscriber doesn't take action within a reasonable period of time after knowing the fact of misrepresentation in the prospectus.
- ◆ Even after knowing the misrepresentation in the prospectus, he affirms his contract for purchase of securities.
- ◆ The company goes into liquidation before he took any legal action for rescission.



- ◆ The investor is a person of such expertise that it's not easy to mislead him.

(b) Claim Damages

This is the second right available to an investor against the company. The allottee of the shares in order to succeed has to satisfy the following conditions in addition to the conditions necessary for rescission of contract:

1. Those who are acting on behalf of the company acted fraudulently,
2. Those who purport to act on behalf of the company were authorized to do, and
3. He has actually suffered a loss or damage.

It must be noted that an allottee can exercise this right to claim for damages only after rescission. He cannot retain the shares and get damages from the company at the same time.

2. Remedies against the promoters, directors and experts

If a person suffers any loss or damage by investing in securities based on the statements given in the prospectus which were misleading, he can sue the company and (i) every director, (ii) every person whose name appears in the prospectus as a proposed director, (iii) every promoter, and (iv) every expert who authorized the issue of the prospectus as per Section 26(5).

The aggrieved allottee can claim:

1. Compensation for untrue statement under Section 35.

The company and every person who:

- ◆ At the time of the issue of the prospectus is a director of the company.
- ◆ Has given authority to be named or is named as a director in the prospectus.
- ◆ Is a promoter of the company.
- ◆ Has authorized the issue of the prospectus of the company.
- ◆ As per section 26(5), Shall be liable to pay for compensation to every person who has suffered any loss or damage,



irrespective of any punishment he is liable to, under Section 36.

2. Damages for omissions under Section 26

The aggrieved investor can take action under sec. 26 for damages caused by omission of matter required to be stated in the prospectus. This section gives rise to an action for damages even if the omission does not make the prospectus misleading or false. But here, the investor needs to prove that he would not have invested his money in the company, had the omission not been there.

3. Damages for fraudulent misrepresentation under general law

Any person induced to invest in the company by making any fraudulent statement in a prospectus can sue the company & the person who is responsible for damages. The share should be first surrendered to the company before the company is used for damages.

Fraud occurs when any statement is made without believing in it or carelessly. A statement which is made having knowledge that it is false, will constitute fraud or deceit. In the leading case, **Derek v. Peek (1889 14 AG 337)**, it has been held that if the person making the statement honestly believes it to be true, he is not guilty of fraud even if the statement is not true. The facts of this case were: The Tramway Company had power by special Act to make tramways and to use steam power with the consent of the Board of Trade. The plans of the company were approved with honesty. The directors of the company thought and believed that since the plans were approved, permission to use steam power from the Board of Trade was merely a formality and would be granted soon. Prospectus was issued in which the directors stated that the consent to use steam power had been obtained by the company. Subsequently, the consent was refused, and the company had to be wound up. On the action by plaintiffs for deceit it was held that the directors were not liable for fraud as they honestly believed that the consent would be obtained, though the statement was untrue.



Defence available to promoter, directors, etc., under section 35(2) against Civil Liability

Every person made liable to pay compensation for any loss or damages may escape such liability by proving that:

- I. After having consented to become a director of the company, he withdrew the consent before the issue of the prospectus and that it was issued without his authority or consent.
- II. The prospectus was issued without his knowledge or consent and on becoming aware of the issue of the prospectus, he gave a reasonable public notice that it was issued without his knowledge or consent.
- III. He was unaware of the untrue statement in the prospectus and as soon as he became aware of the fact, he withdrew his consent and also gave a public notice of the same. The liability can be avoided by him only if he has given the public notice before the allotment.
- IV. He has reasonable ground to believe that the statement was true and he, in fact, believed it to be true till the time of allotment.
- V. The statement was a correct and fair representation or extract, or true copy of an expert's report and that expert had given his consent and had not withdrawn it, the director, etc., is not liable.
- VI. The statement is a correct and fair representation or exact copy of an official document or is based on the authority of an official person, no liability attached to the director, promoter, etc.

2. Criminal Liability

Criminal liability means punishment given by way of jail term or a penalty or both. Thus, a company cannot be held liable for criminal liability. Only promoters and directors can be punished under criminal liability. They can be held criminally liable for a misstatement in the prospectus:

1. Liability for Untrue Statement (Section 34)

According to section 34, if a prospectus is issued, distributed, or circulated, containing any misleading or untrue statement or if



inclusion or omission of any matter is likely to mislead, then every person who authorizes the issue of such a prospectus **shall be held liable for fraud under section 447 and also under section 37.**

2. Penalty for Fraudulently inducing Persons to Invest Money (Section 36)

Any person, knowingly or recklessly, makes any statement, promise or forecast which is false, deceptive or misleading or by any dishonest concealment of material facts & information, induces or attempts to induce another person to enter into:

- ◆ Any agreement with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures.
- ◆ An agreement to secure to any of the parties from the yield of shares or debentures, or by reference to fluctuation in the value of shares or debentures.
- ◆ Any agreement with a motive of obtaining some credit facilities from any bank or financial institution **shall be liable for action for fraud under section 447 and also under section 37.**

3. Issue and Allotment of Shares in Fictitious Names (Section 38)

As per Section 38, if a person:

- ◆ Makes an application under a fictitious name for acquiring or subscribing to any securities, or
- ◆ Makes multiple applications to a company in different names or by making different combinations of his names or surnames for acquiring or subscribing to any securities, or
- ◆ Induces the company to allot or register any transfer of securities to him or to some other person in a fictitious name; **shall be liable for action under section 447.**

4. Penalty for Failure to Issue Abridged Prospectus with Share Application Form (Section 33)

No company can issue any form of application for shares or debentures of a company until & unless it is accompanied by an abridged prospectus. If any company does any act in contravention of this provision, then the company shall be held liable for a fine of Rs. 50,000 for each default.



1.9 Book Building

Rather than going for public issue, companies opt for book building in which applications are accepted from large financial institutions, firms, or high net worth individuals. The provisions for Red Herring Prospectus under Companies Act, 2013 facilitate the process of Book Building. Under the process of Book Building, a draft red herring prospectus is made & issued initially and then Red Herring Prospectus is issued 3 days before the opening of offer. Through the process of book building, the issue price of securities is determined on the basis of the bids received by the company during the bid period. These bids vary between a floor price (*i.e.*, minimum price) and 120% of the floor price. After the closing date of receiving bids, the issue price of securities is determined. In simple words, Book Building is a process of determining prices of securities on the basis of bids received by the issuer company along with Book Runner. Interested investors place their bids for subscription to the securities at different prices and ultimately the price & quantum with maximum demand gets selected.

A company in need of funds may raise money by selling its securities to the public. The company can fix the offer price before the issue, or it can evaluate the intrinsic worth of those securities through the process of Book Building and fix the price accordingly. A book is built by the Book Runner Lead appointed by the company to note down the everyday demand and the price is fixed after the bid closing date. This price is more realistic as compared to the price already fixed in the public issue. The issuer company, the Book Runner Lead Manager, and the Syndicate Members are the main parties who are directly involved in the process of Book Building. Book Building can be done for 100% or 75% of the issue size:

- (a) **100% Book Building:** In this type of Book Building, the whole issue is made through book building. No offer to the public is required to make, whatever is the size of the issue.
- (b) **75% Book Building:** Under this system, 75% issue is made through placement portion and the remaining 25% (*i.e.*, net offer to the public) is made to the public. This 75% of the public issue is offered to mutual funds, foreign institutional investors, high net



worth investors, corporations, etc., who participated in the process of book building. The issue price for both types of allotment remains the same.

Steps in Book Building Process

- 1. Book Runner:** The issuer company proposing to come out with an IPO appoints a lead merchant banker as Book Runner.
- 2. Draft Prospectus:** The Company with the help of the Book Runner prepares a Draft Red Herring Prospectus that has all the details & disclosures of a prospectus, but it does not disclose the price & size of the securities to be offered. It is sent to corporate, financial institutions & high net worth individuals to know their perception & demand for the securities of the company.
- 3. Red Herring Prospectus:** A Red Herring prospectus is prepared which contains every detail & information that a prospectus contains except for the price & quantum of securities offered. Rather than disclosing about the price & size of the securities, it contains a price range (or price band). This price range has a floor price (which is the minimum price below which bids are not accepted) and a ceiling price (which cannot be more than 20% of the floor price). A bidder is required to place his bid in the given band only.
- 4. Filing the Red Herring Prospectus:** This Red herring Prospectus is then filed with SEBI and Registrar of Companies at least 3 days prior to opening of the offer.
- 5. Appointment of Syndicate Members:** Syndicate members such as stockbrokers, mutual funds, merchant banks, etc. are appointed by the Book Runner Lead Manager. These syndicate members basically link the investors with the company. Here, the Book Runner underwrites the issue & the syndicate members sub-underwrite the issue along with the Book Runner.
- 6. Circulation:** The copy of draft prospectus is then circulated among the institutional investors and the Syndicate Members.
- 7. Building up an Order Book:** Syndicate Members help in creation of demand as they ask the high-net-worth investors, foreign institutional investors, financial institutions, corporate firms, etc. for the number



of shares & the prices at which they are likely to buy those shares. These numbers of shares at different prices are then recorded in an order book which shows the demand for the securities.

- 8. Determination of the Issue Price:** With the help of the information collected, the Book Runner and the company determine the Issue Price of the offer. This price is also termed as “Market Clearing Price”. The size of the securities along with their respective prices is known on the closure of the order book. The book runner and the company decide the issue size of (i) placement portion and, (ii) public offer portion.
- 9. Allocation:** When the final price is determined, the book runner starts allocation to various bidders. As per the SEBI guidelines, Qualified Institutional Buyers (QIBs) which include commercial banks, mutual funds, foreign institutional investors, etc. are not allowed to withdraw their bids after closing of the IPO. Whereas other bidders can withdraw their bids until the day of allotment. Usually, allotment happens within fifteen days after the closing date of the issue.
- 10. Final Prospectus:** Within two days of determination of issue price & receipts of acknowledgement card from SEBI, the company is required to file the final prospectus with ROC.
- 11. Listing of Securities:** SEBI has made it mandatory for companies to list their shares on exchanges within 12 days after the closing of public issue.

Advantages of Book Building Process:

1. It reduces the cost of issue as there is a limited number of investors.
2. It also helps in reducing the risk of failure of issue because of underwriting of the issue.
3. It helps in evaluating the true intrinsic worth of the securities.
4. It helps in determining the realistic issue price of securities as it is based on the floor price which gets fixed just 1 to 2 weeks prior to the opening of the issue.

Disadvantages of Book Building Process:

1. This process is more suitable for big issues only.



2. This requires well organized stock exchanges.
3. Issuer Company needs to be well known to the investors for taking part in its book building process.

IN-TEXT QUESTIONS

3. If there is any misstatement or omission of material facts, then the directors, promoters, the persons responsible for the issue of prospectus, and the company incur a liability for the same. (True/False)
4. The company can also allot shares or debentures without issuing the prospectus. (True/False)
5. Under 100% book building, the whole issue is made through book building process. (True/False)
6. Match the following:

Sr. No.	(A)	(B)
1.	A document inviting offers from the public for the subscription of shares in or debentures of a company is known as a prospectus	(a) Book Building
2.	The issue price of securities is determined on the basis of the bids received by the company during bid period	(b) Prospectus
3.	No offer to public is required to make, whatever is the size of the issue	(c) Civil Liability
4.	It means the liability to pay damages or compensation	(d) Criminal Liability
5.	The liability which includes the punishment of imprisonment or fine or both	(e) 100% Book Building

1.10 Summary

A prospectus means any invitation issued to the public inviting to deposit money with the company or to take shares or debentures of the company. Such an invitation can be in the form of a document or a notice, circular, advertisement etc. Section 26 states that every prospectus must be dated, and that date is deemed to be the date of publication of the prospectus. A prospectus should neither contain any misstatement



i.e., untrue or misleading nor omit to disclose any material fact. If there is any misstatement or omission of material facts, then the directors, promoters, the persons responsible for the issue of prospectus, and the company incur a liability for the same. If there is any misstatement of a material fact in a prospectus which is misleading, then this may lead to a civil liability or a criminal liability. A company can avoid making a public issue and instead can go for the process of book building, which is faster, realistic and cost efficient.

1.11 Answers to In-Text Questions

1. True
2. False
3. True
4. True
5. True
6. 1. (b), 2. (a), 3. (e), 4. (c), 5. (d)

1.12 Self-Assessment Questions

1. What is a prospectus? Explain the requirements regarding issue of prospectus.
2. Explain the process of Book Building in detail.
3. Explain the civil and criminal liabilities for misstatement in the prospectus of a company.
4. Mr. Suresh applied for certain shares of a company on the basis of information contained in the prospectus of the company that has the names of six directors in it. Three directors out of these six directors got retired prior to the allocation of shares. Can Mr. Suresh exercise his right of rescission against the company in this case?
5. Vivek bought 200 shares from Rohit of ABC Ltd. on the basis of prospectus that contains a wrong statement in it. Discuss the remedies available to Vivek against the company in this situation.



1.13 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Shares

Author: Dr. R C Garg

Revised by: Mr. Mayur Taneja

STRUCTURE

- 2.1 *Learning Objectives*
- 2.2 *Introduction*
- 2.3 *Allotment of Shares*
- 2.4 *Forfeiture of Shares*
- 2.5 *Issue of Sweat Equity Shares*
- 2.6 *Employee Stock Option Scheme*
- 2.7 *Bonus Issue*
- 2.8 *Right Issue*
- 2.9 *Buy-Back of Securities [Section 68]*
- 2.10 *Membership of Company*
- 2.11 *Modes of Acquiring Membership*
- 2.12 *Who May Become a Member*
- 2.13 *Rights and Liabilities of Members*
- 2.14 *Transfer and Transmission of Shares*
- 2.15 *Demat System*
- 2.16 *Summary*
- 2.17 *Answers to In-Text Questions*
- 2.18 *Self-Assessment Questions*
- 2.19 *Suggested Readings*

2.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Develop conceptual clarity about allotment and its types.



Notes

- ◆ Explain the concept of forfeiture of shares.
- ◆ Discuss about Sweat equity, ESOP's, Bonus Issue and Right Issue.
- ◆ Understand the concept of Buy-Back of Shares.
- ◆ Gain insight into the concept of Membership of a Company.

2.2 Introduction

Section 2(84) of the Companies Act, 2013, defines shares as - "share means share in the share capital of a company and includes stock, except where a distinction between stock and shares is expressed or implied." This definition does not shed any light on the true meaning of the term share. However, the definition given by the Supreme Court of India in the case of **CIT vs. Standard Vacuum Oil Co. (1966)** is far more illuminating. Here the Supreme Court observed, "By a share in a company is not meant 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 short, share is not a sum of money but an interest or right measured in a sum of money to participate in the profits made by the company while it is a going concern, or in the assets of the company when it is wound up.

2.3 Allotment of Shares

Allocation is the company's acceptance of the offer to take shares. Share offers are made on the company's application forms. If a request is accepted, it amounts to an allotment.

General Principles of Allotment

"Allotment" of shares means the act of allocation by the company's board of directors of a certain number of shares from the previously unappropriated capital of a company to persons applying for shares (In Re Calcutta Stock Exchange Association, AIR 1957 Cal. 438). Shares come into existence on allotment.

The following general principles should be observed with regard to allotment of securities:



- ◆ **The allotment should be made by proper authority:** The company's board directors, or a committee allowed to allot shares on behalf of the board, may be the proper authority.
- ◆ **Allotment of securities must be made within a reasonable time:** As per section 6 of the Indian Contract Act, 1872, an offer must be accepted within a reasonable time. In each case, what is a reasonable time is a matter of fact. If the allotment is made after a long time, an applicant can refuse to take securities. (As per section 56 within a period of two months from the date of allotment in the case of allotment of any of its shares) 40 EP-CL.
- ◆ **The allotment should be absolute and unconditional:** The allotment of securities must be made on the same terms on which they were applied for and as they are stated in the application. It is not valid to allot the securities subject to certain conditions. Likewise, if the number of securities allocated is smaller than the amount demanded, it cannot be considered an absolute allotment.
- ◆ **The allotment must be communicated:** As mentioned above, the letter of allotment or allotment advice will be regarded as a legitimate correspondence even if the letter is lost in transit.
- ◆ **Allotment against application only:** Section 2(55) of the Act requires that an individual should consent to become a member in writing.

Statutory Conditions of Allotment

Section 39 forbids the allotment of securities where the minimum amount has not been subscribed; the amount is to be refunded to all the applicants within a given period of time. This section also provides that whenever a company with a share capital makes any securities allotment, it shall file with the Registrar the return of the allotment. In the case of any default, the defaulting company and its officers shall be liable to fine.

No shares of a company offered to the public for subscription shall be allotted unless the amount defined in the prospectus as the minimum amount has been subscribed and the amounts payable on application for the amount so specified have been paid and received by the company by check or other instrument.



Notes

The amount payable on application for each security shall not be less than 5% of the nominal amount of the security or any other percentage or amount that the Securities and Exchange Board may specify by making regulations on this behalf. If the minimum sum stated has not been subscribed and the amount payable on application is not obtained within a period of thirty days from the date of issuance of the prospectus or any other period defined by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within the time and manner prescribed.

Whenever any allotment of securities is made by a company having a share capital, it shall file a return of allotment with the Registrar in the manner prescribed. In the event of any default under sub-section (3) or sub-section (4), the company and its default officer shall be liable for a penalty of one thousand rupees for each day during which the default occurs or one lakh rupee, whichever is less.

Securities to be Dealt with in Stock Exchanges [Section 40]

A company making a public offer shall make a Securities application to one or more recognised stock exchanges or exchanges before making such an offer and shall obtain permission for the securities to be dealt in such stock exchange or exchanges. Where a prospectus specifies that an application has been made under sub-section (1), the prospectus shall also state the name or names of the stock exchange in which the securities are to be dealt with.

All monies obtained on public application for securities subscription shall be kept in a separate bank account in a scheduled bank and shall not be used for any purpose other than - (a) for adjustment against the allotment of securities where securities in the stock exchange or stock exchanges listed in the prospectus have been allowed to be treated; or (b) For the repayment of money received from applicants pursuant to a prospectus within the time specified by the Securities and Exchange Board, where the company is unable to allot securities for any reason.

Any clause requiring or binding any securities applicant to waive any of the compliance of this section shall be void. In case of default is made in complying with the provisions of this section, 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. A company can pay commission to any individual to subscribe to its securities subject to the conditions prescribed.

2.4 Forfeiture of Shares

Article of association of a company usually contains provisions for the forfeiture of shares of a member who fails to pay any call on the day specified for payment of any call or instalment of a call. According to clause 28, at any time thereafter, as any part of call or instalment remains unpaid, the Board may issue a notice requiring payment of as much of the call or instalment as is unpaid together with any interest that may have accrued.

The above notice shall include - (a) Name another day (not earlier than the expiry of fourteen days from the date on which the notice is to be served) on or before which payment is to be made; and (b) State that the shares in respect of which the call was made are liable to be forfeited in the event of non-payment on or before the day referred above (Clause 29).

If the conditions of any of these notices are not met, any share in respect of which the notice has been issued may, at any time, thereafter, be forfeited by a resolution of the Board to that effect before the payment provided by the notice has been made (Clause 30).

Clause 31 states that (i) A forfeited share may be sold or disposed of on certain terms and in the manner that the Board considers acceptable. (ii) The Board may cancel the forfeiture on such terms as it deems fit at any time before a sale or disposal as stated above.

According to clause 32, (i) An individual whose shares have been forfeited shall cease to be a shareholder in respect of the forfeited shares, however, notwithstanding the forfeiture, shall remain liable to pay to the company



Notes

all sums currently payable to the company in respect of the shares on the date of forfeiture. (ii) The person's liability shall cease if and when the company has received full reimbursement in respect of the shares of all such monies.

Clause 33 states (i) A duly verified declaration in writing that the declarant is the company's director, the manager or the secretary and that a share in the company was duly forfeited on a date set out in the declaration shall be conclusive evidence of the facts found therein as against all persons claiming to be entitled to share; (ii) The company may obtain the compensation, if any, granted on any sale or disposal of the share and may pass the share in favour of the person to whom the share is sold or disposed of; (iii) The transferee shall thereupon be registered as the holder of the share; and (iv) The transferee shall not be obliged to pay the purchase money, if any, nor shall his share title be affected by any irregularity or invalidity in the proceedings in connection with the forfeiture, sale or disposal of the share.

The provisions of these Regulations on forfeiture shall apply in the event of non-payment of any sum that becomes payable at a fixed time under the terms of issue of a share, whether on account of the nominal value of the share or by way of a premium, as if it had been payable by virtue of a call duly made and notified (Clause 34).

Legal Requirements

A legal notice to that effect must be given prior to the forfeiture of shares. After the shares have been forfeited, the intimation will be sent to the concerned shareholder.

The forfeiture must be exercised in good faith and in the company's interest. It should not be fraudulent or collusive.

The forfeited shares become the company's property, until the reissue of the stock. Hence, they are usually reissued by companies.

Cancellation of Forfeiture

If the defaulting shareholder approaches after forfeiture to cancel the forfeiture, the board may cancel the forfeiture of securities. The board can claim the due amount from the shareholder with interest.



Re-Issue of Forfeited Shares

At the Board's discretion, securities forfeited by a company may be either cancelled or re-issued to another individual. Forfeited shares are usually reissued at a discount that cannot exceed the amount already paid on those securities. The total amount paid together with the reissue price by the original owner of the shares should not be less than the par value. Upon the surrender of the share certificate by the original holder, a new allottee is issued a share certificate on the execution of a transfer deed by the company; otherwise, a new share certificate will be issued after a public notice in a newspaper.

2.5 Issue of Sweat Equity Shares

Section 54 of the Companies Act, 2013 seeks to provide that on fulfilling certain conditions, a company may issue sweat equity shares of a class of shares already issued.

The provisions laid down in section 54 on the issue of sweat equity shares are as follows:

- ◆ A special resolution passed by the company authorizes the issue. The resolution shall specify the number of shares to be issued, the current market price, consideration if any, and the class or classes of directors or employees to whom such shares shall be issued.
- ◆ At the date of such issue, not less than one year has elapsed since the commencement of the business of the company; and
- ◆ Where the company's equity shares are listed on a recognised stock exchange, the sweat equity shares shall be issued in compliance with the Securities and Exchange Board's regulations in this behalf and, if they are not listed in this manner, the sweat equity shares shall be issued in accordance with the rules that may be laid down.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

According to section 2(88), "sweat equity shares mean such equity shares 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.”

According to rule 8 of Companies (Share Capital and Debentures) Rules, 2014:

The expression “*Employee*” means – (a) a permanent employee of the company who has been working in India or outside India, for at least last one year; or (b) a director of the company, whether a whole time director or not; or (c) an employee or a director as defined in sub-clause (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company; the expression ‘*Value additions*’ means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Section 54 allows issue of such equity shares to employees or directors of the company in recognition of their contribution for providing know-how etc. as aforesaid. Sweat equity shares provide a new form of adequate return as the contribution made by employees/director’s results in increased income for the company over a number of years.

Conditions for Issue of Sweat Equity Shares

Section 54(1) provides that notwithstanding anything contained in section 53, a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

A special resolution has been passed in the general meeting authorizing such issue and the following should be clearly mentioned in the resolution: number of shares; their current market price; consideration, if any; and class or classes of directors or employees to whom such equity shares are to be issued.

Where shares are listed on a recognized stock exchange, the sweat equity issuing company should comply with SEBI’s regulations made on this behalf. A company whose shares are not so listed should comply with



the rules made in this behalf by the Central Government *i.e.*, Companies (Share Capital and Debentures) Rules, 2014.

It is important that all the information should be made available before taking a decision, hence rule 8(2) states that the notice of the general meeting should be sent along with an explanatory statement containing the following particulars:

- (a) Date of the meeting of the Board of Directors at which the sweat equity proposal was accepted.
- (b) The reasons or justification for the issue.
- (c) The class of shares under which sweat equity shares are intended to be issued.
- (d) The total number of sweat equity shares to be issued.
- (e) The class or classes of directors or employees to whom the shares are to be issued.
- (f) The key terms and conditions under which sweat equity shares including valuation basis, are to be issued.
- (g) The length of that person's association with the company.
- (h) The names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/ and Key Managerial Personnel.
- (i) The price at which it is proposed to issue the sweat equity shares.
- (j) Consideration including non-cash consideration if any, to be received for sweat equity.
- (k) The management remuneration ceiling, if any, is breached by issuing such sweat equity and how it is intended to be dealt with.
- (l) A statement that the company complies with the applicable accounting standards.
- (m) Diluted Earnings Per Share pursuant to the issue of sweat equity shares, is measured in compliance with applicable accounting standards.

Validity of Special Resolution authorizing sweat equity shares: Rule 8(3) states that a special resolution authorizing the issue of sweat equity



shares shall be applicable for the allotment within a span not exceeding twelve months from the date of the special resolution.

Limits on issue of sweat equity shares: Rule 8(4) states that, no sweat equity shares shall be issued by the company for more than fifteen per cent of the 70 EP-CL current paid-up equity capital in one year or five crores of the issuing value, whichever is higher. The issuance of the company's sweat equity shares shall not exceed twenty-five per cent of the company's paid-up equity capital at any time.

Sweat Equity Shares to be locked for three years: Rule 8(5) states that the sweat equity shares issued to directors or employees shall be locked in a period of three years from the date of allotment and the fact that the share certificates are locked in and the expiry of the lock in shall be stamped boldly or mentioned on the share certificate in any other prominent manner.

Valuation aspects:

- ◆ Rule 8(6) states that 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.
- ◆ The valuation of intellectual property rights or know-how or value additions for which sweat equity securities are to be issued shall be conducted by a registered valuer, who shall send a proper report to the Board of Directors supporting such valuation [Rule 8(7)].
- ◆ A copy of the list and the critical elements of the valuation report obtained pursuant to rule 8(6) and rule 8(7) shall be forwarded to the shareholders along with notice of the general meeting [Rule 8(8)].

Sweat equity shares for non-cash consideration:

Rule 8(9) states that where sweat equity shares are issued for non-cash consideration on the basis of a valuation report obtained from the registered valuer, such non-cash consideration shall be dealt with in the company's account books as follows:

- (a) Where the non-cash consideration is a depreciable or amortizable asset, it shall be transferred to the company's balance sheet in compliance with accounting standards; or



(b) Where clause (a) is not applicable, it shall be treated as expenses as per the accounting standards.

Sweat equity shares forming part of managerial remuneration: Rule 8(10) states that if the following conditions are met, the amount of sweat equity shares issued shall be treated as part of the managerial remuneration for the purposes of sections 197 and 198 of the Act.

- (a) The sweat equity shares are issued to any director or manager; and
- (b) These are issued for value other than cash, not in the form of an asset that can be carried to the company's balance sheet in compliance with the applicable accounting standards.

Sweat equity shares and compensation aspects:

If the sweat equity shares are not issued pursuant to acquisition of an asset: Rule 8(11) states that, sweat equity shares issued during the accounting period, the accounting value of sweat equity shares, *i.e.*, the fair value of Registered Valuer, shall be treated as compensation for the employee or director in the company's financial statements.

If the shares are issued pursuant to acquisition of an asset: Rule 8(12) states that if the shares are issued for acquiring an asset, the value of the asset, as calculated by the valuation report, shall be carried in the balance sheet and the excess amount of accounting value of the sweat equity shares and the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

Board's Report to disclose the details of sweat equity shares: According to rule 8(13) the Board of Directors shall disclose the following details of the issue of sweat equity shares in the Directors' report for the year in which such shares are issued:

- ◆ The class of director or employee to whom sweat equity shares were issued.
- ◆ The class of shares issued as Sweat Equity Shares.
- ◆ The number of sweat equity shares issued to directors, key managerial personnel or other employees showing separately the number of such shares issued to them, if any, for consideration other than cash and the names of individual allottees who hold one per cent or more of the issued share capital.



Notes

- ◆ The reasons or justification for the issue.
- ◆ The principal terms and conditions for issue of sweat equity shares, including pricing formula.
- ◆ The total number of shares arising as a result of the issue of sweat equity shares.
- ◆ The percentage of the sweat equity shares of the total post issued and paid-up share capital.
- ◆ The consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares.
- ◆ The diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Maintenance of Register: Rule 8(14) states that a register of sweat equity shares shall be maintained by the company in Form No. SH.3 and the descriptions of Sweat Equity Shares issued under section 54 shall be entered immediately therein. The Sweat Equity Shares Register shall be maintained at the company's registered office or any other location that may be determined by the Board.

2.6 Employee Stock Option Scheme

As per section 2(37) of Companies Act, 2013 'Employee Stock Option' (ESOP) is defined as "the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a predetermined price."

Section 62(1)(b) further provides that Further shares may be issued by a company to its employees under an employee stock option scheme, subject to a special resolution passed by the company and subject to the conditions that may be laid down. Special resolution has been substituted by ordinary resolution in the case of a private company.

Separate resolution for granting options to employees of holding/ subsidiary companies etc in certain cases

Rule 12(4) states that the consent of the shareholders shall be sought by the company through a separate resolution in case of: (a) grant of option



to employees of subsidiary or holding company; or (b) grant of option to identified employees, during any one year, equal to or exceeding one per cent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

Varying the terms of ESOP requires special resolution

Rule 12(5) states that, through special resolution the company may vary the terms of an employee stock option scheme that has not yet been exercised through employees, given that such variance does not harm the interests of the option holders. The notice for the passing of a special resolution to change the terms of the Employee Stock Option Scheme shall reveal in full the variation, the rationale and the details of the employees who are beneficiaries of such a variation.

Minimum one-year vesting period

Rule 12(6)(a) states that between the granting of options and the vesting of options there shall be a minimum period of one year. In the case that options are issued by a company under its employee stock option scheme instead of options kept by the same individual under another company's employee stock option scheme, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause.

Company has freedom to specify lock-in period

Rule 12(6)(b) states that the company shall be free to determine the period of lock-in for the shares issued under the exercise of the option.

No right of dividend or voting till exercise of option

Rule 12(6)(c) states that workers shall not be entitled to receive any dividend or vote, or in any way enjoy the shareholder's benefits in respect of the right given to them, until shares are issued on the exercise of an option.

Forfeiture/refund

Rule 12(7) states that the amount payable by the workers, if any, at the time the option is granted—



- (a) If the option is not exercised by the employees within the exercise period, the amount may be forfeited; or
- (b) the amount may be refunded to the employees if the options are not vested due to non-fulfilment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

Conditions

Rule 12(8) states the following conditions:

- ◆ The option granted to employees shall not be transferable to any other person.
- ◆ The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- ◆ No person other than the employees to whom the option is granted shall be entitled to exercise the option.

Death/permanent disability/resignation of employees who were granted with options

Rule 12(8) specifies that, in the event of the employee's death while in service, all the rights given to him up to that date shall apply to the deceased employee's legal heirs or nominees.

In the event that the employee experiences a permanent incapacity while in service, on that day all the options given to him on the day of permanent incapacitation shall vest in him.

In case of resignation or termination of employment, all options not vested in the employee as on that day shall expire. Therefore, the employee may exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions of the scheme granting such options as approved by the Board.

Maintenance of Register

Rule 12(10) states that a register of employee stock options in Form No. SH.6 shall be maintained by the company. And the option information given under clause (b) of sub-section (1) of section 62 shall be entered therein forthwith.

The Employee Stock Options Register shall be maintained at the company's registered office or any other location that may be decided by the Board.



The company secretary or any other person authorized by the board for the purpose shall authenticate the entries in the register.

Listed companies have to comply with the SEBI guidelines

Where the company's equity shares are listed on a recognized stock exchange, the employee stock option scheme shall be issued in compliance with the regulations made in this regard by India's Securities and Exchange Board.

Procedure for Issue of Securities to Employees through "Employees Stock Option Scheme":

- (1) Convene meeting of the Board for getting approved the notice of the General meeting along with special resolution, explanatory statement etc., to be approved by the shareholders through special resolution. In the case of a private company, ordinary resolution is sufficient.
- (2) Ensure that the company has made the following disclosures in the explanatory statement annexed to the notice for passing of the resolution - Ensure that the special resolution is filed with ROC in MGT 14 within 30 days of passing the resolution.
- (3) Under the Employees Stock Option Scheme, companies that give options to their employees will be free to determine exercise price in accordance with the accounting policies applicable, if any.
- (4) The shareholder's consent is sought by the company through a special resolution in the event of:
 - (a) Grant of option to subsidiary employees or holding companies.
 - (b) Grant of option to identified employees, during any one year, equal to or exceeding one per cent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.
- (5)
 - (a) Through special resolution the corporation can vary the terms of the employee stock option scheme that the employees have not yet exercised, given that such variance does not harm the interests of the option holders.
 - (b) The Notice for the Passing of Special Resolution for the variation of terms of Employee Stock Option Scheme Terms shall reveal the full variation, therefore the rationale, and the details of the employees who are beneficiaries of such variation.



Notes

- (6) (a) Between granting options and vesting of options, there shall be a minimum period of one year:
- Provided** that in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause.
- (b) The company shall have the right to specify the time of lock-in for the shares issued pursuant to exercise of option.
- (c) Employees shall not be entitled to receive any dividend or vote or enjoy the benefits of a shareholder in any manner as regards the option granted to them until shares are issued on exercise of option.
- (7) The amount, if any, payable by the employees, at the time of grant of option—
- (a) the company may forfeit the option if not exercised by the employees within the exercise period.
- (b) Maybe forfeited by the company if the option is not exercised by the employees within the exercise period.
- (8) (a) The option granted to employees cannot be transferred to any other person.
- (b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- (c) No other person is entitled to exercise the option other than the employees to whom the option is granted.
- (d) In the event of the employee's death while at employment, all the options granted to him up to that date shall be extended to the deceased employee's legal heirs or nominees.



- (e) In the event that the employee experiences a permanent incapacity while in job, all the options given to him on the day of permanent incapacitation shall vest in him on that day.
- (f) In the case of resignation or termination of employment, options which are not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified on his behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.
- (9) The details to be disclosed by the Board of directors should be ensured.
- (10) (a) The company must retain the employee stock options list in Form No. SH.6 and option particular shall be entered in it. Such registrar shall be kept at the company's registered office or any other place that may be decided by the board.
- (b) The company secretary or any other person approved by the board for the purpose shall authenticate the entries in the register.
- (11) Once the allocation has been made, the company must file with the Registrar within 30 days of the allocation in Form PAS.3, along with the fee as stated in the Companies (Registration of Offices and Fees) Rules, 2014.
- (12) Deliver the share certificates of allotted shares within a period of 2 months from the date of allotment.
- (13) Intimate the details of allotment of shares to the Depository immediately on allotment of such shares.
- (14) Where the company's equity securities are listed on a registered stock exchange, the Employees Stock Option Scheme shall be issued in compliance with the regulations made on this behalf by Securities and Exchange Board of India.

2.7 Bonus Issue

Sometimes the companies have large undistributed profits which they want to distribute among their existing shareholders. Instead of distributing these as dividends, they issue fully paid-up shares to them free of charge,



in proportion to their existing shareholdings. These shares are called Bonus Shares.

As a result of this issue, the company's issued capital increases whereas the assets of the company remain intact. It is for these reasons that the issue of bonus shares is called the "capitalisation of the undistributed profits" of the company.

A Bonus Issue is usually made to ensure that the company's issued capital represents the true worth of the undertakings so that the profits do not seem unduly high as compared to its paid-up share capital.

Prior to Companies Act, 2013 there were no provisions in the Companies Act with regards to Bonus shares. The Bonus Issue was essentially regulated by the provisions given in the articles of a Company and by SEBI guidelines. **Section 63** is a new section introduced by Companies Act, 2013. Which provides for the conditions and manner of issue of Fully paid-up Bonus shares by a company to its members.

As per **section 63(1)**, a company can issue fully paid-up bonus shares to its members, out of—

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

However, the issue of bonus shares cannot be made by capitalizing reserves created by revaluation of assets. This applies to all companies whether listed or unlisted.

Section 63(2), provides that following conditions must be complied with before making a bonus issue:

- (i) Articles of association must permit the issue of bonus shares.
- (ii) Board of directors' resolution must be passed recommending the bonus issue.
- (iii) On the recommendations of the Board of Directors, approval of the shareholders should be taken through a resolution passed in a general meeting.
- (iv) The company should not have defaulted in payment of interest or principal amount with respect to fixed deposits or debt securities issued by it.



- (v) The company should not have defaulted with respect to payment of statutory dues of its employees such as contribution to provident fund, gratuity and bonus.
- (vi) All partly paid-up shares on the date of allotment must be made fully paid up.
- (vii) The company must comply with such other conditions as may be prescribed.

Rule 14 of Companies (Share Capital and Debentures) Rules, 2014, provides that a company which has once announced the decision of its board, recommending the bonus issue, it subsequently cannot withdraw such decision.

2.8 Right Issue

Shares which are offered to the existing members are called “Right Shares” and the right of members to be so offered is called “Right of Pre-emption”. In other words, the right issue is an invitation to existing shareholders to purchase additional new shares in the company at a discount to the market price on a stated future date. In a right issue, the promoter also gets to participate in the fundraising without having to dilute their holding in the company.

Thus, whenever a company, comes out with right issue of shares, it must comply with the provisions of section 62(1) which are as follows—

- (a) The shares must be first offered to the existing equity shareholders in proportion to the capital paid-up by them on the shares by sending them a letter of offer.
- (b) The offer of further shares must be made by a notice dispatched through registered/speed post or through electronic mode to all existing shareholders at least three days before the opening of the issue.
- (c) The notice must specify the number of shares offered and the time within which the offer is to be accepted. The time should not be less than 15 days and not more than 30 days from the date of the offer. The notice must also specify that if the offer is not accepted within the specified time, it will be deemed to have been declined.



Notes

It is to be noted that the Ministry of Corporate Affairs through its notification dated 5th June 2015, provides that in case 90% of the members of a private company give their consent in writing or in electronic mode, the period lesser than those specified in point (b) and (c) given above shall apply.

- (d) The notice must also specify that the shareholder has the right to renounce all or any of the shares offered to them, in favour of their nominee.
- (e) After the expiry of the time as specified in the notice or on receiving intimation of decline of the offer, the board of directors are free to dispose of the shares in such manner as they think is most beneficial for the company.

It is to be noted that for a right issue of listed companies, in addition to complying with the provision of section 62, SEBI (Issue of Disclosure) Regulations, 2009, must be complied with.

Table 2.1: Difference Between Right Shares and Bonus Shares

Basis	Right Shares	Bonus Shares
Meaning	Right Shares are issued against payment and the shareholders are required to pay.	Bonus shares are issued free of charge.
Fully Paid-up	Maybe partly paid up.	Always fully paid up.
Cash	Right shares bring cash to the company's' coffers.	Bonus Shares are free and hence do add anything to the company's cash box.
Separate Bank Account	Till the allotment is being approved by the stock exchange, the money received must be kept at a separate bank account.	Not relevant as no money is received.
Right of Renunciation	Right to renounce is available and member may renounce in favour of his nominee.	No such facility is available.
Guidelines	Right issue is regulated by the provisions of section 62 Companies Act and SEBI Guidelines.	Bonus issue is regulated by the provisions section 63 of Company's Articles/Table A and the detailed SEBI Guidelines.



2.9 Buy-Back of Securities [Section 68]

Sources

As per section 68(1) of the Companies Act, 2013 buy back of securities is defined as “a company may purchase its own shares or other specified securities” out of:

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of the issue of any shares or other specified securities.

Nevertheless, no buyback from proceeds of the earlier offering of the same form of shares or of the same sort of other securities may be made from any type of shares or other stated securities.

Thus, the company should have enough funds in one or more of these accounts at the time of buy-back to cover the total amount of the buy-back.

Free reserves have been identified in accordance with section 2(43) of the Act as those reserves that are available for distribution as dividends according to a company’s latest audited balance sheet. However, it has been established that the following are not considered as free reserves:

- ◆ Any amount that reflects unrealized gains, notional gains or asset revaluation, whether as a reserve or otherwise, or
- ◆ Any adjustment in the carrying amount of an asset or liability acknowledged in equity, including the profit and loss account surplus on the calculation of the asset or the fair value liability, shall not be considered as free reserves.

Authorisation [Section 68(2)]

The main requirement is that the articles of association of the company permit the buy back. If such a provision is not available, in order to authorize buyback, it would be necessary to change the articles of association. Buy-back can be made at a board meeting with the approval of the board of directors and/or with a special resolution passed by the shareholders at a general meeting, depending on the amount of Buy-Back. Shareholders’ consent is received only by Postal Ballot in the case of a listed company.

**Quantum [Section 68(2)]**

The board of directors can accept buyback, by means of a resolution passed at the meeting, up to 10% of the overall paid-up capital and free reserves of the company.

A special resolution allows shareholders to approve the purchase of up to 25% of the Company's total paid-up capital and free reserves for any financial year.

Special Resolution to be accompanied by Explanatory Statement [Section 68(3)]

An explanatory note shall be annexed to the notice of the meeting at which the special resolution is expected to be passed, stating:

- ◆ Complete and full disclosure of all material facts.
- ◆ The necessity for the buy-back.
- ◆ The class of stock or securities to be acquired subsequent to the purchase.
- ◆ The sum to be invested under the buy-back.
- ◆ The timeframe for completing the buy-back.

As per Companies (Share Capital and Debentures) Rules, 2014 and SEBI, Explanatory statement to contain certain disclosures [Rule 17(1)]**Letter of Offer to be Filed with Registrar of Companies before Buy-Back [Rule 17(2)]**

Before the buyback of shares, the company that has been approved by a special resolution shall file a letter of offer with the Registrar of Companies in Form No. SH. 8, together with the prescribed fee. Such letter of offer shall be dated and signed by no less than two directors of the company on behalf of the company's board of directors, one of whom shall be the managing director, where there is one.

Dispatch of letter of offer to shareholders [Rule 17(4)]

The letter of offer shall be sent immediately after filing the same with the Registrar of Companies to the shareholders or security holders, but not later than 21 days after filing with the Registrar of Companies.



Period of offer for buy back [Rule 17(5)]

The buy-back offer shall remain available for a period not less than 15 days and not exceeding 30 days from that date of dispatch of the letter.

Post buy-back debt-equity ratio [Section 68(2)(d)]

The percentage of the amount of secured and unsecured debts owed by the company after buy-back is twice as high as the paid-up capital and its free assets. However, a higher debt-to-capital ratio and free reserves for a class or class of companies may be notified by the central government by order.

Shares/Securities being Bought Back are to be Fully Paid-up [Section 68(2)]

A company shall buy its own shares or other specified securities unless all of the shares or other stated buy-back securities are fully paid-up.

Time gap between two buy-backs [Provision to Section 68(2)(g)]

No offer of buy-back pursuant to section 68(2) shall be made within one year, if any, from the closing date of the previous offer of buy-back.

Time limit for completion of buy-back [Section 68(4)]

Any buy-back shall be completed within one year from the date of the passing of a special resolution or, as the case may be, from the date of the passing of a resolution by the Board.

Methods of buy-back [Section 68(5)]

As per section 68(1) Buy Back may be:

- ◆ On a proportionate basis, from existing shareholders or security holders.
- ◆ From the open market.
- ◆ By purchasing the shares issued under a stock options plan or sweat equity to the company's employees.

Filing Declaration of Solvency with SEBI/ROC [Section 68(6) read with Rule 17(3)]

When a company proposes to buy back its own shares or other specified securities under this section in accordance with a special resolution or board resolution as the case may be, it shall file a declaration of solvency with the Registrar and the Securities and Exchange Board (in the case of



listed companies) signed by at least two directors of the company, one of whom shall be the managing director, if any, in Form No. SH.9 and verified by an affidavit that the company's board of directors has undertaken a thorough investigation into the company's affairs as a consequence of which they have expressed their opinion that it is capable of fulfilling its obligations and that it will not become insolvent within a span of one year from the date of the Board's adoption of the declaration.

Extinguishment of securities bought back [Section 68(7)]

When a company buys back its own shares or other stated securities, the shares or securities so bought back shall be extinguished and physically destroyed within seven days of the last buy-back date.

Prohibition of further issue of shares or securities [Section 68(8)]

When a company completes the buy-back of its shares or other defined securities, it shall not issue a further issue of the same kind of shares or other securities, including the issuance of new shares pursuant to clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months, except by way of a bonus issue or the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Register of buy-back [Section 68(9)]

When a company buy-back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back the date on which shares or securities are cancelled, the date on which the shares or securities are extinguished and physically destroyed.

Return of buy-back [Section 68(10)]

After the buy-back under this section has been completed, a company shall file a return with the Registrar and the Securities and Exchange Board (in the case of listed companies) containing such buy-back details within thirty days of the completion as may be prescribed.

Rule 17(14) of Companies (Share Capital and Debentures) Rules, 2014 states that a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buyback of securities has been made in compliance with the provisions



of the Act and the rules made thereunder shall be annexed to the return filed with the Registrar in Form No. SH.11.

Punishments [Section 68(11)]

If a company fails to comply with the provisions of this section or with any regulation imposed by the Securities and Exchange Board in the case of listed companies, the business shall be punished with a fine not exceeding one lakh rupee but extending to three lakh rupees and each officer of the company in default shall be punished 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.

Transfer to and application of Capital Redemption Reserve Account [Section 69]

An amount equal to the nominal value of the shares so acquired shall be transferred to the capital redemption reserve account when a company purchases its own shares from free reserves or equity premium account and details of such transfer shall be reported in the balance sheet. The capital redemption reserve account may be applied by the company in paying out the company's unissued shares to be issued as fully-paid bonus shares to members of the company.

Circumstances prohibiting buy-back [Section 70(1)]

No company shall buy its own shares or other specified securities directly or indirectly:—

- ◆ Through any subsidiary company including its own subsidiary companies.
- ◆ Through any investment company or group of investment companies; or
- ◆ If the company fails to repay deposits accepted either before or after the commencement of this Act, interest payments thereon, redemption of debentures or preference shares or payment of dividends to any shareholder, or repayment to any financial institution or banking company of any term loan or interest payable thereon: Buy-back is not prohibited however, if the default is remedied and a three-year period has expired after such default has ceased to exist. [Section 70(1)]



No company shall buy its own shares or other prescribed securities, directly or indirectly, in the event that such business has not complied with the provisions of sections 92 (Annual Return), section 123 (Declaration of Dividend), section 127 (punishment for failure to pay dividends) and section 129 (Financial Declaration).

2.10 Membership of Company

Under Section 2(55) of the Companies Act, 2013, member means, with respect to a company:—

- (a) Subscribers to the memorandum of a company who have decided to become members of the company and their names will be registered as members of the company's register of members.
- (b) Any other person whose name is inscribed in the register of members, who decides in writing to join a company shall be a member of the company.
- (c) Every person holding shares of a company and whose name is included in the records of a depository as beneficial owner is considered to be a member of the company concerned.

Consequently, two important elements need to be present before someone becomes a company's member: (i) agreement to become a member; (ii) entry of the name of the person so agreeing, in the register of members of the company. Both these conditions are cumulative. [Balkrishan Gupta v. Swadeshi Polytex Ltd. (1985) 58 Com Cases 563].

The person who wants to become a part of a company must, in accordance with the provisions of the Indian Contract Act, 1972, have the legal capacity to conclude an agreement. Section 11 of the Indian Contract Act provides that each person is competent to contract who—

- (i) Is of the age of majority according to the law to which he is subject.
- (ii) Is of sound mind.
- (iii) Is not disqualified from contracting by any law to which he is subject.

Difference between Member and Shareholder

“Words ‘member’ and ‘shareholder’ have been used interchangeably under the provisions of the Companies Act. Member is a person whose name is



entered in the register of members maintained by the company. As held in *Karachi Oil Products Ltd. v. Kumar Shree Narendra-singhji* (1948) 18 Comp Cas 215 (Bom), as long as a person's name is not entered in the register of members, he will not be considered as a member despite having already purchased the shares of the company. Shareholder, however, means a person, who holds the shares by having his name on the register of members.”

Register of Members

Section 88 of the Companies Act, 2013 lays down:

- (1) The following registers must be kept by and maintained by each company namely: — (a) members who signify for each class of equities and preference shares owned by each of the members residing in or outside India; (b) debenture-holders 'register; and (c) other security owners' register.
- (2) Every register maintained under sub-section (1) shall include an index of the names included therein.
- (3) The beneficial owners register and index, maintained by a depository in compliance with section 11 of the 1996 Depository Act, shall be considered to be the corresponding register and index for the purposes of the Act.
- (4) Foreign register.
- (5) Where the organization does not collect, retain, or otherwise manage a register of shareholders, debenture holders or other security owners in accordance with the provisions of sub-section (1) or sub-section (2), 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.

Modalities of Maintaining the Register

“Rules 3 & 5 of the Companies (Management and Administration) Rules, 2014 deal with maintenance of Register under section 88. It is provided that every company limited by shares shall from the date of its registration maintain a register of its members in Form No. MGT.1.”

**Notes**

The register of member shall include the following particulars with respect to each member of a company not having share capital, namely:

- (a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/Mother's/Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;
- (b) date of becoming a member;
- (c) date of cessation;
- (d) amount of guarantee, if any;
- (e) any other interest if any; and
- (f) instructions, if any, given by the member with regard to sending of notices, etc.

Rule 5 concerning the maintenance in compliance with Article 88 of the Register of Members etc. notes that all organizations shall maintain the register in the following manner:

1. Entries in the register shall take place within seven days after the allotment of shares, debentures or any other securities approved by the Board of Directors or its duly constituted committee.
2. The registers shall be held at the company's registered office unless a special resolution is passed at a general meeting approving the holding of the register at any other place in the city, town or village where the registered office is located or any other place in India where more than one-tenth of the total members registered reside.
3. Consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.



4. Where any modifications occur due to the death, insolvency or change of names or due to transfer to Investor Education Protection Fund or for any other reason in the status of a Member or debenture holder or other protection holder, entries in the respective register describing the alteration shall also be made.
5. Where any correction in the company register is made by the competent authority pursuant to an order under the Act, the necessary reference to this order shall be indicated in the respective register.
6. If any order is issued by any judicial or revenue authority or Securities and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving instructions for the remittance of dividends or interest, the correct reference of such order shall be indicated in the respective register.
7. In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.
8. If the promoters of any listed company that has established a joint venture with another company have pledged or hypothecated or created a charge or lien in respect of any security of the listed company in connection with that joint venture business, the details of such pledges, hypothecation, charges and lien shall be entered in the listed company's register of members within fifteen days from the date of the pledging.

Authentication of the Register

The entries in the registers maintained in compliance with section 88 and the index contained therein shall be authenticated for the purpose by the company secretary or by any other person approved by the board, and the date of the board resolution authorizing the same shall be specified.

The company secretary of the company or person approved by the board shall authenticate the entries in the foreign register by assigning his signature to each entry.

**Index of Members**

Section 88(2) of the Companies Act, 2013 read in compliance with Rule 6 of the Companies (Management and Administration) Rules, 2014 mandates that an index of the names shall be included in each register maintained under section 88(1).

Every register maintained pursuant to sub-section (1) of section 88 shall contain an index of the names entered in the respective registers and the index shall contain sufficient indication for each folio to allow entries relevant to that folio to be easily found in the register.

In case the number of members is less than fifty, it is not necessary to maintain the index.

Simultaneously with the entry for allotment or transfer of any security in such a register, the company shall make the necessary entries in the index.

The inspection of the Index must be authorized in the same way as that given to the register of members.

Foreign Register

Rule 7 of the Companies (Management and Administration) deals with the maintenance of a foreign register, providing that a company that has a share capital or has issued debentures or any other security may, if approved by its articles keep a part of the register of members in any country outside India or, as the case may be, of debenture holders or other security holders or beneficial owners, resident in that country (hereafter in this rule referred to as the “foreign register”).

The company shall file with the Registrar, within thirty days from the date of the opening of any foreign register, a notice of the situation of the office in Form No. MGT.3 together with the fee where such a register is kept; and, in the event of any change in the situation of that office or its discontinuance, within thirty days from the date of such change or discontinuance, as the case may be.

A foreign register shall, as the case may be, be considered to be part of the register of the company (hereafter referred to as the “principal register”) of members or debenture holders or any other security holders or beneficial owners.



The foreign register shall be maintained in the same format as the principal register.

A foreign register shall be available for inspection and may be closed, and extracts may be taken from it and copies thereof may be needed in the same manner, mutatis mutandis, as applicable to the principal register, except that the advertisement shall be published in at least two newspapers circulated in the place where the foreign register is held before closing.

If a company keeps a foreign register in any country outside India, the applicable competent authority's decision to rectify the register is binding.

Entries in the foreign register maintained under sub-section (4) of section 88 shall be made concurrently after the allotment or transfer of shares, debentures or any other securities, as the case may be, has been authorised by the Board of Directors or its duly constituted committee.

The company shall—

- (a) Send a copy of each entry in any foreign register to its registered office in India within fifteen days of the entry.
- (b) Keep a duplicate record of each foreign register properly entered from time to time at that office.

Each such duplicate register shall be deemed to be part of the principal register for all purposes of this Act.

According to the provisions of section 88 and the rules found therein concerning duplicate registers, shares or, as the case may be, debentures or other securities registered in any foreign register shall be differentiated from shares or, as the case may be, debentures or other securities registered in the principal register and in any other foreign register; and no transaction shall be distinguished from those registered therein.

The company may discontinue the maintenance of any foreign register, and consequently all entries in that register shall be transferred to some other foreign register kept outside India by the company or to the principal register.

IN-TEXT QUESTIONS

1. What is a share's 'nominal value?'

- (a) The maximum value that the share can be sold for



Notes

- (b) A fixed amount that represents the notional value of the share's worth
 - (c) The current market value of the share
 - (d) The maximum value that can be paid for a share
2. The allotment of shares refers to the process whereby a person's name is entered into the register of members. (True or False)
3. Which of the following can be used for buying back of shares?
- (a) Free Reserves
 - (b) Securities Premium
 - (c) Proceed of fresh issue of shares
 - (d) All of the above
4. Who cannot become a member of a company?
- (a) LLP (Limited liability partnership)
 - (b) HUF (Hindu Undivided Family)
 - (c) Foreigner as a member
 - (d) Minor
5. Which of the following details of the issue of sweat equity shares shall be disclosed by the Board of Directors in the Director's report for the year:
- (a) The class of director or employee to whom sweat equity shares were issued
 - (b) The class of shares issued as Sweat Equity Shares
 - (c) The reasons or justification for the issue
 - (d) The principal terms and conditions for issue of sweat equity shares, including pricing formula
 - (e) All of the above

2.11 Modes of Acquiring Membership

A person may acquire the membership of a company pursuant to section 2(55) of the Companies Act, 2013:



- (a) by subscribing to the Memorandum of Association (deemed agreement);
or
- (b) by agreeing in writing to become a member:
- (i) by making an application to the company for allotment of shares; or
 - (ii) by executing an instrument of transfer of shares as transferee; or
 - (iii) by consenting to the transfer of share of a deceased member in his name; or
 - (iv) by acquiescence or estoppel.
- (c) by owning the company's shares and the name of which is entered as beneficial owner in the records of the depository (Under the Depositories Act, 1996) and in the register of the company's members.

Also, every person holding the company's shares and whose name is entered in the depository records as beneficial owner shall also be deemed to be a member of the company concerned.

(a) *Subscribers to the Memorandum*

In the case of a subscriber, no application or allotment is necessary to become a member. By subscribing to the memorandum, he is considered to have agreed to become a member and he becomes *I pso Facto* member of the company's incorporation and is liable for the shares that he has subscribed.

A memorandum subscriber cannot revoke the contract for the purchase of shares even on the ground of fraud by the promoters. (In *Re. Metal Constituents Co.* (1902) 1.Ch. 707.)

Pursuant to the provisions of section 10(2) of the Act, all monies payable under the memorandum or articles to the company by any member shall be debt due from him to the company. In fact, a memorandum subscriber will pay cash for his shares even though the promoters promised him the shares for services rendered in connection with the company's promotion. Again, he has to take the shares directly from the company, not through other member(s) transfer. When an individual signs a contract for any number of shares he is bound to take those shares and no delay can release him from that liability until he fulfils that obligation. His responsibility



lasts until the liquidation of the company, and he is bound to bring the money that he is liable to pay to the company's creditors.

(b) Agreement in Writing

(i) By an application and allotment

A person applying for shares will become a member when shares are allocated to him, a notice of allocation will be issued to him, and his name will be entered in the register of members. When the shares are allocated, there is an offer to take shares and accept this offer. An application for shares may be absolute or conditional. If it is absolute, there will be ample approval of an allocation and its notification to the applicant. On the other hand, if the offer is conditional, the allocation must be rendered as specified in the application. There is no contract if there is a conditional application and an unconditional allotment.

(ii) By transfer of shares

A company's shares are movable property as specified in section 44 of the Act and are transferable in the manner provided in the articles of the company and as provided in section 56 of the Companies Act, 2013. An individual may become a member by purchasing shares from an existing member and having the transfer of shares recorded in the company's books, *i.e.*, by having his name entered in the register of members of the company.

(iii) By transmission of shares

Through statute, an individual can become a member of a company *i.e.*, if he succeeds a deceased member's estate. Membership by this method is a legal consequence. Upon a member's death, his executor or the person entitled under the law to succeed his estate shall have the right to have the shares transferred and registered under his name in the company's register of members. In this case, no transfer instrument is needed. If the deceased member's legal representative chooses to be listed as a member instead of the deceased shareholder, the company shall do so or, instead, may order the company to transfer the shares on behalf of another person of his choice. The Official Assignee or Official Receiver is likewise



entitled to be a member in place of the shareholder, who has been adjudged insolvent.

(iv) By acquiescence or estoppels

A person shall be deemed to be a member of a company if, without sufficient cause, he permits his name to be on the register of members of the company or otherwise retains himself or allows himself to be held as a member. In such a case, he is stopped from denying his membership. He can, however, get his name removed from the register of members on permissible grounds and escape his liability by taking prompt action.

(v) Holding Shares as Beneficial Owner in the Records of Depository

Any person holding the company's shares and whose name is entered in the depository's records as a beneficial owner shall be considered a member of the company concerned.

2.12 Who May Become a Member

Under the Memorandum and Articles, any sui juris (a person who is competent to contract) may become a member of a company except the company itself. However, it is important to note the following points in relation to certain organizations and persons:

(a) Company as a member of another company:

A company is a legal person, so it is capable of contracting. It can thus become a member of any other company. Nevertheless, it must be allowed to invest in the securities of that company or any other company by its Association Memorandum. A company can't become a part of itself either. A subsidiary company cannot become a member of its holding company under section 19 of the Companies Act, 2013. Nevertheless, only under the following exceptional circumstances can a subsidiary hold shares in its holding company:—

- (i) Where the subsidiary company retains shares as the legal representative of the holding company's deceased member; or
- (ii) Where such securities are owned by the subsidiary as trustees; or



(iii) If the subsidiary is a shareholder before it became a subsidiary of the holding company.

(b) Partnership firm as a member:

A partnership firm is not a legal person and therefore cannot become a member of a corporation in its own name except in a company registered u/s 8 of the law.

(c) Limited Liability Partnership:

LLP may become a member of a corporation as an incorporated entity under the law.

(d) HUF:

The Company's Act does not prohibit Hindu Undivided Family membership. HUF's is represented by its Karta. Therefore, the shares can be reported in the name of their Karta in the case of HUF.

(e) Non-profit making company:

A non-profit making company licensed under section 8 of the Act may become a member of another company if it is allowed to invest in the other company's shares by its Memorandum of Association.

(f) Foreigners as members:

A foreign national may participate and become a participant in an Indian enterprise, subject to the provisions of the Foreign Exchange Management Act, 1999, but he becomes an alien enemy, his voting power and notification rights are suspended in case of war with his country.

(g) Minor as member:

The member who is not a sui juris, for example a minor, is incapable of entering into a contract and cannot become a member of a company as such. Therefore, a minor's agreement to take shares is *void ab initio*.

The Company Law Board (replaced by the Tribunal under the Companies Act, 2013) held that a written agreement for a minor to become a member could be signed on behalf of the minor by his legal guardian and the registration of the transfer of shares on behalf of the minor by his or her guardian, in particular where the shares are fully paid cannot be denied on the ground. [Miss



Nandita Jain v. Bennett Coleman and Co. Ltd., Appeal No. 27 of 1972 dated 17.2.78].

(h) Insolvent as member:

An insolvent may be a member of a company as long as he is on the register of members. He is entitled to vote, but he loses his beneficial interest in the shares and the company pays the Official Assignee or Receiver a dividend on his shares.

(i) Public office:

Since the Central Excise Collector's office or the Indian Government Secretary as such is not a legal entity, shares cannot be owned on behalf of such offices. Accordingly, shares in a company cannot be registered in the name of a public office that is not solely a company as understood by laws.

IN-TEXT QUESTIONS

6. As per **section 63(1)**, a company can issue fully paid-up bonus shares to its members, out of:
 - (a) Its free reserves
 - (b) The securities premium account
 - (c) The capital redemption reserve account
 - (d) All of the above
7. Bonus shares are always:
 - (a) Always partially paid up
 - (b) Always fully paid up
 - (c) May be partially paid up
 - (d) None of the above
8. For Buy-back of securities an explanatory note shall be annexed to the notice of the meeting at which the special resolution is expected to be passed, stating:
 - (a) Complete and full disclosure of all material facts
 - (b) The necessity for the buy-back
 - (c) The class of stock or securities to be acquired subsequent to the purchase



- (d) The sum to be invested under the buy-back
- (e) The timeframe for completing the buy-back
- (f) All of the above

9. Which of the principle is not valid related to allotment?

- (a) The allotment should be made by proper authority
- (b) Allotment for securities must be made within a reasonable time
- (c) Allotment should be conditional
- (d) Allotment must be communicated

2.13 Rights and Liabilities of Members

A person who is the shareholder of a company enjoys many rights. Some of these rights are enjoyed by him by virtue of entering into a contract with the company, and some of them are expressly granted to him by the Companies Act:

- (a) The right to vote at all meetings, either in person or by proxy; **(Section 113)**
- (b) The right to requisition an extraordinary general meeting of the company or be party to joint requisition; **(Section 100)**
- (c) The right to receive notice of a general meeting; **(Section 101)**
- (d) The right to elect directors.
- (e) Right to receive dividend and bonus shares.
- (f) Right to apply to the ‘**Tribunal**’ (a) for prevention of oppression and mismanagement (section 241), (b) for the investigation of the affairs of the company (section 210), (c) for the refusal of a private company to register shares. **(Section 58)**
- (g) Right to apply to the Central Government in case of default in holding annual general meetings by the company. **(Section 97)**
- (h) Right to transfer shares subject to the provisions of the companies act and Articles of Association. **(Section 44)**

**(i) Right to obtain copies of:**

- (i) Memorandum and Articles of association.
- (ii) Annual Accounts of the company.
- (iii) Resolutions and Agreement.
- (iv) Minutes of Proceedings of the general meeting.

2.13.1 Liability of Members

A member has certain obligations, some of these are:

- (a) To pay calls on shares.
- (b) If the company goes into liquidation, a member holding partly paid shares is to pay as contributory.
- (c) If shares have not been allotted for consideration other than cash, the member must pay the whole dues in cash.
- (d) If the statutory membership of a company falls below the statutory limit and business is carried for more than six months, every member who is aware of the reduced membership, shall have unlimited liability.
- (e) In the case of a Guarantee Company, a member may be asked to contribute to the extent of the guarantee amount at the time of winding up.

2.14 Transfer and Transmission of Shares

Transfer of shares refers to a voluntary act between the transferor and transferee. Transfer of shares is usually mentioned in the transfer deed. The title of the shares is transferred from one party to another. The contract also contains the adequate amount of the shares on which both the party agree for the transfer. Once the shares have been transferred, the liability of the transferor ceases. The shares of a public company can be easily transferred if the company does not specifically mention about its non-transferability. The shares belonging to a private limited company are non-transferable except in some specific situations.

Provisions: The transfer of shares is done when a proper instrument of transfer, in Form SH-4 as mentioned in sub-rule (1) of rule 11 of Companies



Notes

Rules, 2014 is duly stamped, dated and executed by the transferor/transferee or on his behalf is initiated by any other party. The document should contain the details like name, address, occupation etc. The instrument has to be delivered to the company within the 60 days of its execution. The instrument has to be accompanied by the certificate of shares or the letter of allotment. In case of the partly paid shares, the SH-5 form has to be filled according to the sub-rule (3) of Rule 11.

Transmission of shares: Refers to the transfer of shares but by the virtue of law and not by the will. The transmission of shares is performed when the shareholder is no more or is declared insolvent or lunatic. The transmission of shares is a process that is initiated by a legal heir of a legal representative in case of a deceased holder. Unlike transfer of shares, here no transfer deed is required. In the case of transmission, the liability also continues.

Provisions: As the transmission takes place in case of Death/insolvency of the holder the following documents are required in the process:

- ◆ Certified copy of the death certificate
- ◆ Self-Attested copy of PAN card
- ◆ Succession certificate/probate of will
- ◆ Specimen signature of the successor

Table 2.1: Difference between Transfer and Transmission of shares

Basis	Transfer of Shares	Transmission of Shares
Choice	Voluntary Act	Operational by the law
Initiation	By the transferee or transferor	By the legal representative
Result of	A deliberate act	Death or insolvency
Adequate consideration	Present	Absent
Transfer deed	Present	Absent
Stamp duty	Compulsory	Not Applicable
Liability	Ends with the transfer	Continues to exist

2.15 Demat System

Dematerialization:

In short it is known as Demat. The basic purpose for having dematerialisation or Demat is accessibility of physical certificate of security into the



electronic form. Thus dematerialisation means the conversion of physical certificate of securities of an investor into electronic form in the equal number of securities. After the conversion of securities into electronic form it is converted into the investor's account with his/her Depository Participant (DP). So for the purpose of conversion of physical securities into the dematerialised form, investors or shareholders are provided Dematerialised Request Form (DRF). The shareholders are required to fill the DRF form and submit it to DP along with physical form of share certificate that need to be dematerialised. There is also a provision of separate submission of DRF form for each company. After the submission of DRF form, the DP have to renunciate DRF and share certificate to the concerned company. The company then replaces the name of Depository in the Register of Member in place of the share certificate and inform the Depository accordingly. After receiving information form the company the Depository submits the name of such investors and its beneficial owner in its record along with the information related to number of shares held by the particular investor. After having the information of confirmation, the client's demat accounts are credited by DP with equivalent number of share electronically held by him/her. All these processes are known as Dematerialisation which normally takes around 30 days. Further section 10 says that a depository shall be deemed to be the registered owner of the shares for the purposes of effecting transfer of ownership of the shares on behalf of a beneficial owner and the depository as a registered owner shall not have any voting rights or any other rights in respect of the shares held by it. It is only the beneficial owner of the shares who shall be entitled to all the rights and benefits and be subject to all the liabilities in respect of his shares held by a depository (Depositories Act, 1996). However, the above said procedure of Dematerialisation is not compulsory. It is purely optional and up to the investors whether they want to hold the securities in physical form or in electronic form. Also, manually each share certificate has a distinctive number which is not the case with securities in dematerialized form. The securities in dematerialization have become fungible (Section 9 of Depositories Act, 1996) and not separate number has been allotted. Another feature is that the transfer of securities held in dematerialized form is not restricted and the securities are freely transferable.



Procedure for Selling and Buying Dematerialised Shares: If the investor who has availed the facility of dematerialisation wish to make transaction of purchase from or sale to can make the same transaction with the other person who also has availed the facility of depository. The investor has to give his/her account details to the Depository Participant. It is to be noted here that such transfer do not require the payment of stamp duty. Other point to be considered is that the investor has to make such transaction via Stock Broker and not through Depository Participant. If the investor is selling the securities, in such case, he/she has to submit DIS, *i.e.*, Delivery Instruction Slip to his/her Depository Participant. The said slip should contain all the details of the security sold and must be duly signed. In case the investor is purchasing certain securities, he/she is required to submit RIS, *i.e.*, Receipt Instruction Slip and the slip must be duly signed and must contain all the details of the securities purchased. The depository participant will give due effect to the above transactions in the books of account by making sufficient book entries. Also, Depository Participant is required to inform the depository about the transactions electronically. The depository, in turn, will register the transacted securities in transferee's name and will debit the transferor's account. The depository participant is required to update the statement of accounts of the investors within 15 days of each transaction and is also obliged to send the above said statement to the investors at regular intervals. If the investors have any complaint or query, they may first contact Depository Participant. If the complaint is not resolved by the depository participant, then investors may go to Depository. If the problem still does not get solved, the investors may approach SEBI. However, this doesn't mean that the investors can't approach SEBI directly. They can always approach SEBI directly. If any depository participant or depository appointed by SEBI to redress the complaint, fails to do so, then the defaulting party shall be liable to a penalty of Rs. 1 Lakh for each day during which the default continues or Rs. 1 Crore, whichever is less (Securities Laws (Amendment) Act, 2004).

Rematerialization:

The investors always have an option of converting their dematerialized securities in physical form. This process is called Rematerialization. Rematerialisation is conversion of electronic securities into physical certificates of such securities. This can be done in the following manner:



- (1) Beneficial owner sends request to DP.
- (2) DP intimates Depository (NSDL or CDSL) of such request electronically.
- (3) Depository confirms rematerialisation request to the company's Share Transfer Agents.
- (4) Share Transfer Agent updates accounts, prints certificates and confirms the Depository.
- (5) Depository updates accounts and downloads the details to the DP.
- (6) Share Transfer Agent dispatches certificates to holder thereof.
- (7) The DP also sends intimation about rematerialisation to its client.

2.16 Summary

Shares are the division of the share capital into defined shares of a particular value or of different classes and assignment of such shares of different persons. Shares can be issued as sweat equity, Employee Stock Option' (ESOP), bonus issue and right issue. The companies may sometimes go for Buy back of securities using its free reserves, securities premium account and the proceeds of the issue of any shares or other specified securities. A person may acquire the membership of a company either by subscribing to the Memorandum of Association (deemed agreement); or by agreeing in writing to become a member; or by owning the company's shares and the name is entered as beneficial owner in the records of the depository and in the register of the company's members.

2.17 Answers to In-Text Questions

1. (b) A fixed amount that represents the national value of the share's worth
2. True
3. (d) All of the above
4. (d) Minor
5. (e) All of the above
6. (d) All of the above
7. (b) Always fully paid up



8. (f) All of the above
9. (c) Allotment should be conditional

2.18 Self-Assessment Questions

1. What are the conditions for Issue of Sweat Equity Shares?
2. Explain the concept of Forfeiture of shares and legal requirement regarding it.
3. Explain the concept of Employee stock option (ESOP) and also explain the procedure for issue of Securities to Employees through “Employees Stock Option Scheme”.
4. Define the concept of Bonus Issue and also state the conditions that must be complied with before making a bonus issue as per section 63(2).
5. What is the difference between Right Shares and Bonus Shares.
6. State the circumstances prohibiting buy-back as per [Section 70(1)].
7. What are the points needs to be included in register of members as per Companies Act, 2013.

2.19 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.

UNIT - IV



Company Management

Author: Dr. R C Garg
Revised by: Ms. Deepika

STRUCTURE

- 1.1 *Learning Objectives*
- 1.2 *Introduction*
- 1.3 *Meaning of Directors*
- 1.4 *Legal Positions of Directors*
- 1.5 *Number of Directors*
- 1.6 *Classification under the Companies Act*
- 1.7 *Further Classification of Directors*
- 1.8 *Appointment of Directors*
- 1.9 *Director Identification Number (DIN)*
- 1.10 *Disqualification for Appointment of Director*
- 1.11 *Removal of Directors*
- 1.12 *Powers of Directors*
- 1.13 *Duties of Directors*
- 1.14 *Key Managerial Personnel*
- 1.15 *Summary*
- 1.16 *Answers to In-Text Questions*
- 1.17 *Self-Assessment Questions*
- 1.18 *Suggested Readings*

1.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Explain legal requirements for appointing directors and removal of directors.
- ◆ Understand the legal technicalities involved in the appointment or removal or vacation of office.



- ◆ Discuss the Concept of independent directors.
- ◆ Understand the concept of Key Managerial Personnel.

1.2 Introduction

Since interests of various parties like shareholders, creditors etc. have been associated with the company, its proper management becomes a matter of public interest. Therefore, in order to protect the interests of various parties, the Act contains many strict provisions regarding appointment, powers and duties of the top managerial positions. Various key managerial positions have been discussed later in detail. But various key managerial personnel might be optional for the company, but this is not the case with the Board of Directors. The company has to appoint directors for the proper functioning of the company.

The legal provisions that deal with the appointment of directors and various key managerial personnel, *i.e.*, managers, managing director and whole-time director are discussed in detail one by one.

1.3 Meaning of Directors

Section 2(34) of the Act defines a director as “*a director appointed to the Board of a company*”. However, this definition is not explanatory as it does not explain the appropriate meaning of the term director. Therefore, we define directors as those persons who are appointed to direct and supervise the affairs of the company. They are responsible for directing and controlling the powers of the company. Since a company is an artificial person which cannot work on its own, it requires some persons who perform certain functions on behalf of the company. It implies that if company is a body, directors are the brain. Further, directors have to act collectively, and no individual director has the power to bind the company. Directors collectively are known as Board.

1.4 Legal Positions of Directors

There is quite ambiguity in the exact legal position enjoyed by any director in the company. The Act itself is silent on this ambiguity. Directors



are highly efficient and competent professionals and have dexterity in performing the operations of the company. Thus, based on the kinds and level of work that they perform, usually they are sometimes labeled as an agent of the company, sometimes as trustee of the company and sometimes as managing partners of the company.

◆ **Directors as Agents**

The relationship of an agent has emerged from the ground that a company is an artificial legal entity, therefore it cannot work on its own. For efficiently performing and operating several activities, there is dire need to appoint a person who is professionally competent and thus can work on behalf of the company. Thus, as per the usual rule of principal and agent, wherever the director enters into the contract on behalf of the company for ordinary course of business, the director shall not be liable for any default.

◆ **Director as Trustee**

Apart from acting as an agent, a company's director acts as a trustee as well. The role of directors is to take care of company's assets and properties and work on its behalf with diligence specially for the benefits of shareholders, instigated to assume that a director acts as a trustee as well. Although it is very important to note that the strict rules of Trustee Act are not applicable here. Therefore, it can be said that they are not trustees in a legal sense.

◆ **As Managing Partners**

Apart from acting as Agent or Trustee, directors are the employees of the company as employed either as managing director or whole-time director. More importantly they are elected by shareholders for managing the affairs of the company in the best of the best interests of the company. Thus, they occupy the position of managing partners as well.

IN-TEXT QUESTIONS

1. The Board of Director is the top administrative _____ of the company.
2. Directors as an agent must conduct the business with reasonable care and diligence and _____ by the memorandum and articles.



Notes

3. Every listed company having paid up share capital Rs. 100 crores or more and turnovers of Rs. 300 crores or more must appoint at least one _____ director.
4. First Director shall hold the position _____ the first annual general meeting.
5. Director works as a brain in the company. (True/False)
6. Legal positions of director in the company are not like trustee. (True/False)

1.5 Number of Directors

The minimum number of directors to be appointed to public companies is three directors and in case of a private company is two directors and a one-person company must have at least one director. The act has also specified a ceiling on the maximum number of directors. The company can appoint a maximum of 15 directors and the said limit can be increased by the company by passing a special resolution. However, these limits are not applicable on Section 8 companies and Government Companies. Such companies may appoint directors as per their convenience.

1.6 Classification under the Companies Act

Broadly, there are two types of Directors:

- ◆ Executive Director (who is either a Whole-time director or a Managing Director of a company).
- ◆ Non-executive Director (who is neither a Whole time director nor a Managing Director of a company).

Executive directors actively participate in the day-to-day functioning of the company. They take care of the company's administration, programs, affairs, strategic plan and many such activities directly related to the company, which is not true in case of non-executive directors.

1.7 Further Classification of Directors

- ◆ First Director
- ◆ Resident Director



- ◆ Women Director
- ◆ Independent Director
- ◆ Alternate Director
- ◆ Additional Director
- ◆ Small Shareholder Director
- ◆ Nominee Director
- ◆ Casual Vacancy

1.8 Appointment of Directors

For smooth, effective and efficient functioning of a company, appointment of directors become an unavoidable activity. In the Companies Act, 2013, there are many several types of directors that are appointed for successful operation and smooth functioning of the company. Thus, following types of directors may be appointed:

First Director [Section 152]:

Section 152 of the Act deals with the provision of the appointment of First Director. The subscribers of the memorandum of association of the company appoints the first director of the company. In case it is not done, then in that situation, Article may prescribe the rule for the same. If the article neither provides name of the director nor any method for appointment, then in that case the subscribers of memorandum who is an individual deemed to be the first director.

Subsequent Directors:

Members of the company will appoint subsequent directors in the general meeting. Director Identification Number will be mandatory for appointment as director. Certain documents are required to be submitted. These documents are:

- ◆ DIN
- ◆ Written Consent by such directors which is to be filed with the Registrar of Companies within 30 days of such appointment.



- ◆ Such a director has to give a declaration that he is not disqualified for being appointed as director.

At least two-third of the total number of directors are liable to be retired on rotational basis unless provided in the Articles of association of companies. However, this rule is applicable only on Public Companies. This is explained in detail in the succeeding paragraph.

Retirement by Rotation [Sec. 152(6)]:

This section is applicable on Section 8 companies as well but doesn't apply to Government companies and its subsidiaries. This section states that at every Annual General Meeting, directors shall retire on rotational basis. Out of the total number of directors (excluding independent directors and small shareholders' directors), one-third of such directors are appointed by ratification and the other two-third are liable for retirement on rotational basis. However, out of such two-third numbers, one-third of such directors shall actually retire (in case of decimals, the number nearest to one-third will be taken).

Resident Director [Sec. 149(3)]:

Section 149(3) of the Act provides that, at least one director of every company has to stay in India for a total period of 182 days or more during the financial year. The clause of 182 days is not exhaustively applicable to newly incorporated companies. In this particular case, the number of days of stay are decided proportionately at the end of the financial year in which the company is incorporated.

Women Director [Sec. 149(1)]

All the listed companies and the prescribed companies are required to appoint at least one woman in its board of directors as specified by the Act. As per second provision to section 149(1) *i.e.*, section 149(1)(2) of the Act, which read with Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 states that the following conditions are mandatory for appointment of at least one Women Director:

- ◆ All listed Companies
- ◆ Other public company having:
 1. Paid up capital of Rs. 100 Crore or more OR
 2. Turnover of Rs. 300 Crore or more.

**Note:**

1. The above specified provisions have to be followed within a period of 6 months from the date of incorporation. This rule is applicable only and only for those company who has incorporated under the Companies Act, 2013.
2. Recently SEBI has issued a notification for top 500 and top 1000 listed entities. As per the notification, all the top 500 listed companies based on market capitalization, shall have to appoint at least one women independent director by April 2019 and for top 1000 listed companies too at least one women independent director by April 2020.

Independent Director [Sec. 149(6)]

For the first time the concept of Independent Director was introduced in the Companies Act, 2013 only, with the exclusive objective of ensuring good corporate governance. All listed companies shall have at least 1/3rd of total directors as independent directors [Section 149(4)].

In relation to a company an independent director means a director other than *managing director or a whole-time director or a nominee director*. Section 149(6) of the Act defines Independent Director as follow:

- ◆ *Who has expertise, experience, competency and integrity in the opinion of the Board.*
- ◆ *Who is or was not a promoter of the company and has not ever directly or indirectly related to the affair of the company.*
- ◆ *Who is not related to promoters or directors in the company, its holding, subsidiary or associate company.*
- ◆ *Who has or had no pecuniary relationship with the company, its holding subsidiary or associate company or their promoters, or directors during two immediately preceding financial years or during the current financial year.*
- ◆ *None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters or directors, amounting to 2 per cent or more of its gross turnover or total income or Rs. 50 lakh or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year.*

Notes



Notes

- ◆ *He must not either directly or any of his relatives—*
 1. *hold or has held the position of a key managerial personnel or is or has been employee of the company or its holding, or subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed.*
 2. *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—*
 - I. *firm of auditor or company secretaries in practice or cost auditors of the company or its holding, subsidiary, or associate company; or*
 - II. *any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to 10 per cent or more of the gross turnover of such firm.*
 3. *hold together with his relatives at least two per cent or more of the voting power of the company; or*
 4. *is a chief executive or director by whatever name called of any non-profit organization that receives 25 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, then also he is not eligible for the office of independent directors; or*
- ◆ *who possesses such other qualifications as prescribed in Rule 5 as an independent director shall possess appropriate skills, knowledge and experience in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other discipline related to the company's business.*

It can be said by looking at the above definition that lots of care has been taken off to curb the chances of possible financial gain either directly or indirectly by an independent director.

**Declaration by Independent Director [Sec. 149(7)]:**

In order to meet the criteria of independence, every independent director, as per section 149(7) of the Act, has to submit declarations on the three occasions which are as follows:

- A. When he/she attends the first board meeting as an independent director.
- B. In every first board meeting of each financial year.
- C. In case of any change in the circumstances that directly or indirectly affect the status of independent director.

Remuneration of an Independent Director [Section 149(9)]:

In order to protect the conflict of interest, Section 149(9) of the Act has provision of complete restriction on the fixed remuneration of any independent director of the company. It means he is not entitled to receive any fixed salary or any stock option like others. He is only entitled to receive a sitting fee, reimbursement of any expenses incurred for attending any board meeting and profit related commission.

Term of an Independent Director [Section 149(10) & (11)]:

As per the provisions of this act, independent directors shall hold office for a period of five years; after that he/she may be reappointed for another period of five years. Meaning hereby, an independent director can only be appointed for maximum two consecutive terms. If a company wants to further appoint the same person as an independent director after the expiration of two consecutive terms, then the rule of cooling period has to be followed. The same person can only be appointed after the expiry of three years provided, he/she has not been directly or indirectly associated with the company or its holdings or any of its subsidiary or associate company during the cooling period.

Obligation of an Independent Director as Per SEBI:

- ◆ There is a strict prohibition on serving more than seven listed entities as an independent director; and if a person is serving as a whole-time director in any listed company, he/she can serve as an independent director for more than three listed entities.
- ◆ Holding at least one meeting in the absence of non-independent directors and members of management in a year is mandatory.



- ◆ The liability of an independent director is limited only to the subject of matters or act(s) that are in his/her direct knowledge or where he/she acted negligently. If a company acted either without taking his/her consent or the matter brought under his consideration and he/she denied, under such circumstances the independent director shall not be held liable section 149(12).

Retirement by Rotation: Independent Directors are not liable to retire by rotation.

Small Shareholders' Director [Section 151]:

In section 151 of the Act, Small Shareholders has been defined as “a shareholder holding shares of nominal value of not more than Rs. 20000 or such other sum as may be prescribed”. Out of the prescribed limited number of directors in a listed entity, one director representing the interests of small shareholders may be appointed. Such a Small Shareholders' Director (SSD) is elected by the small shareholders consisting of both equity and preference. With reference to the appointment of SSD, there are two situations, as notified by Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014, as follows—

- (i) Either *suo motu*; or
- (ii) Upon the application proposing the name of SSD submitted in writing either by one tenth of the total small shareholders or by 1000 small shareholders, whichever is lower.

Note: Such an application must be submitted at least 14 days before the meeting.

The tenure of such SSD is for the prescribed period of three years and acts like others except in the matter of appointment of whole-time director and managing of the company. Once a person is appointed as SSD, there is a strict prohibition for holding such a position simultaneously in more than two companies.

Appointment of Directors by Board:

The following types of Directors may be appointed by the Board of Directors by resolution.

The Casual Vacancies:

As per section 161(4) laid down the provisions for the appointment of casual vacancies by the Board subject to the regulation of Article of



company. Thus, where the existing director's office falls vacant before the expiry of fixed tenure like in case of death or resignation etc. of any existing director, the board may fill such casual vacancies through resolution. The tenure of such a director is till the term of the original director.

Additional Director [Section 161(1)]:

Section 161(1) of the Act provides the provision for the appointment of additional director. Additional directors are appointed by the board only if articles of the company empower them to do so. Further, articles allow the board only when the maximum number of directors fixed by the article does not exceed. Thus, when the strength of the directors falls below the prescribed limits, the board can appoint the additional director subject to the following conditions—

- (i) Person does not fail to get appointed as a director in a general meeting.
- (ii) The additional director shall hold the office till the next annual general meetings or the last date of scheduled annual general meetings (AGM), whichever is earlier.
- (iii) In case AGM fails to be held on the scheduled date, then the additional director has to vacate the office on the date on which AGM ought to happen.

Note: Section 161(1) of the Act applies to all companies irrespective of private or public.

Alternate Director [Section 161(2)]:

Alternate Director is appointed in the absence of the original director. The original director should be absent for more than three months from India. Section 161(2) provides the power to board (keeping in mind the provision of the article of the company) to appoint the alternate director. The tenure of such director depends on the expiry of the term of the original director or the return of the original director to India. A person holding alternate directorship in any other company or directorship in the same company shall cease to be appointed as the alternate director. However, in case of appointment of alternate director in absence of independent director the proposed person must qualify to be appointed as independent director in accordance with section 149(6) of the Companies Act, 2013.



Appointment of Director by Third Parties

The provision for the appointment of a third-party director is only and only subject to the approval of the Article of Association of the Company. The Article of a company may authorize the debenture holders and special creditors for appointing non-rotational director in the board of the company. Such directors are appointed to take care of the interest of third party.

1.9 Director Identification Number (DIN)

As per section 153 of the Companies Act, an individual who wishes to be appointed as director of any company must have to obtain DIN by electronically applying Form DIR 3 to the Central Government. MCA 21 portal facilitates the submission of such applications. The Central Government has to make the allotment of DIN within one month from the date of submission of application [Section 154].

◆ Prohibition on More Than One DIN [Section 155]

As per section 155 of the Act, a person cannot hold more than one DIR. Once a DIR is allotted to a person, he/she cannot seek for the allotment of another number.

◆ Director to Inform DIN [Section 156]

Section 156 of the Act mandates that every existing director has to inform his/her DIN to all the companies where he/she is acting as director within one month from the date of receipt of DIN from the Central Government.

◆ Company to Inform DIN to ROC [Section 157]

After receiving the information of DIN, the company has to submit the detail of DIN to ROC or authorized office by Central Government in e-form DIR 3C within in 15 days after intimation of DIN by directors. The e-form has to be digitally signed either by company secretary of the company or by company secretary in practice. If company fails to do so, there is provision of punishment in section 157(1) which mandates that company has to pay a fine of not less than Rs. 25000 it may extend to Rs. 100,000. There is also a provision for same amount of fine for officers directly concerned for such fault in the company.



1.10 Disqualification for Appointment of Director

Section 164 of the Act provides detailed conditions for the appointment of a person as a legitimate director of any company. As per section 164(1), the person having any of the following conditions shall not be eligible for the same—

- ◆ He/she is lunatic as approved by any competent court.
- ◆ He/she is undischarged insolvent.
- ◆ He/she has applied to be adjudicated as an insolvent and his application is pending.
- ◆ He/she has been convicted by a court of justice for any offences and imprisonment for a minimum period of six months. This does not stand alone. There is another provision in the Act which says that the period of five years has not elapsed from the expiry of sentence. In other words, any person shall be eligible for appointment only after five years from the expiry of imprisonment. Provided further if he/she has been convicted for any offences and sentenced for imprisonment for a period of seven years or more, in that particular situation he/she ceased to be appointed as director.
- ◆ He/she has been disqualified by court or tribunal and the order is still in practice.
- ◆ He/she is unable to pay his/her due share call money even after the six months of the last date for the payment of such call money.
- ◆ He/she found guilty by court of justice in case of related party transactions during the last preceding five years.
- ◆ He/she has not complied with any of the provisions of section 152(3) of Act that deals with DIN.
- ◆ He/she has been the director of such company that (i) has not submitted its financial statement or annual returns consecutively in the last three years; (ii) has not repaid the due deposit or failed to redeem debentures amount or has failed to pay interest on deposits, debentures, or dividend for one or more years section 164(2).



1.11 Removal of Directors

The new Companies Act, 2013 clearly explains the procedure for the removal of directors from the company. In this reference the Act highlights two ways for doing so. One through the owners of the company that is, shareholders and another one through the regulators that is, Tribunal.

Removal by Shareholders [Section 169]:

Section 169 of the Act empowers the shareholders who are the actual owners of the company to remove any director before the expiry of his/her term from the office of the director of the company. Thus, the act clearly says that after serving a special notice of at least 14 days and passing the ordinary resolution a director can be removed from the office. Shareholders must give a special notice clearly stating the intention of removal of the director at least 14 days before the meeting. There is also a provision of right to be heard on the ground of equality and justice. Therefore, the special notice is sent to the concerned director who has the right to be heard against resolution in the general meeting of the company. Thus, if the concerned director sends any of his representation and request the company for circulating to the members, the company has to do so.

However, there are certain exceptions to section 169 under which shareholders cannot remove the directors which are as follows:

- ◆ A director appointed by Tribunal under section 242.
- ◆ A director appointed under the principle of proportional representation under section 163.

Removal by Tribunal [Section 242]:

Under section 242 of the Act, the regulator's court of justice i.e., Tribunal has also power to remove a director on the ground of his mismanagement or misconduct or behave against the ethical standard of the company. If a Tribunal removes a person, he/she cannot be reappointed at any managerial position for the period of five years.



1.12 Powers of Directors

Article of the company empower the directors to act in the best interest of the company. As per section 179(1) the directors are empowered to do all those activities which the company authorizes them to do. If directors are working within the scope of authorized power, the shareholders can not interfere and control in their ways of doing and performing activities. There are certain exceptions to this provision. In the following cases shareholders can interfere and exercise their power in general meeting:

- ◆ *Mala fide* interest when directors act not for the interest of the company rather than for their own interest.
- ◆ Incompetency of Board - when board is incompetent to Act.
- ◆ Deadlock when directors are either unable or unwilling to Act.

Statutory Powers of Directors:

Section 179(3) of Act, the following powers have been conferred to the directors subject to the provisions of Article of the company:

- ◆ The power to make calls.
- ◆ The power to issue shares or debentures.
- ◆ The power to borrow money.
- ◆ The power to invest in the fund of the company.
- ◆ The power to approve financial statements and the Board of Directors Report.
- ◆ The power to diversify the business of the company.
- ◆ The power to approve amalgamation, merger or reconstruction of the company.
- ◆ The power to take over a company or acquire the controlling power or substantial stake in another company.

Note: All the above stated power of directors can only be exercised by the resolution passed in the board meetings. Circulation issued on any of the abovementioned activities are not subject to the provision of legal status.

Apart from the statutory powers given in section 179(3) of the Act, some other powers given in other sections of the Act are also the subject of



discussion. The list of some other important powers of directors are given below—

- ◆ The power to approve corporate social responsibility policy of the company (Sec. 135).
- ◆ The power to fill casual vacancies and appoint additional director, alternate director of the company (Sec. 161).
- ◆ The power to make contribution to political party (Sec. 182).
- ◆ The power to recommend the rate of dividend in the general meeting subject to be approved by shareholders of the company.
- ◆ The power to make a ‘declaration of solvency’ (Sec. 305).
- ◆ The power to fill the vacancy in the office of key managerial personnel [Sec. 203(4)].

Restrictions on the Powers of Directors [Section 180]:

Section 180 of the Act deals with restriction on the power of directors. There are certain activities that are beyond the statutory purview of the Board of Directors be it public or private company. Thus, in the following conditions the board of directors cannot take decision without taking shareholders’ consent by a special resolution—

- ◆ To sell, lease or dispose whole or substantially whole of the undertaking of the company.

Here exclusively two jargons have been used *i.e.*, “undertaking” and “substantially the whole of the undertaking”. The meaning of the term Undertaking here is- investment in a company more than 20 per cent of its net worth or a company that generates 20 per cent of its total income of the company during the previous financial year. The meaning of the term substantially the whole of the undertaking here is 20 per cent or more than that of the value of the undertaking as per previous year balance sheet.

- ◆ To make investment in securities from the funds generated through any merger or amalgamation. This is not applicable in case of investment in trust securities.
- ◆ If the board wants to borrow money more than the sum of paid up capital and free reserves of the company.
- ◆ To give some extra time for the repayment of any due from directors.



1.13 Duties of Directors

For the first time, the duties of directors have been categorically mentioned in Companies Act, 2013 under section 166. There was no such statutory provision in the previous company law. Therefore, as per the new law, there are some following duties of the directors—

- ◆ Duty to Act as per the articles of association of the company.
- ◆ Duty to Act in good faith.
- ◆ They should exercise their duties with full competency and with the extra care for the present and future betterment of the company.
- ◆ They should prohibit the conflict of interest.
- ◆ Their judgment should not be biased and must not be influenced with any personal gains at the cost of the company.
- ◆ Not to make any undue advantage.

1.14 Key Managerial Personnel

The Companies Act, 2013 has introduced the concept of Key Managerial Personnel. It defines the executive management as the one who takes care of day-to-day management and operation of the company. Key Managerial Personnel (KMP) is the first contact between company and shareholders. It is the KMP who actually implements the strategies and policies designed by the Board of Directors.

Section 2(51) defines KMP with respect to the Company as—

- ◆ The chief executive officer or the managing director or the manager.
- ◆ The company secretary.
- ◆ The whole-time director.
- ◆ The chief financial officer.
- ◆ Such other officers, not more than one level below the directors, who are in whole-time employment, designated as key managerial personnel by the Board.
- ◆ Such officers may be prescribed.



Managing Director

Section 2(54) of the Act defines a managing director (MD) as “a director who by virtue of the articles of a company or an agreement with the company or of a resolution passed by the company in general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the positions of a managing director, by whatever name called”. MD must be a director of a company and have substantial power either by an agreement or by articles or by board resolution or by general body resolution. The substantial Act of power does not include routine acts related to administration like, sign on share certificate, affix seal of company, draw any negotiable instrument etc. MD works under the control and supervision of the Board.

Manager

In the ongoing context the term manager is used as synonymous with the chief executive officer of the company appointed as general manager. But it does not mean the terms like factory manager, work manager, sales manager etc. too issued interchangeable to Manager.

Section 2(53) defines manager as “an individual who, subject to superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not”.

Thus, it appears from the above definition that, both the term manager and managing director have similar functions. But it is important to note that the whole power of the management is not enjoyed by MD. He has only substantial power of management.

Whole Time Director (WTD)

Section 2(94) of the Act defines the term whole time director as “a director who is in the whole-time employment of a company”.

Appointment of Managing Director, Whole time Director or Manager-Section 196

Section 196 of the Companies Act, 2013, deals with the certain restriction on the appointment of some of the key managerial personnel like MD, Manager and WTD, which are discussed below:



- ◆ A managing director and a manager cannot be appointed simultaneously.
- ◆ The maximum tenure for a manager, MD, and WTD can be for five years. As far as the provision of reappointment is concerned, they can be reappointed only in the last year of their present term.
- ◆ Under the following condition, no company can appoint or reappoint any individual as MD, Manager and WTD who—
 - (i) Is below the age of 21 years and has attained the age of 70 years. In case of an individual having the age of 70 years, and company want to appoint him then in that case, there is provision of appointment by a special resolution of shareholders.
 - (ii) Is an undischarged insolvent.
 - (iii) Has suspended due to the non-payment of creditors at any time.
 - (iv) Has been convicted by court of justice in any of the offences and sentenced to imprisonment for not less than 6 months.
- ◆ If the appointment of such individuals has been rejected by shareholders in general meetings.

IN-TEXT QUESTIONS

7. A person cannot become director until he does not acquire _____.
8. Resignation takes effect from the date on which the _____ is received by the company.
9. When the directors are unable or not willing to act called _____.
10. Academic qualification does not mention in the law about appointment of director. (True/False)
11. Director must not delegate any of the powers to some other person. (True/False)
12. Unanimous consent of shareholders is required where assets of the company's sale. (True/False)
13. Director cannot be removed from his positions before expiry of the tenure. (True/False)



14. Whole Time Director is just like simple employee. (True/False)
15. M. D has more substantial powers than manager. (True/False)

1.15 Summary

Since a company is an artificial person, it cannot act on its own. The company requires some persons who can act on its behalf. These persons are the directors of the company appointed in the general meeting. If the company is the body, the directors act as its brain. So as to protect the interests of various stakeholders, certain powers and duties have been given to the top management of the company. It is compulsory for the company to appoint directors for the smooth functioning of the company.

1.16 Answers to In-Text Questions

1. Organ
2. Abides
3. Women
4. Till
5. True
6. False
7. DIN
8. Notice
9. Deadlock
10. True
11. True
12. True
13. False
14. True
15. True



1.17 Self-Assessment Questions

1. Define the term director. Explain his legal position in company.
2. State the qualification and disqualification of director for appointment.
3. Can the directors of a company be removed during the terms of office?
4. What are the powers which the board of directors cannot exercise without unanimous consent?
5. How may the small shareholders appoint the director in company?
6. (A) Distinguish between a Managing Director and a Whole Time Director. Is there any significance difference in their powers?
(B) Distinguish between a Managing Director and a Manager.
7. A director can always be held liable for breach of his fiduciary duties. Explain with examples.
8. Only members can be appointed directors of a company. Comment.

1.18 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N.D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M.C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S.N., & Maheshwari, S.K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Meetings

Author: Dr. R C Garg

Revised by: Ms. Swati Khanna

STRUCTURE

- 2.1 *Learning Objectives*
- 2.2 *Introduction*
- 2.3 *Kinds of Meeting*
- 2.4 *Board Meetings*
- 2.5 *Annual General Meetings*
- 2.6 *Extraordinary General Meeting*
- 2.7 *Class Meetings*
- 2.8 *Requisites of a Valid Meeting*
- 2.9 *Voting and Poll*
- 2.10 *Resolutions*
- 2.11 *Postal Ballot*
- 2.12 *E-Voting*
- 2.13 *Summary*
- 2.14 *Answers to In-Text Questions*
- 2.15 *Self-Assessment Questions*
- 2.16 *Suggested Readings*

2.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Define the concept of meeting and describe different kinds of meetings.
- ◆ Discuss the statutory provisions relating to various types of meeting of shareholders.



- ◆ Give details about the requisites of a valid meeting.
- ◆ Explain the provisions for voting and poll, proxies and resolutions.

2.2 Introduction

The company is described as an artificial person that is created by law which has its own separate identity distinct from its members. Since it is an artificial person; it cannot make decisions by itself. Decisions for company matters are taken through resolutions that are passed in properly constituted and convened meetings of shareholders/ directors. Decisions relating to the company's management are taken by the directors in their meetings and these decisions are to be ratified in the general meetings of the company by the shareholders.

An old proverb "Two heads are always better than one" explains that whenever two or more people come along to discuss matters of common interest, a meeting takes place between them. From this, it can be understood that to constitute a meeting there must be two or more persons. In general, conducting a meeting involves consideration of issues that are of common interests to its attendants.

2.3 Kinds of Meeting

The meetings of a company are of three kinds:

1. Meetings of the Directors.
2. Meetings of the Shareholders:
 - (i) Annual General Meeting
 - (ii) Extraordinary General Meeting
 - (iii) Class meetings
3. Meetings of the Creditors.

2.4 Board Meetings

Section 173 of the Companies Act provides that every company within thirty days of its incorporation must conduct the first meeting of its Board of Directors. For every company, a meeting of its Board of directors shall



be held at least once in every three months and a minimum of four such meetings must be held every year:

(i) Notice of Board Meetings

For every meeting of the Board of directors, a notice of not less than seven days shall be given in writing to every director for the time being in India and to every other director in India at the address registered with the company.

Every officer of the company whose duty it is to give notice as stated above and who fails to do so shall be punishable with fine which may extend to fine of twenty-five thousand rupees.

(ii) Quorum for Board Meetings

For meeting of the Board of directors, quorum shall be one-third of its total strength or two Directors, whichever is higher. For the purpose of total strength, any fraction contained in one-third being shall be rounded off as one.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength, the number of the remaining directors (directors who are not interested) present at the meeting being not less than 2 shall constitute the quorum during such time.

Interested director means any director whose presence cannot, by reason of his being interested in some manner in the subject matter of discussion be counted for the purpose of forming a quorum at a meeting of the Board, at the time of discussion or vote on any matter.

(iii) Procedure when meeting is adjourned 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 next week of same day at same time and same place or if that day is holiday, till the next succeeding day which is not a public holiday, at same place and time.

2.4.1 Meeting Through Video Conferencing

The Companies Act, 1956 gave the flexibility to the Board to pass the required resolutions either through board meetings or through circular



resolutions in case of emergency. But passing a circular resolution had its own drawbacks. Circular resolutions cannot be considered as Board meetings *per se* while calculating the number of meetings to be held in a year. Besides certain provisions of the Companies Act, 1956 insist that resolutions have to be passed in a duly convened Board Meeting.

In recent times, Information Technology has made it viable to have all kinds of meetings through video conferencing either personal or business. A meeting through video conferencing has shrunk the world and has made it look smaller than ever before. Any person in any part of the world can be approached through click of mouse. Acknowledging and maintaining the pace with new technology, the Ministry of Corporate Affairs under the Companies Act, 1956 incorporated holding of board meetings through video conferencing *vide* its notification bearing No. 28/11 dated 28-5-2011.

Under the Companies Act, 2013, the Government has attempted to bring in more regulations by notifying a set of rules to be observed for conducting board meetings through video conferencing. For the first time, the Government has used words 'Board Meeting through Video Conferencing and other audio visual means' through sections 173 and 174.

Rules 3 and 4 of the Companies (Meetings of Board and its Powers) Rules, 2014 details the rules for conduct of board meetings through video conferencing or other audio-visual means. Following provisions must be complied with before convening meeting through video conferencing:

A. General Rules for conducting Board Meeting through Video Conferencing

Before contemplating to conduct a board meeting through video conferencing, the management should adhere to the following general rules governing the conduct of such meeting:

- (i) The Company should ensure that there is an effective video or audio-visual connection. If the broadband signals are weak, it would result in poor audio and video communication. An agitated board member could even take up the matter to Court and invalidate the poorly recorded meeting.
- (ii) The Chairman/Secretary shall take due and reasonable care –
 - (a) To safeguard the integrity of the meeting by ensuring sufficient security and identification procedures.



Notes

- (b) To ensure availability of proper video conferencing or other audio-visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorized participants at the Board meeting.
- (c) To record proceedings and prepare the minutes of the meeting.
- (d) To store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year. The recorded proceedings could be erased once the audit for the particular financial year is over.
- (e) To ensure that no person other than the concerned director are attending the meeting or has access to the proceedings of the meeting through video conferencing mode or other audio-visual means.
- (f) To ensure that participants attending the meeting through audio visual means are able to hear and see other participants clearly during the course of the meeting.
- (g) The notice of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.
- (h) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio-visual means and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio-visual means.
- (i) The director intending to participate through video conferencing or other audio-visual means shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangements on this behalf.
- (j) The scheduled venue of the Board meeting should be in a place situated in India and all recordings of the proceedings at the meeting shall be deemed to have been made only in that place mentioned in the notice.



- (k) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode, if they have given their consent to this effect and it is so recorded in the minutes of the meeting.
- (l) From the commencement of the meeting and until the conclusion of such meeting, no person other than the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.
- (m) “Video conferencing or other audio-visual means” has been explained as Audio- Visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

B. Specific Rules for Individual Directors who intend to participate in the Board Meeting through Video Conferencing

- (i) A director intending to participate through video conferencing or audio-visual means shall communicate his intention to the Chairman/ Company Secretary of the Company.
- (ii) If the director intends to participate through video conferencing or other audio-visual means, he shall give prior intimation to that effect sufficiently in advance so that the company is able to make suitable arrangements on this behalf.
- (iii) The director, who desires to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year. (In the absence of any intimation it shall be assumed that the director shall attend the meeting in person).



C. Prohibited Matters in a Board Meeting conducted Through Video Conferencing:

As per Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014 in a Board Meeting through Video Conferencing or through Audio Visual Means at least for the time being.

Following matters shall not be dealt with in any meeting through video conferencing or audio-visual means:

- ◆ The approval of the annual financial statements.
- ◆ The approval of the Board's report.
- ◆ The approval of the prospectus.
- ◆ The Audit Committee Meetings for consideration of accounts; and
- ◆ The approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

2.4.2 Rules to be Observed while Conducting the Proceedings of the Board Meeting

- (i) A roll call should be taken at the commencement of the meeting by the Chairperson/Secretary of the company. A roll call involves calling out the name of each director, the location from where he is participating, confirming whether he has received the agenda and concerned relevant material for the meeting and also confirming that no one other than the director participating himself is having access to the meeting's proceedings at the location where he is presently attending.
- (ii) The Chairperson/Secretary shall then read out the names of persons (other than the directors who are present at the meeting) to assist/guide/witness the proceedings of the meeting of the Board. (A non-director could attend at the request/permission of the Chairperson)
- (iii) The Chairperson/Secretary shall confirm that the required quorum is present throughout the meeting. (The rule says that a director participating either in person or through video conferencing or other audio-visual means shall be counted for the purpose of quorum. However, none of the directors either present personally or through



video conferencing or other audio-visual means shall be counted for the purpose of quorum for such an item of business where his name should be excluded for the purpose of quorum under any of the provisions of the Act or the rules). This is in line with Section 300 of the Old Companies Act, 1956 maintaining disinterested quorum.

- (iv) Each item of business should be taken up one by one as per the agenda specified in the notice.
- (v) Every participant shall identify himself for the record before speaking on each item of business on the agenda.
- (vi) If a statement of a director in the meeting is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration by the director.
- (vii) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll that which means he shall first announce that he shall be doing the roll call and call out the name of each director who shall identify himself while casting his vote and the Chairperson shall then note the vote of each director.
- (viii) The Chairperson shall then announce the summary of the decision taken on such an item along with names of the directors, if any, who dissented from the decision taken by majority.

2.4.3 Rules to be Observed after the Conclusion of the Meeting in Context of Minutes of the Meeting

- (i) After completion of the meeting, the minutes shall be entered in the minute book as specified under Section 118 of the Act and signed by the Chairperson.
- (ii) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio-visual means.
- (iii) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode, which includes fax or email, as may be decided by the Board.



- (iv) Every director who attended the meeting, whether personally or through video conferencing or other audio-visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which, his approval shall be presumed.
- (v) Finally, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

2.4.4 Circular Resolutions

A. Section 175 lays down the following criteria for passing resolution by circulation:

- (i) The draft resolution should be circulated to all the Directors or the members of the committee together with the necessary papers if any for their perusal. The said documents could be sent to the local Indian address registered with the company and the same could be either hand delivered or sent by post or by courier.
- (ii) The said documents could be sent through any electronic mode as prescribed by the Government.
- (iii) The circular resolution should be approved by the majority of the Directors or the members who are entitled to vote at the resolution.
- (iv) The circular resolution should be noted by the Board in the subsequent board meeting or by the members in the subsequent committee meeting thereof and it shall be made as part of the minutes of that meeting.

B. Circular resolution shall not be passed under the following circumstances:

- (i) Specific items and general business items as described by the Act state that certain matters shall be dealt with only in a duly convened board meeting.
- (ii) One third of the total number of directors could insist that an intended circular resolution should be dealt only in a duly convened board meeting.

**IN-TEXT QUESTIONS**

1. A meeting is a gathering or assembly of a _____ for transacting any lawful business. But every gathering of persons does not constitute a meeting.
2. A meeting would be valid if it is held by following the prescribed _____.
3. _____ of the members of the company and the purpose of this meeting is to provide an opportunity to the members of the company express their views on the management of company's affairs.
4. Any meeting other than the statutory and the annual general meeting of the company is known as _____ class meeting is the meeting of a particular class of shareholders.

2.5 Annual General Meetings

Every company in addition to any other meeting a general meeting shall hold its annual general meeting each year and specify the meeting as such in the notices calling it [Section 96(1)]. Holding of an annual general meeting in every calendar year (to be calculated from January 1 to December 31 and not twelve months from the date of incorporation of the company) is a statutory necessity.

A. First Annual General Meeting

A company must hold its first annual general meeting within a period of not more than 18 months from the date of its incorporation. If such a general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year [Section 96(1)]. For example, a company was incorporated in October 1994. Its first annual general meeting is required to be held within 18 months from the incorporation, *i.e.*, up to March 1996 and if such a meeting is held within this period, no other meeting will be necessary either for 1995 or 1996.



B. Subsequent Annual General Meeting

As stated, a company is compulsorily required to hold an annual general meeting every year. Where a meeting called and held on a day in one year is adjourned to a date in the next year and held on that date, the meeting held on the latter date is not a different meeting and does not comply with the requirements of Section 166. The gap between one annual general meeting and the next should not be more than fifteen months.

In case of **Shree Meenakshi Mills Company Limited vs. Assistant Registrar of Joint Stock Companies, Medural [AIR 1938 Mad. 640]**, the annual general meeting of a company called in December 1934 was adjourned and held in March 1935. The next annual general meeting was held on January 9, 1936, and no other meeting was held in 1935. The company was prosecuted for failure to call the annual general meeting in 1935. It was held that there should be one meeting per year and as many meetings as there are years.

For any special reason however, the Registrar can extend the time within which any annual general meeting is required to be held by a period not exceeding 3 months but the time for holding the first annual general meeting cannot be so extended.

Power to convene an Annual General Meeting

Board of Directors is the proper authority to convene an annual general meeting, and if in case the managing director, manager, secretary or other officer calls a meeting without such authority, it will not be effective unless the Board ratifies the act before the meeting is held.

Notice

A public company is required to give at least 21 clear days' notice for convening any general meeting including annual general meeting. However, if it is agreed by all the members entitled to vote in the meeting (Section 101), the annual general meeting may be called after giving a shorter notice than 21 days. In calculation of these 21 days, the date on which the notice is issued, and the day of the meeting are excluded.

Date, time and place of holding the annual general meeting

Every annual general meeting shall be called at any time during the business hours (*i.e.*, between 9 am to 6 pm) on a day that is not a national



holiday. It 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]. The Central Government may exempt any company from this provision.

Adjournment

Where an annual general meeting is held but adjourned, the adjourned meeting is nothing but continuance of the earlier meeting and therefore if in the adjourned meeting the Balance Sheet and the Profit and Loss Account of the company are laid and adopted and thereafter sent to the Registrar is not violated.

Holding of Annual General Meeting when Annual Accounts are not Ready

According to Central Government instructions, in case the annual accounts are not ready for laying at the appropriate annual general meeting, the company must hold the annual general meeting within the time limit, transact all business other than the consideration of the accounts, announce when the accounts are expected to be ready for laying and pass a suitable resolution adjourning the said annual general meeting to a specific date or to a date to be specified later on. Thus, the company cannot take the plea that the annual general meeting was not held because the accounts were not ready.

Power of Tribunal to Call Annual General Meeting

The Tribunal may, on the application of any member of the company, call or direct the calling of a general meeting of the company. However, it is to be noted that the Court has no power to call such a meeting. A general meeting held in pursuance of this order will be deemed to be an annual general meeting of the company.

The Tribunal may direct that only one member of the company presents in person or by proxy shall be deemed to constitute a meeting. [Section 97]

Penalty

Section 99 provides that if a default is made in holding an annual general meeting in accordance with the above provisions or in complying with the directions given by the Central Government, 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 case of continuing default, with a further fine which may extend to five thousand rupees for every day during which the default continues.

Importance

It is the annual general meeting in which the shareholders can exercise control over affairs of the company. The business transacted at the annual general meeting could be ordinary business or special business. Usually following ordinary business transactions are discussed in the annual general meeting:

1. Consideration of the accounts and balance sheet; reports of auditors and directors.
2. Declaration of dividend.
3. Appointment of directors in place of those retiring; and
4. Appointment of auditors and fixation of their remuneration.

At this meeting the shareholders can discuss any other matter relating to the company's business. Such a business would be considered a special business.

IN-TEXT QUESTIONS

5. Extraordinary meeting held to discuss _____ business.
6. In addition to AGM and EGM one meeting is convene in the company called _____ meeting.
7. Minimum presence of number of members called _____.
8. One person shall constitute the quorum if it is called by _____ for the welfare of company.
9. Proxy does not have right to _____ in the meeting.
10. Shareholders need not _____ for e-voting.

2.6 Extraordinary General Meeting

Any general meeting other than annual general meetings shall be called an extraordinary general meeting. An extraordinary general meeting is called to consider those transactions or business which cannot be postponed till the next annual general meeting. Hence it is generally held between two



consecutive annual general meetings to transact some urgent or special business. As per Section 100, an extraordinary general meeting may be convened by:

- (i) The Board of Directors on its own
- (ii) The Board on requisition
- (iii) The requisitionists themselves
- (iv) The Tribunal

(i) Extraordinary meeting convened by the Board on its own

Section 100 provides that the board may, whenever it thinks fit, call an extraordinary general meeting. An extraordinary general meeting may be convened by the Board of Directors if some business of special importance requires the approval of the members and which in the opinion of the Board of Directors cannot be postponed till the next annual general meeting. The directors can call an extraordinary general meeting by passing a resolution in a properly convened board meeting or by a circular resolution.

Extraordinary meeting convened by the Board at the requisition

The directors are bound to call an extraordinary general meeting of the company if the requisition is made by a specified number of members. The specified number of requisitions is:

- (a) in the case of a company having a share capital, by the holders of at least one-tenth paid up share capital carrying the right to vote on the matter of requisition; or
- (b) in the case of a company not having a share capital, by members representing not less than one-tenth of the total voting power in regard to the matter of requisition.

It is a legal obligation for the Board to proceed within 21 days of the receipt of the requisition to call a meeting. The meeting shall be held within 45 days of such receipt of the requisition with the company (Rule 17(1) of the Companies (Management and Administration) Rules, 2014. On receipt of the requisition, the Board shall send out notices for the meeting giving not less than 21 days' time.

**(ii) Extraordinary meeting convened by the requisitionists themselves**

If the Board does not call the meeting within 45 days of the receipt of the requisition, the requisitionists may call the extraordinary general meeting, within a period of three months from the date of receipt, *i.e.*, date of deposit of the requisition.

(iii) Extraordinary meeting convened by the Tribunal

As per Section 98, the Tribunal may, either on its own motion (*suo moto*) or on the application of any director or member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the Tribunal may think fit. The tribunal may give such consequential directions which it thinks expedient, including direction that one member present in person or proxy shall be deemed to constitute a meeting.

The power to call EGM by tribunal can be exercised only if it is impracticable for the company to call the same. Section 99 provides that if provisions of section 98 are not complied with, then the company and every officer in default shall be liable to fine upto Rs. 1 lakh and in case of continuing default with a further fine of Rs. 5000 per day of default.

2.7 Class Meetings

Class meetings are the meetings of the shareholders and the creditors. Class meetings are held to pass resolutions which will bind only the members of the particular class concerned. According to section 48 if the rights attached to any class of shares are to be varied, it can be done with the consent of the holders of 3/4 of the issued shares of that class in a separate meeting of that class of holders. Similarly, where a scheme of arrangement or compromise is proposed, the meetings of several classes of shareholders and creditors are required to be held. Class meetings can only be attended by the members of that class. Whenever it is necessary to alter or change the rights or privileges of a class as provided by the Articles, a class meeting must be called.



2.8 Requisites of a Valid Meeting

A meeting to be in order must fulfil certain requirements:

1. Proper Authority

The Board of Directors is the proper authority to convene a general meeting of a company and for this purpose the board should pass a resolution at a duly convened meeting of the board. However, if the board fails to call a general meeting of the company, the requisitionists or the Tribunal may call a general meeting.

2. Notice of Meetings (Section 101 and Section 102)

A proper notice of the meetings must be given to:

- (i) every member of the company, legal representative of any deceased member or assignee of an insolvent member;
- (ii) the auditor or auditors of the company; and
- (iii) every director of the company.

The notice must be given 21 clear days before the date of the meeting. The period of 21 days excludes the day of service of the notice and also the day on which the meeting is to be held.

A general meeting may be called after giving a shorter notice if consent is given in writing or by electronic mode by members not less than 95% of the entitled to vote at such meeting.

3. Contents of Notice

Every notice of a meeting is required to specify the place and the day and hours of the meeting and must contain a statement of the business to be transacted at the meeting. If the time of holding the meeting and other essential particulars is not specified in the notice, the meeting will be invalid, and all resolutions passed at the meeting will have no effect.

The notice of general meeting must contain a statement of the business to be transacted at the general meeting of the company. The business to be transacted at a meeting may be general business or special business (Section 102).

General business includes:

- (i) Consideration of financial statements and reports of the Board of Directors and auditors



- (ii) Declaration of dividend
- (iii) Appointment of directors in place of retiring ones
- (iv) Appointment and fixation of the remuneration of the auditors

Special business means any other business except those specified in the annual general meeting. All businesses at an extraordinary general meeting are called special business.

4. Quorum

Quorum refers to the minimum number of members who must be present at a meeting in order to constitute a valid meeting. A meeting without the minimum quorum is invalid and decisions taken at such a meeting are not binding. The articles of a company may provide for a quorum without which a meeting will be construed to be invalid. Unless the articles of a company provide for a larger quorum, 5 members personally present (not by proxy) in the case of a public company and 2 members personally present (not by proxy) in the case of a private company shall constitute the quorum for a general meeting of a company. But now according to the Companies Act, 2013, Section 103(1) quorum has changed according to the number of members as on the date of the general meeting.

(A) In case of public company:

- (a) If the members are less than 1000; 5 members shall constitute the quorum
- (b) If the members are more than 1000; 15 members shall constitute the quorum
- (c) If the members are more than 5,000; 30 members shall constitute the quorum

In the case of a private company, two members present personally shall constitute the quorum for the meeting of the company.

It has been held by Courts that unless the articles otherwise provide, a quorum need to be present only when the meeting commenced, and it was immaterial that there was no quorum at the time when the vote was taken. Further, unless the articles otherwise provide, if within half an hour from the time appointed for holding a meeting of the company, a quorum is not present in the person, the meeting:

- ◆ If called upon, the requisition of members shall stand dissolved.



- ◆ In any other case, it shall stand adjourned to the same day in the next week, at the same time and place, or to such other day and time as the Board of Directors may determine.

If at the adjourned meeting also, the quorum is not present within half an hour from the time appointed for holding the meeting, the members present shall have a quorum.

In case the Company Law Board calls or directs the calling of a meeting of the company, when default is made in holding an annual general meeting, the government may give directions regarding the quorum including a direction that even one member of the company present in person, or by proxy shall be deemed to constitute a meeting. Similarly, the Company Law Board may direct a meeting of the company (other than an annual general meeting) to be called and held where for any reason it is impracticable to call a meeting and direct that even one member present in person or by proxy shall be deemed to constitute a meeting.

5. Chairman of a Meeting

Before a meeting of a company can start its business, it is required to have a chairman who can preside over the meeting of the company. He/she conducts the meeting; maintains the order; puts up the resolution, counts the votes and declares the result. Usually, the articles provide for the appointment of a Chairman but if there is no provision in the articles to this effect, the members present in the meeting shall elect one of themselves to be the Chairman of such meeting by show of hands [Section 104]. If a poll is demanded on the election of the Chairman, it shall be taken forthwith and in such a case the Chairman elected by show of hands will exercise all the powers of the Chairman of the meeting. He can adjourn the meeting in the event of disorder, but he should do so only as a last resort, if his attempts to restore order have failed.

Duties of the Chairman

- (a) He must take care that the minority is not oppressed in any way.
- (b) He must give the members who are present a reasonable opportunity to discuss any proposed resolution and it must be ensured that all views are adequately aired. But at the expiry of a reasonable time, if he thinks fit, he should stop the discussion on any resolution.



Notes

- (c) He must see that the meeting is properly convened and constituted *i.e.*, proper notice was given to every person who is entitled to attend the meeting and his own appointment is in order. Chairman should ensure that quorum is present before proceeding with the business.
- (d) The Chairman must conduct the proceedings in accordance with the provisions of the Act, the company's Articles of Association or Table A or in the absence thereof, the common law relating to the meetings.
- (e) He should adjourn the meeting when it is impossible, by reason of disorder or other any similar cause, to conduct the meeting and complete its business. He must not use this power in a *mala fide* manner.
- (f) He must take care that the opinion of the meeting is properly ascertained with regard to the questions before it. He must do so by putting the resolution in a proper form before the members and then declaring the result.
- (g) He must keep order in the meeting. He must decide all questions which arise at the meeting, and which require decision at the time.
- (h) He should exercise his casting vote, if any, provided by the articles for the benefit of the company.
- (i) The minutes of the meeting should be properly recorded and signed by the chairman.

6. Minutes of the Meeting

Every company must keep a record of all proceedings of every general meeting and of all proceedings of every meeting of its Board of Directors and of every committee of the board.

These records are known as minutes and the books in which these records are written are known as 'minute books'.

Rules of Keeping Minutes (Section 118)

- (i) Within 30 days of every such meeting or passing of resolution by postal ballot, entries of the proceedings must be made in the books kept for that purpose.



- (ii) Each page of a minute book must be initialled or signed by the Chairman of the same meeting or the next succeeding meeting. In the case of minutes of proceedings of a general meeting, each page of the minute book must be initialled or signed by the Chairman of the same meeting.
- (iii) The minutes of each meeting must contain a fair and correct summary of the proceedings at the meeting.
- (iv) All the appointments of officers made at any of the meetings aforesaid must be included in the minutes. In case of a meeting of the Board of Directors or of a committee of the board, the minutes must contain the names of the directors present at the meeting and the names of the directors dissenting from or not concurring in the resolution passed at the meeting.
- (v) The Chairman may exclude from the minutes, matters which are defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of the company.
- (vi) As per Rule 25 the minutes books must be kept at the registered office of the company; and be open during business hours to the inspection of any member without charge subject to reasonable restrictions but at least two hours each day must be allowed for inspection.

Section 119 of the Act provides, in case of default in not furnishing the copy of minutes within specified time, the company shall be fined Rs. 25000 and every officer in default shall be punishable with fine which may extend to Rs. 5000.

Proxy (Section 105)

In case of a company having share capital and in case of any other company, if the articles so authorize, any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person (whether a member or not) as his proxy to attend and vote instead of himself. Every notice calling a meeting of the company must contain a statement that a member entitled to attend, and vote is entitled to appoint one proxy in case of a private company and one or more proxies in case of a public company and that the proxy need not be a member of the company.

**Notes**

A member may appoint another person to attend and vote at a meeting on his behalf. Such other person is known as “Proxy”. A member may appoint one or more proxies to vote in respect of the different shares held by him, or he may appoint one or more proxies in the alternative, so that if the first named proxy fails to vote, the second one may do so, and so on. The member appointing a proxy must deposit with the company a proxy form at least 48 hours before a meeting of the company.

The proxy form must be in writing and be signed by the member or his authorized attorney duly authorized in writing. If the appointer is a company, the proxy form must be under its seal or be signed by an officer or an attorney duly authorized by it.

The proxy can be revoked by the member at any time and is automatically revoked by the death or insolvency of the member. The member may revoke the proxy by voting himself before the proxy has voted, but once the proxy has exercised the vote; the member cannot retract his vote. Where two proxy forms by the same shareholder are lodged in respect of the same votes, the last proxy form will be treated as the correct proxy form.

A proxy is not entitled to vote except on a poll. Thus, a proxy cannot vote on show of hands.

IN-TEXT QUESTIONS

11. How many types of general meetings are held in the company?

- (a) 1
- (b) 2
- (c) 3
- (d) 4

12. Gap between two annual general meetings must be:

- (a) 10 Months
- (b) 12 Months
- (c) 15 Months
- (d) 18 Months



13. Clear notice to call annual general meetings must be:

- (a) 14 Days
- (b) 21 Days
- (c) 30 Days
- (d) 45 Days

14. First annual general meeting must be held in the company within:

- (a) 6 Months
- (b) 9 Months
- (c) 12 Months
- (d) 15 Months

2.9 Voting and Poll

A vote is a formal expression of will of the members of the house either for or against a proposal. The matters proposed and duly recommended in a general meeting of the company are decided by the voting of the members of the company.

The procedure of voting is regulated by the Articles subject to the provisions of the Act. Members holding share capital of the company have the right to vote on every motion placed before the company. However, the members holding preference shares can vote only on those motions which affect the rights attached to their capital. Share warrant holders, executors of a deceased member, receiver of an insolvent member cannot exercise any voting right unless registered as members. The voting rights of an equity shareholder at a poll are in proportion to his share of the paid-up equity capital.

Voting may take place in either of the following two ways:

(i) Voting by Show of Hands

At any general meeting, unless the Articles otherwise provide, a resolution put to the vote is in the first instance decided by a show of hands except when a poll is demanded, or voting is done electronically [Section 107]. While voting by a show of hands, one member has one vote irrespective of the number of shares held by him. Proxies cannot vote except on a poll.



Chairman will count the hands raised and will declare the result accordingly. Chairman's declaration of the result of voting by show of hands is conclusive evidence that is recorded in the minutes book [Section 107].

(ii) Voting by Poll [Section 109]

'Poll' means exercising the voting right as per the number of shares held. The voting rights of a member on a poll shall be in proportion to his share of the paid-up equity capital of the company.

Before or on the declaration of the result of voting on any resolution by a show of hands, the Chairman of the meeting on his own may order or on demand made by a specified number of members shall order for a poll. Specified number of members for this purpose shall include:

- (a) In the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up; and
- (b) In the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power.

The demand for a poll may be withdrawn at any time by the person or persons who made it.

A poll demanded for the adjournment of the meeting or appointment of the Chairman shall be taken forthwith. A poll demanded on any other question shall 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 taken, the meeting will be deemed to continue until the ascertainment of the result of the poll. The Chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken. Where a poll is to be taken, the Chairman of the meeting shall appoint scrutinizer(s) to observe the votes given on the poll and to report thereon to him. Rule 21 of the Companies (Management and Administration) Rules, 2014 provides that the chairman shall ensure that the scrutinizers are provided with specimen signatures of all persons entitled to vote.



2.10 Resolutions

A proposal when passed and accepted by the members becomes a resolution. Such decisions of a meeting take the form of resolutions as they carry the majority of votes. A question on which a vote is proposed to be taken is called a 'motion'. Once a 'motion' has been put to the members and they have opted in its favour, it becomes a resolution. A resolution may, thus, be defined as the formal decision of a meeting on a particular proposal before it.

Types of Resolutions

Resolutions include the following types:

- (i) Ordinary Resolutions;
- (ii) Special Resolutions; and
- (iii) Resolutions requiring special notice.

Ordinary Resolution

At a general meeting of which notice has been duly given as per the provisions of the Act, if votes cast in favour of the resolution by members exceed the votes, if any, cast against the resolution by members, the resolution so passed is known as an ordinary resolution [Section 114]

Unless the Companies Act or the memorandum or the articles expressly require a special resolution or resolution requiring special notice, an ordinary resolution is sufficient to carry out any matter.

Transactions where ordinary resolution is required include:

- (i) Change of name of company pursuant to a direction from Registrar of Companies. [Section 4(5)(ii)(b)(i)].
- (ii) Change the name of a company pursuant to directions of Central Government when identical or too nearly resembling the name of another company or a trademark. [Section 16(1)(a) and (b)].
- (iii) An issue of equity shares with differential rights of companies. [Section 43(a) r/w rule 4(1)(b) of Companies (Share Capital and Debentures) Rules, 2014].
- (iv) Alteration of a capital clause of memorandum in a company limited by shares. [Section 61(1) and Arts. 35, 36 of Table F, Schedule I].



Notes

- (v) An issue of shares to employees under employee stock option scheme (for private companies). [Section 62].
- (vi) An issue of bonus share [Section 63].
- (vii) To invite deposits from its members [Section 73(2)].
- (viii) Transaction of ordinary business at AGM (including a declaration of dividend, appointment of auditors) [Section 102(2)].
- (ix) Appointment of first auditors at EGM when auditor not appointed within 30 days of incorporation [Section 139(6)].
- (x) Ratification of the appointment of auditors to be passed every year during the tenure of the auditors [proviso to Section 139(1)].
- (xi) Approval of auditor appointed by Board following casual vacancy (except companies subject to audit by CAG) [Section 139(8)(i)].
- (xii) Ratification of remuneration of cost auditor appointed by board [Section 148(3) r/w rule 14 of Companies (Audit and Auditors) Rules, 2014].
- (xiii) Appointment of director (except as expressly provided in the Act) in a general meeting [Section 152(2)].
- (xiv) Authorising the Board to appoint an alternate director [Section 161(2)].
- (xv) Removal of the director before the expiry of his office (not applicable to the director appointed by Tribunal) [Section 169(1)].
- (xvi) Permitting contributions to charities and charitable funds where such contributions exceed five per cent of the net profits [Section 181].
- (xvii) Approval of related party transactions in certain cases [Section 188].
- (xviii) Approval of proposal for payment of compensation to a director for loss of office or as consideration for retirement from office or approval for non-case consideration to directors/transferees in relation to an acquisition of assets [Section 191(1)(b)(iv) and section 192].
- (xix) Appointment of MD/WTD/Manager and payment in accordance with Schedule V and section 197 [Section 196(4) and Schedule V].

Special Resolution

The resolution is a special resolution, if—



- (i) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting;
- (ii) the notice required has been duly given of the general meeting; and
- (iii) the votes cast in favour of the resolution by members are three times the number of the votes, if any, cast against the resolution by the members [Section 114].

A copy of the special resolution must be filed with the Registrar within 30 days of its passing.

Special Resolution Matters

In addition to the matters given in the articles of the company, the Companies Act specifies certain matters for which a special resolution must be passed. These comprise:

- (i) Insertion of entrenchment clause in the articles [Section 5(3)].
- (ii) Change in registered office of the Company [Section 12(5)].
- (iii) Alteration of MoA [Section 13(1)].
- (iv) Change in object of a public company which has raised money from the public through prospectus and still has an unutilized amount. [Section 13(8)].
- (v) Alteration of AoA [Section 14].
- (vi) Variation in terms of a contract referred to in the prospectus or objects for which the prospectus was issued [Section 27(1)].
- (vii) Issue of Sweat Equity Shares [Section 54(1)].
- (viii) Reducing Share Capital [Section 66(1)].
- (ix) Purchase of its own shares or other specified securities (buy-back) [Section 68].
- (x) Issue of debentures with an option to convert such debentures into shares [Section 71(1)].
- (xi) Registers of the Company to be kept at a place other than the Registered Office [Section 94(1)].
- (xii) Appointment of more than 15 directors [Section 149(1)].
- (xiii) Removal of auditor appointed u/s 139 before the expiry of his term [Section 140(1)].



(xiv) Winding up by Tribunal [Section 271(1)(b)].

(xv) Removal of names of companies from the Register of Companies [Section 248].

Resolutions Requiring Special Notice (Section 115)

A resolution requiring special notice is not an independent class of resolutions. Resolution requiring special notice may be an ordinary resolution or special resolution. The Companies Act, 2013 has prescribed certain circumstances where such a special notice is required to be given. Apart from that, articles of the company may also provide for resolutions where special notice is compulsory.

In addition to the purposes enumerated in the articles requiring special notice, provisions of the Act provide special notice has to be given for the following matters:

- (i) Passing of resolution for appointing a person other than a retiring auditor or providing expressly that the retiring auditor shall not be reappointed. [Section 140(4)]
- (ii) Passing of resolution to remove a director and to appoint somebody in place of director so removed in the same meeting. [Section 169(2)]

2.11 Postal Ballot

Postal Ballot under Companies Act, 2013

Section 110 of the Companies Act, 2013 and Rule 22 of the Companies (Management and Administration) Rules, 2014 deal with Postal Ballot.

Postal Ballot

A company shall transact the following business only by means of Postal Ballot:

- (i) Alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum. [Section 13]
- (ii) Alteration of articles of association in relation to insertion or removal of provisions which are required to be included in the articles of a company in order to constitute it a private company. [Section 2(68)]



- (iii) Change in place of registered office outside the local limits of any city, town or village. [Section 12(5)]
- (iv) Change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised. [Section 13(8)]
- (v) Issue of shares with differential rights as to voting or dividend or otherwise. [Section 43(a)(ii)]
- (vi) Variation in the rights attached to a class of shares or debentures or other securities. [Section 48]
- (vii) Buy-back of shares by a company. [Section 68(1)]
- (viii) Election of a director. [Section 151]
- (ix) Sale of the whole or substantially the whole of an undertaking of a company. [Section 180(1)(a)]
- (x) Giving loans or extending guarantee or providing security in excess of the limit. [Section 186(3)]

A company may transact any other business by postal ballot instead of transacting at a general meeting except:

- ◆ ordinary business; and
- ◆ any business in respect of which directors or auditors have a right to be heard at any meeting.

If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

Procedure to be followed for conducting Postal Ballot:

- (i) **Notice to Shareholders:** Where a company is required or decides to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons there for and requesting them to send their assent or dissent in writing on a postal ballot as postal ballot means voting by post or through electronic means within a period of 30 days from the date of dispatch of the notice.
- (ii) **Mode of dispatch:** The notice shall be sent either:
 - (a) by Registered Post or speed post, or



- (b) through electronic means like registered email-id, or
 - (c) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.
- (iii) Notice on website:** The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.
- (iv) Appointment of Scrutinizer:** The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board, can conduct the postal ballot voting process in a fair and transparent manner.
- (v) Obligation of Scrutinizer:**
- (a) The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.
 - (b) Postal ballots received back from the shareholders shall be kept in the safe custody of the scrutinizer and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.
 - (c) The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereafter.
 - (d) The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.
 - (e) The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall



return the ballot papers and other related papers or register to the company who shall preserve such ballot papers and other related papers or register safely.

- (f) The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.
- (g) The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.

2.12 E-Voting

Electronic voting (e-voting) is a term encircling several different types of voting, including both electronic means of casting a vote and electronic means of counting votes.

Electronic voting technology comprises punched cards, optical scan voting systems and specialized voting kiosks (including self-contained direct-recording electronic voting systems, or DRE). It can also involve transmission of ballots and votes *via* telephones, private computer networks, or the Internet.

In general, two types of e-Voting can be identified:

- ◆ e-voting which is physically supervised by representatives of governmental or independent electoral authorities (e.g., electronic voting machines located at polling stations).
- ◆ remote e-Voting where voting is performed within the voter's sole influence, and is not physically supervised by representatives of governmental authorities (e.g., voting from one's personal computer, mobile phone, television *via* the Internet).

Shareholders of a company have been expressing their assent or dissent for the resolutions requiring their approval by way of voting. It is impossible for the shareholders of the company to be present physically for every general meeting, so "Passing of Resolutions by Postal Ballot" under section 192A was introduced in the Companies Act, 1956 along with The Companies (Passing of the Resolution by Postal Ballot) Rules, 2001.



The Companies Act, 2013 has introduced new provision, voting through electronic means under Section 108 read with Companies (Management and Administration) Rules, 2014.

Voting through Electronic Means

- (i) As per Rule 20 of the Companies (Management and Administration) Rules, 2014, every listed company or a company having not less than one thousand shareholders shall provide to its members facility to exercise their right to vote at general meetings by electronic means.
- (ii) A member may exercise his right to vote at any general meeting by electronic means and company may pass any resolution by electronic voting system in accordance with the provisions of this rule.

“Voting by electronic means” or “electronic voting system” means a ‘secured system’ based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, such that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralized server with adequate ‘cyber security’;

“**secured system**” means computer hardware, software, and procedure that –

- (i) are reasonably secure from unauthorized access and misuse;
- (ii) provide a reasonable level of reliability and correct operation;
- (iii) are reasonably suited to performing the intended functions; and
- (iv) adhere to generally accepted security procedures.

“Cyber security” means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorized access, use, disclosures, disruption, modification or destruction.

Procedure to be followed by the Company:

A company which opts to provide the facility to its members to exercise their votes at any general meeting by electronic voting system shall follow the following procedure:



- (i) The notices of the meeting shall be sent to all the members, auditors of the company, or directors either by registered post or speed post; or through electronic means like registered e-mail id; through courier service.
- (ii) The notice shall also be placed on the website of the company, if any and of the agency forthwith after it is sent to the members.
- (iii) The notice of the meeting shall clearly mention that the business may be transacted through an electronic voting system and the company is providing facilities for voting by electronic means.
- (iv) The notice shall clearly indicate the process and manner for voting by electronic means and the time schedule including the time period during which the votes may be cast and shall also provide the login ID and create a facility for generating password and for keeping security and casting of vote in a secure manner.
- (v) The company shall cause an advertisement to be published, at least twenty-one days before the date of general 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 having a wide circulation in that district, and at least once in English language in an English newspaper having countrywide circulation. The advertisement must contain the matters as specified in Rule 20(4)(v). The following matters should be included:
 - (a) Statement that the business may be transacted by e-voting.
 - (b) The date of completion of sending of notices.
 - (c) The date and time of commencement of voting through electronic means.
 - (d) The date and time of end of voting through electronic means.
 - (e) The statement that voting shall not be allowed beyond the said date and time.
 - (f) Website address of the company and agency, if any, where notice of the meeting is displayed.
 - (g) Contact details of the person responsible to address the grievances connected with the electronic voting.



Notes

- (vi) The e-voting shall remain open for not less than one day and not more than three days. In all such cases, such voting period shall be completed three days prior to the date of the general meeting.
- (vii) During the e-voting period, shareholders of the company, holding shares either in physical form or in dematerialized form, as on the record date, may cast their vote electronically. Once the vote on a resolution is cast by the shareholder, he shall not be allowed to change it subsequently.
- (viii) At the end of the voting period, the portal where votes are cast shall forthwith be blocked.
- (ix) The Board of Directors shall appoint one scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an advocate, but not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinize the e-voting process in a fair and transparent manner. The scrutinizer so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system.
- (x) The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.
- (xi) The scrutinizer shall, within a period of not exceeding three working days from the date of conclusion of e-voting period, unblock the votes in the presence of at least two witnesses not in the employment of the company and make a scrutinizer's report of the votes cast in favour or against, if any, forthwith to the Chairman.
- (xii) The scrutinizer shall maintain a register either manually or electronically to record the assent or dissent, received, mentioning the particulars of name, address, folio number or client ID of the shareholders, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights.
- (xiii) The register and all other papers relating to electronic voting shall remain in the safe custody of the scrutinizer until the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the register and other related papers to the company.



- (xiv) The results declared along with the scrutinizer's report shall place on the website of the company and on the website of the agency within two days of passing of the resolution at the relevant general meeting of members.
- (xv) Subject to receipt of sufficient votes, the resolution shall be deemed to be passed on the date of the relevant general meeting of members.

IN-TEXT QUESTIONS

15. Annual General Meeting is held to review the overall progress of the company during a year. (True/False)
16. Ordinary business transacted in Extraordinary General Meeting. (True/False)
17. One person company is not required to hold the AGM. (True/False)
18. Adjourned meeting may be held any time by the Directors. (True/False)
19. Resolution passed through postal ballot only through electronic means. (True/False)
20. E-Voting is the more secure method to pass the resolution than other means. (True/False)

2.13 Summary

A meeting is a place where all the members of the company come together with the Board members and review the progress or discuss any agenda or issue concerning the company. But holding any general meetings for passing any resolution whether ordinary or special requires proper quorum otherwise the meeting cannot be convened by the members. Thus, presence of quorum is the most significant requirement and proper authority *i.e.*, Board of Directors should also be available at the meeting place.

Generally, there are two types of meetings, namely annual general and extraordinary, that are held in the company. Annual general meeting is conducted at the end of every financial year to review and discuss the overall progress of the company and declaration of the dividend for the shareholders. Extraordinary meeting is also called by the Board to consider some special class of business resolutions like change in capital, alteration in memorandum and articles and buy back of shares.

**Notes**

Meetings generally involve passing of resolutions which means passing and accepting of proposals by members. Sometimes a resolution is passed through the postal ballot as well. Postal ballot is a system where the draft resolution is sent to all the concerned members through registered post or electronic mode(s) at the registered address of the members. Members are required to reply in writing whether they are in favour of that resolution or not. For evaluation of received reply a scrutinizer is appointed to draw a result.

On many occasions it is not possible for the members to participate in the meeting. So, if articles authorize, he may appoint a proxy. A proxy is a person who participates in a meeting on behalf of the members, but proxy form requests must be filled at least 48 hours before meeting though it is revocable. Proxy cannot speak in the meeting and a separate proxy is required to attend different meetings.

2.14 Answers to In-Text Questions

1. Number of persons
2. Rules and regulations
3. Annual General Meeting
4. Extraordinary General Meeting
5. Special
6. Class
7. Quorum
8. Tribunal
9. Speak
10. Registrar
11. (b) 2
12. (c) 15 Months
13. (b) 21 Days
14. (b) 9 Months
15. True
16. False



17. True
18. False
19. True
20. False

2.15 Self-Assessment Questions

1. State the provisions of the Companies regarding holding of an Annual General Meeting. What are the consequences of default in holding an AGM?
2. What do you mean by Extraordinary Meeting? Who can call this meeting?
3. What are the requisites of a valid meeting? Discuss in detail.
4. What is a quorum? What happens if there is no quorum at a meeting?
5. What are different types of resolutions which must be passed in the meeting of shareholders?
6. What matters are restricted to discussed through video conferencing?
7. Write a short note on E-Voting.

2.16 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.

UNIT - V



Dividend, Audit and Auditors

Author: Dr. R C Garg

Revised by: Ms. Jaspreet Kaur

STRUCTURE

- 1.1 *Learning Objectives*
- 1.2 *Introduction of Dividends*
- 1.3 *Provisions Related to Payment of Dividend (Interim and Unpaid & Unclaimed Dividend)*
- 1.4 *Audit & Auditors – Introduction*
- 1.5 *Qualification of Auditor*
- 1.6 *Disqualification of Auditor*
- 1.7 *Appointment of Auditor*
- 1.8 *Auditor's Rotation*
- 1.9 *Removal of Auditor*
- 1.10 *Auditor's Report*
- 1.11 *Powers of Auditor*
- 1.12 *Summary*
- 1.13 *Answers to In-Text Questions*
- 1.14 *Self-Assessment Questions*
- 1.15 *Suggested Readings*

1.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Get knowledge about relevance of dividend.
- ◆ Know the provisions related to payment of dividends.

**Notes**

- ◆ Get knowledge about unpaid and unclaimed dividend.
- ◆ Learn the circumstances where declared dividend gets revoked.
- ◆ Gain familiarity with the concept of audit and the appointment of auditor.
- ◆ Know qualifications and disqualifications of an auditor.
- ◆ Understand the instances of removal of auditor.
- ◆ Learn about the power and duties of auditor.
- ◆ Understand the prime responsibility of an auditor *i.e.*, preparation of audit report.

1.2 Introduction of Dividends

Dividend is the part of profit distributed among members/shareholders which is declared in the annual general meeting of the company. Distribution of dividend depends upon the profit earned by the company, if no profit is made or nothing is available for distribution, then there will be no declaration of dividends. It is the implied power of the Board of Directors to declare dividends which need not be expressed in Memorandum of Association or in Article of Association.

1.3 Provisions Related to Payment of Dividend (Interim and Unpaid & Unclaimed Dividend)

Legal provisions related to dividends have been laid down in sections 123 and 127 of Companies Act which are as follows:

1. Dividends can be declared and paid only from:
 - (a) current profit, or
 - (b) accumulated revenue profits, or
 - (c) money provided by the govt. for the guarantee given in relation to dividends.
2. A percentage of profits should be transferred to reserve before declaration of dividend.
3. Dividends should be declared or paid only from general reserves. No dividend shall be paid out of capital.



4. Amount of dividends must be deposited in a separate schedule bank account within 5 days from the date when the dividends were declared.
5. Dividends should be paid only to registered shareholders.
6. Dividends should be paid only in cash through cheque or dividend warrant or through any digital mode.
7. Dividends shall be paid proportionately on the basis of shares held by each shareholder.
8. Dividends must be paid within 30 days from the date of declaration of dividends.

Penalty in case of inability to pay dividends: If any company is unable to pay dividend within 30 days of declaration of dividend, then every director of the company who knows about the default will be liable to pay at least 1000 per day till the default ends and will be punishable with imprisonment upto two years. Further, the company will be liable to pay interest on the defaulted amount at the simple interest rate of 18% p.a. till the period of default.

According to section 2(35), “dividend includes interim dividend”. Thus, all the provisions of Companies Act concerning payment of final dividends are applicable to interim dividends to the extent possible.

According to section 123(3) & 123(4), “the directors may:

- (1) Declare interim dividend during any financial year.
- (2) Declare interim dividend out of profits of the financial year in which the dividend is being declared or out of previous years’ accumulated profits.
- (3) Deposit the amount of interim dividend declared in a separate account, opened with a scheduled bank, within 5 days of declaration”.

Unpaid and unclaimed dividends account (Sections 124 & 205A)

The provisions for the dividends which are not paid or not claimed by the shareholders are provided under section 124 of the Companies Act, 2013:

- (1) If the dividend which has been declared by the company, remains unpaid or unclaimed for 30 days from the date of declaration of such dividend, the company shall deposit the amount of unpaid or unclaimed dividend in a separate account, to be opened in a scheduled

**Notes**

bank for this purpose, known as Unpaid Dividend Account within seven days from the completion of 30 days period.

- (2) The company shall prepare a detailed statement related to the amount transferred to the Unpaid Dividend Account. The statement shall contain the names of the shareholders, their last known addresses and the dividend to be paid. This statement shall be uploaded on the company's website and the website prescribed by the Central Government, in the given format within 90 days from transferring the amount in the Unpaid Dividend Account.
- (3) If the company has made any default in transferring the amount mentioned in sub-section (1), it shall pay interest at a rate of 12% per annum from the date of default on the amount which is not transferred to the Unpaid Dividend Account. The interest accumulated thereon shall be used for the benefit of the shareholders to whom dividends are not paid.
- (4) Any person, who claims to get the amount transferred in sub-section (1), shall apply to the company in order to claim the money transferred in the Unpaid Dividend Account. (Section 205B).
- (5) If the amount transferred in Unpaid Dividend Account remains unclaimed for a period of seven years from the date of transferring the amount, the company shall transfer the amount and the interest accumulated thereon to the Investor Education and Protection Fund (sub-section (1), section 125). The details of such transfer shall be sent to the concerned authority of the fund and the receipt shall be obtained from the authority as a proof of such transfer.
- (6) The company shall provide all the details of the shares for which the amount was transferred from unpaid dividend account to Investor Education and Protection Fund. The claimant of such shares shall be allowed to claim their shares from Investor Education and Protection Fund.
- (7) If any company fails to follow provisions of this section, then it will be liable to pay fine of at least 5 lakh rupees, extendable to 25 lakh rupees and every officer of the company who is related to default will be liable to pay a fine ranging from 1 lakh rupees to 5 lakh rupees.

**IN-TEXT QUESTIONS**

1. A dividend is the part of _____ which is distributed among shareholders.
2. Once the dividend is declared, it becomes _____ of the company.
3. The dividend which is declared by the directors between two annual general meeting is called _____ dividend.
4. Dividends are not allowed to be paid from _____ of the company.
5. Dividend shall be paid to the _____ shareholders.
6. The amount equivalent to dividend must be deposited in a _____ schedule bank within 5 days from the date on which dividend was declared.
7. Shareholders consent is not required at the time of declaring the dividends. (True/False)
8. Dividend may be paid in any kind or form. (True/False)
9. Dividend cannot be paid out of capital. (True/False)
10. Every company shall transfer the amount of unpaid or unclaimed dividend in a separate account known as Unpaid dividend Account. (True/False)

1.4 Audit & Auditors - Introduction

Audit is referred to as a systematic examination or review of all the transactions of a company in order to know whether the company is providing a true and fair view of its financial statements to its stakeholders. Audit is done to test the claim that a company makes on its financial position and check the accuracy of that claim. Due to objectivity involved in the process, the audit is done by an independent party. Law governing appointment, qualification, removal, powers etc. of an auditor of a company has been provided under various sections of the Companies Act, 2013.



1.5 Qualification of Auditor

Qualification or eligibility for a person to be appointed as an auditor in a company has been stated in section 141(1) & (2). These are as follows:

- (1) Only a qualified Chartered Accountant can be appointed as an auditor of a company.
- (2) Where a firm or Limited Liability Partnership (LLP) is appointed as an auditor, only those members of the firm who are Chartered Accountant are qualified to be signatories on the behalf of the firm.

1.6 Disqualification of Auditor

According to provisions of section 141(3), the following persons disqualified to be appointed as auditors:

- (1) A body corporate except “Limited Liability Partnership registered under LLP Act, 2008.”
- (2) An officer or an employee of the concerned company.
- (3) A person who is related to the officer or employee of the company by way of being a partner or in employment.
- (4) “A person who, or his/her relative or partner:
 - (i) Is having an interest in the company or its subsidiary, or its holding company or any other subsidiary of the holding company, given that the interest of the relative in the company to the extent face value of 1 lakh rupees is permissible.
 - (ii) Owes an amount, to the company or its subsidiary, or its holding company or subsidiary of that holding company, in excess of 5 lakh rupees.
 - (iii) Has given guarantee for indebtedness of a third person to the company or its subsidiary or holding company or subsidiary of holding company for an amount exceeding 1 lakh rupees.
 - (iv) Has a direct or indirect business relationship with the company or its subsidiary or its holding company or subsidiary of the holding company.



- (v) Is relative of the director or any key managerial personnel of the company.
- (vi) Is employed full time at some other place or he is a part of a firm which is appointed as auditor for more than 20 companies.
- (vii) Is convicted for an offence or a fraud and 10 years has not been passed from such conviction by the court.
- (viii) Renders any service to the company or its subsidiary or its holding company”

Vacation of office in case of disqualification: If a person is appointed as an auditor and later on found to be disqualified for such a position on the basis of disqualifications mentioned above, then the person shall vacate the office and such vacancy will be considered as a casual vacancy in the office of the auditor.

1.7 Appointment of Auditor

As Per section 139(1), “an individual or a firm shall be appointed as an auditor of the company at the first annual general meeting” in line with following provisions:

- (1) The company shall appoint an auditor in the first annual general meeting with a written consent of the auditor, certificate of qualification and notifying the registrar within 15 days of such appointment.
- (2) The auditor remains in the office from the date of appointment in the annual general meeting till the conclusion of the sixth annual general meeting.
- (3) A listed company shall not appoint or re-appoint an individual auditor for more than one term consisting of continuous five years and an audit firm for more than two terms consisting of continuous five years each.
- (4) Members of the company are required to ensure rotation of auditing partner and their team belonging to the appointed audit firm during the tenure of the appointment and audit by more than one auditor.

In case of a government company or any other company owned or controlled, directly or indirectly by central or state government, an auditor



shall be appointed within 180 days from the beginning of the financial year till the ending of the annual general meeting.

Except a government company, every other company shall appoint the first auditor within 30 days from the date of registration of the company. This appointment of auditor shall be done by the Board of Directors of the company. “In case of **Board’s failure**, an **EGM shall be called** within 90 days to appoint the first auditor. The law is silent regarding when this time limit of 90 days is reckoned, so it is better to take a stricter view and interpret that the 90 days limit starts from Incorporation rather than expiry of 30 days (*i.e.* failure of Board)”. Whereas, for a government company, the first auditor shall be appointed by Comptroller and Auditor - General of India within 60 days from the date of registration of the company, and in case of failure, the Board of Directors shall appoint a qualified auditor within next 30 days, and in case of Board’s failure, the auditor shall be appointed by the members of the company in an EGM within 60 days.

Procedure of appointment

As per section 139, the procedure of appointment of auditor is:

- 1. “Intimate the proposed auditor(s) regarding the intention of appointing him/it as auditor and ask whether he/it is eligible and not disqualified to be appointed as auditor of the company.***
- 2. Obtain consent & certificate from auditor.***
- 3. If the audit committee is required to be constituted under section 177, then obtain its recommendation.***
- 4. Call Board meeting.***
- 5. Approve the appointment of auditor at the first Board Meeting.***
- 6. Intimate the auditor and file with ROC form ADT-1(to be attached in Form GNL-2 as per MCA circular 09/2014 dated 25th April, 2014) within 15 days”.***

1.8 Auditor’s Rotation

As per section 139(2), “a company shall not reappoint an individual auditor for more than one term (of 5 consecutive years) and an audit firm for more than two terms (of 5 consecutive years each)”. The company is



required to hold the reappointment of the same individual auditor or the audit firm till the five years from the completion of their term.

The Central Government provides the rule relating to rotation of auditors as given under section 139(4):

- (1) “The audit committee of the company is required to recommend the name of the individual auditor or the audit firm that would become auditor of the company after the completion of tenure of the present auditor. In case of absence of an audit committee, the Board of Directors shall recommend the name to be finally decided by the members of the company in the annual general meeting.
- (2) The auditor or the audit firm who is being considered for appointment in the next term shall not be associated (belonging to the audit firm working under the same brand or trade name or having common control) with the current auditor.
- (3) Any break taken by the appointed auditor within the continuous tenure of five years shall be considered as fulfilling the requirement of rotation.
- (4) If a partner of an audit firm, who is in-charge of the appointed audit firm, retires and joins any other audit firm, then both the audit firms remain ineligible to be reappointed after completion of the present tenure”.

1.9 Removal of Auditor

The auditor in office shall stand removed from the position, by way of removal by the company or by the auditor’s resignation. It can be done by giving a special notice in the annual general meeting. The provisions governing removal, resignation and giving of special notice of auditor (section 140) are as follows:

- (1) The auditor serving a company can be removed from its position between his tenure of service by special resolution only. This can be done only after obtaining approval from the Central Government in the prescribed format and after giving an opportunity to the auditor for being heard.



Notes

- (2) If the auditor wants to resign from his position, he shall submit the same indicating the reasons and other relevant facts about his resignation with the company and the registrar within 30 days. In case of a Government Company or a company having direct or indirect government control, the auditor is required to submit his resignation to the Comptroller and Auditor General of India.

Penalty for violation: If the auditor is unable to follow the rules for resignation, then he/it shall be punishable with an amount of 50000 rupees or an amount equal to the remuneration of the auditor, whichever is lower. Also, if the failure to abide by the law continues, then there will be a fine of 500 rupees each day with an upper limit of 5 lakh rupees.

Procedure of removal of auditor:

- ◆ A special notice is required for resolution in the annual general meeting in order to appoint a new auditor given that the retiring auditor is getting removed from its position before completing the tenure of five (or ten, as the case may be) consecutive years.
- ◆ A copy of such resolution shall be sent to the retiring auditor.
- ◆ The retiring auditor is then given a chance for representation. If the retiring auditor sends a written representation and asks to share that with the members of the company, then the company shall disclose to the members that representation has been made and attach the copy of representation with the special notice sent earlier.
- ◆ If the copy of the representation is not sent to the members as mentioned above, then the same shall be filed with the registrar of the company and auditor shall ask to read out the representation in the meeting.
- ◆ However, if it is found that the auditor is misusing its rights related to representation, then the representation shall not be sent or read in the meeting.

Final order by Tribunal:

- ◆ If the Tribunal is satisfied that the auditor is directly or indirectly engaged in any fraudulent activity against the company, then it may order the company to replace its auditors.



- ◆ The individual auditor or the audit firm against whom the tribunal has given the final order shall not take up audit assignment of any other company for at least 5 years from the date of such order and shall also be liable for the punishment according to section 447.

1.10 Auditor's Report

Audit of accounts is systematic examination and evaluation of records to know the true and fair view of the financial position of the business concerned . After completion of audit work, it is mandatory obligation of an auditor to prepare the audit report which is an evidence of authenticity of relevant records.

As per section 143(2) of Companies Act, 2013, “the auditor shall prepare a report on the accounts examined by him and all the financial statements and any other important financial documents which are laid before the company in the annual general meeting”. The auditor shall ensure that the financial statements prepared are as per the laws and give a true and fair picture of the company's affairs and shall prepare a report keeping in mind the accounting and auditing standards and other requirements under this Act.

Content of Auditor's Report:

Section 143(3) requires that the auditor's report shall state:

- (i) That the auditor has taken and obtained all the relevant information needed to carry out the audit of the financial statements and if any information was not available then its details and impact of non-inclusion on the financial statements.
- (ii) Whether the auditor is satisfied by his examination that the company has maintained proper books of account as required by law and that the proper details have been provided by the branches where the auditor has not visited.
- (iii) How the auditor has dealt with the information of an audit, done by any other person in case of any branch office of the company [sub-section (8)], while preparing his report.
- (iv) That the company's income statement and balance sheet audited are in-line with the books of account.

**Notes**

- (v) Whether the financial statements of the company are prepared as per the accounting standards.
- (vi) Auditor's views or comments on any information or fact which may have adverse effects on the company.
- (vii) That all the directors qualify to be director as per the section governing the qualification of directors of the company (section 164).
- (viii) Any information, qualification or negative remark related to maintenance of books of account.
- (ix) Any other matter as prescribed.

Wherever the auditor has given any qualification or any remark or negative comment, then the reason for that shall be explained in the report.

In case a company is owned or controlled, directly or indirectly by the Central/State Government and where the auditor is appointed by Comptroller and Auditor-General of India, then the audit report shall be submitted by the auditor to the Comptroller and Auditor General of India and the report shall state the directions, if any, and the action taken and its impact on the financial statements.

Signing the Audit Report:

The report prepared shall be signed by authorized signatories:

- ◆ If an individual auditor is appointed by the company, then that auditor has to sign the report.
- ◆ If a firm is appointed as an auditor of the company, then only those partners who are Chartered Accountant have to sign the report.

Thus the final report duly signed and authenticated by the auditor has to be presented before the company in annual general meeting and shall be kept open for further discussion or inspection by any member of the company.

1.11 Powers of Auditor

The act specifies the powers and duties of the auditor that he must be entitled to carry out the process of audit. As per section 143, the following are the powers and duties of the auditor of the company:



- (1) Auditor shall be given access to all the information of books of account and vouchers as required by him to perform the audit of financial statements. He shall also be granted liberty to know or inquire about any fact from the officers of the company needed to carry out his job. An auditor may inquire about:
- ◆ The loans and advances granted by the company and the security against it. They can ensure the proper security of such loans and advances.
 - ◆ The transactions in the books of account and whether they are in the interest of the company.
 - ◆ Whether the investments of the company (except banking or investment company), like shares, debentures and other securities are sold at a price which is less than the purchase price.
 - ◆ Whether the deposits of the company include the loans and advances granted by the company.
 - ◆ The disclosure of personal expenses (to check if the personal expenses are shown as revenue expenses).
 - ◆ The cash received against the shares that are shown as being allotted for cash. If the cash is not received, whether it is properly recorded and shown in books of account.
- (2) An auditor of a holding company has a right to get access of records of its subsidiary and associated companies in order to carry out the consolidation of the financial statements of the holding company with that of the subsidiary and other associated companies.
- (3) The auditor is also required to prepare a proper report of the audit as explained in section 143(2) & (3).
- (4) An auditor shall follow and practice auditing standards.
- (5) The auditor has a right to report any fraud or offence, that he may come across while performing his duties, directly to the Central Government given that the amount of fraud is equal to or more than 1 crore rupees and if less than 1 crore rupees he shall inform audit committee about such a fraud.
- (6) No duty of auditor stands violated in course of informing about fraud as mentioned above, if it is done in good faith.



Notes

- (7) If an auditor is found to knowingly hide any fraudulent activity of the company which he came across while performing his duties, then the auditor will be punishable with a fine ranging between 1 lakh to 25 lakh rupees.

IN-TEXT QUESTIONS

11. An auditor is a person who _____ the systematic way of financial record.
12. An auditor is a watch dog not the _____ hound.
13. An auditor may be removed from expiry of his terms only by passing _____ resolution.
14. Tribunal may directed the company to change its auditor if he is acted _____ manner.
15. Auditor has right to get intimated with all the notices and _____ related to any general meeting.
16. Auditor is not responsible to detect the errors and frauds.
(True/False)
17. Unqualified report is the evidence of error free financial statements.
(True/False)
18. Auditor cannot freely have access over the books of account and documents.
(True/False)
19. Auditor must be a Chartered Accountant.
(True/False)
20. Auditor is entitled to get the remuneration even before completion of audit.
(True/False)

1.12 Summary

Every person makes some investment in the company expecting some rewards in form of interest and dividend. Basically a dividend is declared for the registered shareholders of the company. Dividend is declared by the Board of Directors in AGM. It should be remembered that once the dividends are declared it becomes debt and the company is compelled to pay it to the shareholders.

The dividends are real ways declared from the current or accumulated profit and shall be paid within thirty days from the date of declaration



of dividend. Declared dividends are never evoked until the conditions that are beyond the control of the company like disputes among Board members and shareholders and war breakout etc.

Companies also declare interim dividends which are considered as a part of the final dividend. The provisions that are applicable to dividends, similar provisions are applicable to interim dividends also. If the dividend remains unpaid or unclaimed, then the company shall transfer the amount to a separate account and if the amount remains there for a period of seven years then it should be transferred to Investor Education and Protection Account which is utilized for public welfare.

Concisely, dividend is the legal right of the members but at the time of declaration of dividend financial position of the company must be intact. It is true the heavy declaration dividend attracts the potential investors and increases the earning per share and market price of shares but inability to fulfil the payment of dividends attracts bad name for the company and other penalties.

It has been discussed earlier under the head of chapter maintenance of books of account that it is mandatory for every company to maintain proper books of account. After the task of preparation of financial statements like balance sheet and profit and loss account and cash flow statement etc. then the next step is to conduct the audit work in the company to know the exact financial position of the company whether it is giving a true and fair view of the financial position of the company or not.

This work can be done through a person called an auditor. Auditor is a person who undertakes the responsibility to examine the financial record in a systematic way. It is required because the true financial position can only be true when it is examined by the auditor and he prepares the auditor report which must be clean and as per the laws.

The auditor is appointed by the board of directors and in case of failure of board to appoint, then shareholders in the annual general may appoint the auditor. The remuneration must be determined by the board in the annual general meeting and he is liable to continue in the office of auditor till the 5 years period.

But it does not mean that he cannot resign or get removed from his position. For this a proper notice is needed and the auditor can be removed from its position after given a chance for representation.



Notes

Discuss the prime responsibility of the auditor to perform his duty and prepare a report in such a manner as prescribed in the act. If he is found guilty or negligent towards his duties, then he shall be liable to face some legal consequences. He is a watchdog of a company, not the bloodhound.

1.13 Answers to In-Text Questions

1. Profit
2. Debt
3. Interim
4. Capital
5. Registered
6. Separate
7. False
8. False
9. True
10. True
11. Examine
12. Blood
13. Special
14. Fraudulent
15. Communication
16. False
17. True
18. False
19. True
20. False



1.14 Self-Assessment Questions

1. What is dividend? State the legal provisions concerning with dividend.
2. What do you mean by Interim Dividend? Are there any provisions of interim dividend?
3. Which amount is required to be transferred in Investor Education and Protection Fund?
4. Explain the provisions concerning with removal and resignation of auditors.
5. Write a short note on preparation of auditor's report.

1.15 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.

Winding Up

Author: Dr. R C Garg

Revised by: Ms. Komal Singhaniya

STRUCTURE

- 2.1 *Learning Objectives*
- 2.2 *Introduction*
- 2.3 *Meaning of Winding Up*
- 2.4 *Distinction Between Winding Up and Dissolution*
- 2.5 *Modes of Winding Up*
- 2.6 *Circumstances for Winding Up by Tribunal*
- 2.7 *Winding Up of Company Under Just and Equitable Grounds*
- 2.8 *Petition for Winding Up*
- 2.9 *Powers of Tribunal*
- 2.10 *Direction for Filing Statements of Affairs*
- 2.11 *Provisions for Winding Up Under Insolvency and Bankruptcy Code, 2016*
- 2.12 *Summary*
- 2.13 *Answers to In-Text Questions*
- 2.14 *Self-Assessment Questions*
- 2.15 *Suggested Readings*

2.1 Learning Objectives

After studying this chapter students may be able to understand:

- ◆ Familiar with the concept and modes of winding up.
- ◆ Clear about winding up and dissolution of company.
- ◆ Able to impart knowledge about the circumstances where company may be wound up.
- ◆ Clear as to how the liquidator proceeds with the winding up process.
- ◆ Able to enhance your knowledge about the powers of Tribunal.



2.2 Introduction

As we all know that a company comes into existence by a legal process basically known as incorporation, similarly, it can also cease to exist by following another legal process called dissolution. Winding up is one of the ways by which the dissolution of a company can be brought about and until all the winding formalities have been complied with, its existence cannot come to an end. The process starts with the appointment of a liquidator by the Tribunal. The liquidator is an insolvency professional who is selected from amongst other such professionals registered under the Insolvency and Bankruptcy Code, 2016.

2.3 Meaning of Winding Up

Winding up is the process where the life of the company is brought to an end. Prof. Gower has defined the winding up as, “Winding up of a company is the process whereby its life is ended, and its property is administered for the benefit of its members & creditors. An administrator, called a liquidator, is appointed and he takes control of the company, liquidates its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.”

Sec. 2(94A) of the Companies Act, 2013 defines winding up as, “winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable”.

IN-TEXT QUESTIONS

1. Winding up is that process where the life of the company _____ to an end.
2. Insolvency and Bankruptcy Code, 2016 lays down provision for _____ winding up of the company.
3. Liquidator is a person who _____ the assets of the company.
4. Dissolution is the last stage of winding up of company.
(True/False)
5. Liquidator is free to exercise any powers even without permission of the Tribunal.
(True/False)



2.4 Distinction Between Winding Up and Dissolution

The two terms might be sometimes used interchangeably but there are some major differences between the two which are as follows:

- (a) Winding up is prior stage and dissolution is final stage.
- (b) In case of winding up, the legal existence of the company continues till it's complete but in case of dissolution, the existence of the company comes to an end. In other words, the name of the company gets struck off from the register of companies.

2.5 Modes of Winding Up

A company may be wound up either –

- (a) compulsorily by the Tribunal; or
- (b) by liquidation under the Insolvency and Bankruptcy Code, 2016.

2.6 Circumstances for Winding Up by Tribunal

As per Sec. 271 of Companies Act, 2013, “A company may, on a petition under section 272, be wound up by the Tribunal:

- (a) If the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (b) If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (c) If on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company 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 affairs 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 a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (e) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up.”

2.7 Winding Up of Company Under Just and Equitable Grounds

A company may also be ordered to be wound up if the Tribunal is of the opinion that it is just and equitable that the company should be wound up. Following circumstances may result in the winding up of the company on just and equitable grounds:

1. **Loss of substratum:** The companies are formed to fulfil some objective(s) and when they fail to do so or are not able to fulfil it while being profitable, it is said that the company’s substratum has failed. In other words, the company has lost the whole or a substantial part of its capital.
2. **Deadlock in management:** When the directors are not able to take timely and suitable decisions in the company due to disagreements amongst decision-makers resulting from groupism in the company. This results in management ignoring the interests of the shareholders and avoiding taking initiatives that will increase their value and wealth.
3. **Fraudulent object:** If the company was incorporated to carry out any fraudulent or illegal activity or its objects have become illegal owing to the changes in the law.
4. **Losses:** Due to heavy losses sustained by the company and its incapability to continue its business activities.
5. **Oppression minority:** When the majority of the shareholders take decisions without taking into consideration the interests of minority shareholders which unfairly prejudices them.
6. **Bubble company:** When it is a mere bubble company and does not carry out any business activities or does not have any property.



2.8 Petition for Winding Up

As per Sec. 272, “(1) Subject to the provisions of this section, a petition to the Tribunal for the winding up of a company shall be presented by—

- (a) the company.
 - (b) any contributory or contributories.
 - (c) all or any of the persons specified in clauses (a) and (b).
 - (d) the Registrar.
 - (e) any person authorised by the Central Government in that behalf;
or
 - (f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.
- (2) A contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder.
- (3) The Registrar shall be entitled to present a petition for winding up under section 271, except on the grounds specified in clause (a) of that section:
- Provided** that the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition:
- Provided further** that the Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.
- (4) A petition presented by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.
- (5) A copy of the petition made under this section shall also be filed with the Registrar and the Registrar shall, without prejudice to any



other provisions, submit his views to the Tribunal within sixty days of receipt of such petition.”

2.9 Powers of Tribunal

Section 272, pass any of the following orders, namely—

- (a) dismiss it, with or without costs.
- (b) make any interim order as it think fit.
- (c) appoint a provisional liquidator of the company till the making of a winding up order.
- (d) make an order for the winding up of the company with or without cost; or
- (e) any other order as it think fit.

The Tribunal shall, within ninety days from the date of presentation of the petition, make the order under this sub-section.

The Tribunal shall give a notice to the company and provide it with a reasonable opportunity to make its representations before the appointment of a provisional liquidator.

Section 273 also provides that, “the Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets”.

As per Section 273(2), “Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy”.

2.10 Direction for Filing Statements of Affairs

According to Section 274(1), “where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a *prima facie* case for winding up of the company

**Notes**

is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order”.

In a situation of contingency or special circumstances, the Tribunal is empowered to allow a further period of thirty days.

The petitioner may be directed by the Tribunal to deposit certain security for costs as it may consider reasonable as a precondition for issuing directions to the company:

- ◆ Failure to file the statement of affairs by the company shall result in its forfeiture of the right to oppose the petition and the directors and officers of the company who have been found responsible for such a failure, shall be liable for punishment.
- ◆ The directors and other officers of the company, which is to be wound up by an order of the Tribunal, shall submit the books of account of the company duly completed and audited up to date till the receipt of the order, to the appointed liquidator within a period of thirty days of such order.

As per Sec. 274(4) and (5), “If any director or officer of the company contravenes the provisions of this section, the director or the 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. The complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorized by the Tribunal”.

2.11 Provisions for Winding Up under Insolvency and Bankruptcy Code, 2016

IBC Code 2016 lays down provisions for insolvency resolution of companies, partnership firms as well as individuals in a time bound manner. IBC Code is applicable to issues relating to insolvency and liquidation of companies where the minimum amount of default is Rs.1 lakh.

Under IBC Code 2016, a company may be voluntarily wound up by following the below mentioned procedure:



I. Convene a Board Meeting

The company shall be required to call a board meeting with the majority of directors wherein:

- ◆ a resolution for the proposal of Voluntary Liquidation of the company shall be passed.
- ◆ as per Sec. 59(3) of IBC Code 2016, “(a) a declaration from majority of the directors of the company verified by an affidavit stating that—
 - (i) they have made a full inquiry into the affairs of the company, and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full of the proceeds of assets to be sold in the voluntary liquidation; and
 - (ii) the company is not being liquidated to defraud any person.
- (b) the declaration under sub-clause (a) shall be accompanied with the following documents, namely: —
 - (i) audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later.
 - (ii) a report of the valuation of the assets of the company, if any prepared by a registered valuer.”

II. Convene a General Meeting

Sec. 59(3)(c) of IBC Code, 2016 provides that, “within four weeks of a declaration under sub-clause (a), there shall be—

- (i) a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or
- (ii) a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator.”



III. Approval of Creditors

Sec. 59(3)(c) of IBC Code, 2016 also provides that, “in case the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within seven days of such resolution.”

This can be done by holding a meeting of the creditors, presenting them with a copy of the resolution and securing approval from at least two-third of the creditors for the same.

According to Sec. 59(4), “The company shall notify the Registrar of Companies and the Board about the resolution under sub-section (3) to liquidate the company within seven days of such resolution or the subsequent approval by the creditors, as the case may be.”

IV. Public Announcement by Liquidator

According to Regulation 14 of IBBI (Voluntary Liquidation Process) Regulations, 2017:

- “(1) The liquidator shall make a public announcement in Form A of Schedule I within five days from his appointment.
- (2) The public announcement shall—
- (a) call upon stakeholders to submit their claims as on the liquidation commencement date; and
 - (b) provide the last date for submission of claim, which shall be thirty days from the liquidation commencement date.
- (3) The announcement shall be published—
- (a) in the Official Gazette.
 - (b) in one English and one regional language newspaper with wide circulation at the location of the registered office and principal office, if any, of the corporate person and any other location where in the opinion of the liquidator, the corporate person conducts material business operations.
 - (c) on the website, if any, of the corporate person; and
 - (d) on the website, if any, designated by the Board for this purpose.”



V. Proceedings by the Liquidator

(i) Preliminary Report

A Preliminary Report (as per Regulation 9(1) of IBBI (Voluntary Liquidation Process) Regulations, 2017) shall be submitted by the liquidator to the company within forty-five days from the liquidation commencement date, detailing—

- ◆ the capital structure of the company,
- ◆ estimates for the assets and liabilities based on the books of the company as on the liquidation commencement date,
- ◆ whether any further enquiry into matters relating to the conduct of the company is intended to be made by him,
- ◆ the proposed plan of action for liquidation including the timeline within which the liquidation shall be carried out and the estimated liquidation costs.

(ii) Maintenance of Registers and Books of Account

- ◆ The registers and books of the company shall be maintained by the liquidator and shall be preserved by him for a period of eight years after the dissolution of the company.
- ◆ In case of incomplete books of account, the liquidator shall have the books completed and brought up to date.
- ◆ Receipts for all the payments made and the costs incurred by the liquidator in the process shall be kept by him.

(iii) Duties and responsibilities of the liquidator

- ◆ **Substantiation of claims:** He may call any Claimant for any evidence or clarifications for substantiating the whole or a part of its claim. (Regulation 22)
- ◆ **Verification of claims:** As per Regulation 29 of IBBI (Voluntary Liquidation Process) Regulations, 2017, “the liquidator shall verify the claims by stakeholders within thirty days from the last date for receipt of claims and may either admit or reject the claim, in whole or in part, as the case may be, as per section 40 of the Code. A creditor may appeal to the Adjudicating Authority against the decision of the liquidator as per section 42 of the Code.”



- ◆ **List of stakeholders:** As per Regulation 30(1) of IBBI (Voluntary Liquidation Process) Regulations, 2017, “the liquidator shall, within forty-five days from the last date for receipt of claims, prepare a list of stakeholders on the basis of proofs of claims submitted and accepted under these Regulations, with—
 - (a) the amounts of claim admitted, if applicable,
 - (b) the extent to which the debts or dues are secured or unsecured, if applicable,
 - (c) the details of the stakeholders, and
 - (d) the proofs admitted or rejected in part, and the proofs wholly rejected.”
- ◆ **Pay money into bank accounts:** Regulation 34 provides that, “the liquidator shall open a bank account in the name of the corporate person followed by the words ‘in voluntary liquidation’, in a scheduled bank, for the receipt of all money due to the corporate person. All payments out of the account by the liquidator above five thousand rupees shall be made by cheques drawn or online banking transactions against the bank account.”
- ◆ **Distribution:** Regulation 35 of IBBI (Voluntary Liquidation Process) Regulations, 2017 provides for the distribution of proceeds by the liquidator by stating that, “the liquidator shall distribute the proceeds from realization within six months from the receipt of the amount to the stakeholders. The liquidation costs shall be deducted before such distribution is made.”

VI. Completion of Liquidation

As per Regulation 37 of IBBI (Voluntary Liquidation Process) Regulations, 2017:

- (1) The liquidator shall endeavour to wind up the affairs of the corporate person within one year from the voluntary liquidation commencement date.
- (2) In the event of the voluntary liquidation continuing for more than one year, the liquidator shall—
 - (a) call a meeting of the contributories of the corporate person within fifteen days from the end of the year in which he is appointed, and at the end of each succeeding year; and



- (b) shall present a Status Report indicating progress in liquidation, including—
- (i) settlement of list of stakeholders,
 - (ii) details of any property that remain to be sold and realized,
 - (iii) distribution made to the stakeholders, and
 - (iv) distribution of unsold property made to the stakeholders,
 - (v) developments in any material litigation, by or against the corporate person, and
 - (vi) filing of, and developments in applications for avoidance of transactions in accordance with Chapter III of Part II of the Code.

- (3) The Status Report shall enclose an audited account of the voluntary liquidation showing the receipts and payments pertaining to liquidation since the liquidation commencement date.”

VII. Preparation of Final Report

As per Regulation 38(1) of IBBI (Voluntary Liquidation Process) Regulations, 2017, “when the affairs of the corporate person are fully wound up, the liquidator shall prepare a Final Report consisting of—

- (a) an audited account of the voluntary liquidation, showing the receipts and payments pertaining to liquidation since the liquidation commencement date; and
- (b) a statement demonstrating that—
 - (i) the assets of the corporate person have been disposed of,
 - (ii) the debt of the corporate person has been discharged to the satisfaction of the creditors,
 - (iii) no litigation is pending against the corporate person.
- (c) a sale statement in respect of all assets containing –
 - (i) the realized value,
 - (ii) cost of realization, if any,
 - (iii) the manner and mode of sale,
 - (iv) if the value realized is less than the value assigned by the registered valuer in the report of the valuation of assets



prepared in accordance with section 59(3)(b)(ii) or Regulation 3(2)(b), as the case may be,

- (v) the person to whom the sale is made; and
- (vi) any other details of the sale.”

VIII. Submission of Final Report

As per Regulation 38(2), “the liquidator shall send the Final Report to –

- (a) the contributories of the corporate person.
- (b) the Registrar; and
- (c) the Board,

by registered post at their registered address and by electronic means.”

When the affairs of the company have been completely wound up and the assets have been completely liquidated, the liquidator shall apply to the National Company Law Tribunal (NCLT) in the form NCLT-1 for the dissolution of the company. On receipt of such application, the Tribunal shall fix a date for hearing of the petition and when satisfied, it shall pass an order that the company shall be dissolved from the date of that order and the company shall follow the order and be dissolved accordingly.

IX. Filing of the order of Tribunal with the ROC

The company shall file the order of the Tribunal with the Registrar of Companies within fourteen days of receipt of the order, or any other such time as may be fixed by NCLT.

IN-TEXT QUESTIONS

6. Winding up _____ dissolution of the company.
7. Voluntary winding up is the _____ of the company.
8. Director may intervene in the working of the liquidator.
(True/False)
9. In case of voluntary winding up, the provisions of Companies Act, 2013 shall apply. (True/False)
10. Compulsory winding shall be deemed from the date of filling of petition to Tribunal. (True/False)



2.12 Summary

This chapter talks about how the life of a company is brought to an end, in other words, how a company is wound up. A company may be wound up by an order of the NCLT or it may also be wound up on its own accord as per the provisions of the Insolvency and Bankruptcy Code, 2016. In either mode of winding up, a liquidator must be appointed who shall take full authority over the company mainly for the purpose of realization of its assets, satisfaction of liabilities and distribution of the surplus left among the equity shareholders.

When a liquidator is appointed in the company to perform the winding up proceedings, then certain rights and obligations are automatically imposed upon him. Some of these rights can be exercised by him only with the sanction of court but some rights can be exercised by him even without the sanction of court.

As soon as the liquidator is appointed in the court, the powers of the Board of directors are terminated and he takes over the control of the company. Sometimes the court with its own discretion may dismiss the petition and sometimes it may issue an interim order etc.

Concisely speaking, winding up proceedings should only be done by following the provisions laid down under the Companies Act, 2013 or the Insolvency and Bankruptcy Code, 2016, whichever is applicable, otherwise the directors or any other officer found guilty of non-compliance shall be punishable with fine.

2.13 Answers to In-Text Questions

1. Comes
2. Voluntary
3. Administers
4. True
5. False
6. Precedes
7. Initiative



8. False
9. False
10. True

2.14 Self-Assessment Questions

1. What do you mean by winding up? Distinguish between winding up and dissolution.
2. State the legal provisions of compulsory winding up under Tribunal order.
3. What shall be the contents of the Final Report to be submitted by the liquidator.
4. In what circumstances a company may wound up under just and equitable grounds?
5. Write short notes on:
 - (i) Powers of the Tribunal
 - (ii) Duties and responsibilities of the liquidator.

2.15 Suggested Readings

- ◆ Jagota, R. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Kapoor, N. D. (2022). Corporate Laws. Sultan Chand.
- ◆ Kaur, H. (2022). Company Law, Delhi: Kitab Mahal.
- ◆ Kuchhal, M. C. & Kuchhal, A. (2013). Company Law, Mahavir Publications.
- ◆ Kumar, A. (2021). Corporate Laws. Delhi: Taxmann Publications Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2015). Elements of Corporate Laws. Himalaya Publishing House Pvt. Ltd.
- ◆ Maheshwari, S. N., & Maheshwari, S. K. (2019). Company Law. Himalaya Publishing House Pvt. Ltd.
- ◆ Ramaiya, A. (2020). A Guide to Companies Act, India: Lexis Nexis.



Glossary

Abridges Prospectus: An abridged prospectus is basically a summary of the prospectus containing all the details as may be prescribed by the SEBI.

Annual General Meeting: Every company must in each year hold in addition to any other meeting, a general meeting.

Article of Association: The Articles lay down the rules and regulations for the internal management of the company.

Associate Company: It means a company in which that other company has a significant influence, but which is not a subsidiary company of the company of having such influence and includes a joint venture company.

Audit: Audit is referred to as a systematic examination or review of all the transactions of a company in order to know whether the company is providing a true and fair view of its financial statements to its stakeholders.

Bonus Shares: Instead of distributing the profits as dividend, they issue fully paid-up shares to them free of charge, in proportion to their existing share holdings. These shares are called Bonus Shares.

Chartered Company: A Company which is formed by the grant of the Charter by the crown and which is regulated by that charter is called as chartered company.

CLB: The Company Law Board (CLB) is a quasi-judicial body, exercising equitable jurisdiction, which was earlier being exercised by the High Court or the Central Government.

Company: The term company is taken from the Latin word where- “Com” means together, panis means “bread” which refers to an association of people taking their bread together.

Corporate Veil: Company is a separate legal entity and the corporate veil is a curtain between company and its member.

Deemed Prospectus: Where a company allots or agrees to allot any of its securities to an intermediary for sale to the public then any document by which this offer of sale to the public is made, is termed as Deemed Prospectus.

Demat: Demat is accessibility of physical certificate of security into the electronic form.

Directors: Persons who are appointed to direct and supervise the affairs of the company. They are responsible for directing and controlling the powers of the company.



Dissolution: In case of dissolution, the existence of company comes to an end. In other words, name of the company gets struck off from the register of companies.

Dividend: Dividend is the part of profit distributed among members/shareholders which is declared in the annual general meeting of the company.

Doctrine of Constructive Notice: Every person who deals with the company is deemed to have read and understood the proper meaning of the contents of the relevant documents.

Doctrine of Indoor Management: The doctrine of indoor management lays down that when the officers of the company act on behalf of the company in a manner which seems to be in compliance with the provisions of the articles, then the parties dealing with the company are not affected by the irregularities in the internal management and proceedings of the company.

Doctrine of Ultra Vires: These transactions cannot be ratified or legitimized even though the whole body of shareholders gives their consent to it as they are *void-ab-initio*. This rule is known as Doctrine of *Ultra Vires*.

ESOP: (ESOP) is defined as “the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

Extraordinary General Meeting: Any meeting other than a statutory and an annual general meeting.

Foreign Company: It means any company or body corporate incorporated outside India which has a place of business in India whether by itself or through an agent, physically or through electronic media.

Holding Company: A company which holds, or control other company is called holding company.

Independent Directors: In relation to a company an independent director means a director other than *managing director or a whole-time director or a nominee director*.



Meeting: A meeting is a gathering or assembly of a number of persons for transacting any lawful business.

Memorandum of Association: Memorandum means Memorandum 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.

NCLAT: The National Company Law Appellate Tribunal.

NCLT: National Company Law Tribunal.

OPC: One Person Company is a company which has only one person as a member.

Pre-incorporation: Pre-incorporation contract are those contracts which are made before the company is incorporated. Promoters entered into preliminary contract on the behalf of the company as an agent.

Promoter: A promoter may be an individual, a firm or a company, association of people or even the government who performs all basic and preliminary work and duties which is necessary to bring company into existence.

Prospectus: A prospectus can be defined as an invitation to the public to subscribe to a company's securities.

Provisional Contracts: Provisional contracts refer to those contracts in which only public company entered after its incorporation but before getting the certificate to commence business.

Quorum: It means the minimum number of members that must be present at the meeting.

Red Herring Prospectus: It is a first or preliminary prospectus that is submitted by a company with reference to public offering. It has most of the details with respect to company's present operations and prospects but does not have the key information about the securities' price or the quantum of shares.

Registered Company: Company registered under the Indian company's Act is known as Registered companies.

Rights Shares: Right Shares are issued against payment and the shareholders are required to pay.



Notes

Share: Share means share in the share capital of a company and includes stock, except where a distinction between stock and shares is expressed or implied.

Shelf Prospectus: It is a type of public offering under which companies are allowed to offer securities to the public without a separate prospectus for each issue of same class.

Statutory Company: There are the Companies which are created by a special Act of the central and state legislature is called Statutory Company.

Winding Up: Winding up is the process where the life of the company is brought to an end.

978-81-19169-01-6



9 788119 169016

**Department of Distance and Continuing Education
University of Delhi**