# KLE LAW ACADEMY BELAGAVI

(Constituent Colleges: KLE Society's Law College, Bengaluru, Gurusiddappa Kotambri Law College, Hubballi, S.A. Manvi Law College, Gadag, KLE Society's B.V. Bellad Law College, Belagavi, KLE Law College, Chikodi, and KLE College of Law, Kalamboli, Navi Mumbai)

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STUDY MATERIAL

*for*

COMPANY LAW

Prepared as per the syllabus prescribed by Karnataka State Law University (KSLU), Hubballi

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This study material is intended to be used as supplementary material to the online classes and recorded video lectures. It is prepared for the sole purpose of guiding the students in preparation for their examinations. Utmost care has been taken to ensure the accuracy of the content. However, it is stressed that this material is not meant to be used as a replacement for textbooks or commentaries on the subject. This is a compilation and the authors take no credit for the originality of the content. Acknowledgement, wherever due, has been provided.

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# SYLLABUS

**Objectives:**

In view of the important developments that have taken place in the corporate sector, the course is designed to understand the formation, management and other activities of the companies. Important regulations pertaining to the issue of shares and the capital raising have come into force. This course aims to impart the students, the corporate management, control, possible abuses, the remedies, and government regulation of corporate business and winding up of companies.

**Course contents:**

## UNIT – I

Introduction and Concept

Company – historical development – nature and characteristics of company – kinds of company – Corporate personality – limited liability – lifting of corporate veil – promoters – duties and liability of promoters

## UNIT – II

Incorporation

Procedure of incorporation – certificate of incorporation – MOA – AOA – Doctrine of indoor management – prospectus

## UNIT – III

Management and Control of Companies

Board of Directors – powers and functions: Distribution of powers between Board of Directors and general meeting

Directors: appointment – qualification – position of directors – types of directors – powers and duties of directors – remuneration – removal

Meetings: Meetings of Board and Committees – kinds of meetings – procedure relating to convening and proceedings at General and Other meetings – resolutions – Prevention of oppression and Mismanagement

Corporate social responsibility

## UNIT – IV

Financial structure of company

Sources of capital: Shares – types – allotment – transfer of shares – rights and privileges of shareholders – dividends – declaration and payment of dividends, prohibition of buy back – private placement –

Debentures – floating charge – appointment of debenture trustees and their duties – kinds – remedies of debenture holders – redemption

Acceptance of Deposit by Companies, charge on assets

## UNIT – V

Reconstruction and amalgamation and winding up

Reconstruction, rehabilitation and amalgamation: concept – jurisdiction and powers of courts and NCLT – vesting of rights and transfer of obligations – takeover and acquisition of minority interest

Winding up: concept – modes of winding up – who can apply – procedure under different modes.

**Prescribed Books:**


1. Taxman, *Companies Act 2013.*
2. Singh, Avtar, Company *Law,* (Lucknow: Eastern Book Company,2007)


**Reference Books:**


1. Ramaiah,A, *Guide to Companies Act*, (Nagpur: Wadhwa, 1998)
2. Shah, S.M., Lectures *on Company Law, (*Bombay: Tripathi, 1988)
3. Kuchal, S.C, *Corporation Finance: Principles and problems,* 10th Edition, (Chaitanya Publishing House, 1973)
4. Y. D. Kulshreshta, *Government regulation of financial management of private corporate sector in India,* Indian Law Institute, (1986)
5. S. K. Roy, Corporate *Image in India A Study of Elite Attitudes towards Public and Private Industry,* (Shri Ram Centre for Industrial Relations and Human Resources ,1974)
6. Gower, L.C.B, *Principles of Modern Company Law,* (London: Sweet & Maxwell, 1997)
7. D. L. Majumdar, *Towards a philosophy of Modern Corporation.* (Asia Publishing House, 1967)
8. Pennington, Robert R., *Pennington's Company Law,* (U.K: Oxford University Press, 2001)
9. Rajiv Jain, Guide *on foreign collaboration – Policies & Procedures* (Vidhi Publication, 2007).
10. C. Singhania, *Foreign collaborations and Investments in India – Law and procedures,* (Fred B. Rothman & Co, 1999)
11. Joyant M Thakur, *Comparative Analysis of FEMA – FEMA Act, 1999 with FERA.*
12. Sanjiv Agarwal, *Bharat's guide to Indian capital,* 2nd Edition*, (*New Delhi: Bharat Law House Pvt Ltd, 2001)


***Note:*** *The course teachers have to keep track of the notification regarding enforcement of the Companies Act, 2013 and teach the provisions enforced. For the provisions not enforced, the parallel provisions from the Act of 1956 are to be taught.*

# UNIT – 1

# INTRODUCTION AND CONCEPT

**Synopsis**

- Introduction
- Meaning of a Company
- Definition of Company
- Historical Development
- Nature and Characteristics of a Company
- Kinds of Company
- Corporate Personality
- Limited Liability
- Lifting of corporate veil
- Promoters
- Duties of Promoter
- Liabilities on Promoter

## Introduction

The concept of 'Company' or 'Corporation' in business is not new but was dealt with, in 4th century BC itself during 'Arthashastra' days. Its' shape got revamped over a period according to the needs of business dynamics. Company form of business has certain distinct advantages over other forms of businesses like Sole Proprietorship/Partnership etc. It includes features such as Limited Liability, Perpetual Succession etc.

After reading this lesson, you would be able to understand the historical development in the evolution of corporate law in India and England, emerging regulatory aspects including Companies Act, 2013, besides dealing with basic characteristics of the company and how it differs from other forms of businesses.

## Meaning of a Company

The word 'company' is derived from the Latin word (Com=with or together; panis =bread), and it originally referred to an association of persons who took their meals together. In the leisurely past, merchants took advantage of festive gatherings, to discuss business matters.

Nowadays, business matters have become more complicated and cannot be discussed at festive gatherings. Therefore, the company form of organization has assumed greater importance. It denotes a joint-stock enterprise in which the capital is contributed by several people. Thus, in popular parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking.

*A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.*

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law and clothing it with legal personality. The word 'corporation' is derived from the Latin term 'corpus' which means 'body'. Accordingly, 'corporation' is a legal person created by a process other than natural birth. It is, for this reason, sometimes called an artificial legal person. As a legal person, a corporation can enjoy many of the rights and incurring many of the liabilities of a natural person.

An incorporated company owes its existence either to a special Act of Parliament or to company law. Public corporations like Life Insurance Corporation of India, SBI etc., have been brought into existence by special Acts of Parliament, whereas companies like Tata Steel Ltd., Reliance Industries Limited have been formed under the Company law i.e. Companies Act, 1956 which is being replaced by the Companies Act, 2013.

## Definition of Company

In the legal sense, a company is an association of both natural and artificial persons (and is incorporated under the existing law of a country). In terms of the Companies Act, 2013 (Act No. 18 of 2013) a "company" means a company incorporated under this Act or under any previous company law [Section 2(*20*)].

*In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. However, an association formed not for profit also acquires a corporate character and falls within the meaning of a company by reason of a license issued under Section 8(1) of the Act.*

A company is not merely a legal institution. It is rather a legal device for the attainment of the social and economic end. It is, therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organization in the conduct of an enterprise".

It is "an intricate, centralized, economic and administrative structure run by professional managers who hire capital from the investor(s)".

***Lord Justice Lindley*** *has defined a company as "an association of many persons who contribute money or money's worth to common stock and employ it in some trade or business and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company.*

The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his "share". The shares are always transferable although the right to transfer them may be restricted."

From the foregoing discussion, a company has its own corporate and legal personality distinct which is separate from its members. A brief description of the various attributes is given here to explain the nature and characteristics of the company as a corporate body.

**Historical Development**

As we all know that India has drawn a lot of legislation from England. Similarly, in the case of Companies law, India enacted company law based upon the company law enacted in England. The three phases which influenced the Company legislations may be divided as i) Colonization era; ii) Period after World War II & iii) the Opening up of Indian markets in the year 1990.

## Legislation Enacted

In the year 1850, the first Company enactment for the registration of the joint-stock company was introduced in India. This enactment as mentioned before was based upon the English Companies Act, 1844.

Later in the year 1857, the concept of limited liability was recognized in the companies legislation but the said limited liability was not extended to the banking company. The concept of limited liability into the Companies Act was introduced earlier in the English Companies Act of 1856. But by the year of 1858, the concept of limited liability was extended to banking company even in India.

In the year 1866 Companies Act was yet again passed for consolidating and amending the laws relating to incorporation, regulation and winding up of trading companies and other associations. This Act was based upon the Companies Act 1862 of England. This Act was recast in the year 1882 and was in use until 1913.

In the year 1913 another Indian Companies Act was enacted based upon English Companies Consolidation Act, 1908. Companies Act of 1913 was amended in the year 1914, 1915, 1920, 1926, 1930 and 1932. But the major amendment to the Companies Act of 1913 who was made in the year 1936 this amendment was based upon the English Companies Act. 1929. The act of 1913 regulated the Indian business company until 1956.

By the end of 1950, Bhabha committee was set up under the chairmanship of H. C. Bhabha. For the difference of Indian Companies Act with reference to the development of Indian trade and industry.

The committee submitted its report on 1952, this report of Bhabha committee was accepted Companies (Amendment) Act, 1956. This legislation was made keeping in mind the English legislation of Companies Act in 1948.

## Act of 1956

The period of the Second World War and the post-war years witnessed an upsurge of Industrial and commercial activity on an unprecedented scale in India and large profits were made by businessmen through incorporated companies. The Government of India took up the revision of

Company Law immediately after the termination of the last war. Two company lawyers— one from Bombay and the other from Madras— were successively appointed to advise Government on the broad lines on which, the Indian Companies Act, 1913, should be revised and recast in the light of the experience gained during the war years. Their reports were considered by Government and a memorandum embodying its tentative views was circulated towards the end of 1949 for eliciting an opinion.

On 28th October 1950, the Government of India appointed a Committee of twelve members representing various interests under the chairmanship of Shri H. C. Bhabha, to go into the entire question of the revision of the Companies Act, with particular significance to the development of trade and industry of India. This Committee, popularly known as the Bhabha Committee, submitted its report in March, 1952, recommending comprehensive changes in the Companies Act of 1913. The report of the Bhabha Committee was again the subject of discussion and comment by Chambers of Commerce, Trade associations, professional bodies, leading industrialists, shareholders and representatives of labour. The Bill, which eventually emerged as the Companies Act, 1956, was introduced in Parliament on 2nd September 1953. IT was a comprehensive and consolidating as well as amending piece of legislation. The Bill was referred to a Joint Committee of both Houses of Parliament in May 1954. The Joint Committee submitted its report in May 1955, making some material amendments to the Bill. The Bill, as amended by the Joint Committee, underwent some further amendments In Parliament and was passed in November 1955. The new Companies Act (I of 1956) came into force from 1st April 1956.

Major Changes brought forth by the Companies Act 1956

- Promotion and growth of Companies.
- Capital structure of the Companies.
- Company meetings and procedures.
- Company accounts and its presentation & powers and duties of the auditors of the company.
- Inspection and investigations of the affairs of the Company.
- The constitution of the Board of Directors, Powers and functions of directors, Managing Directors and Managers; and
- Administration of the Company Law.

The Amendments in the Companies Act, 1956

As any other legislation various amendments were made to the Companies Act 1956 as mentioned below:

Timeline of Amendments

| 1960 | 1962 | 1963 | 1964 | 1965 | 1966 | 1967 | 1969 | 1974 | 1977 | 1985 | 1988 | 1991 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|

Opening of the market gates to the Globe-1990

The Era of liberalisation, privatization and globalisation saw the anachronistic Companies legislation made in time of closed market and hence inadequate to handle the global entry. This non-conducive legislation would have obstructed the Indian Corporate Sector. In pursuance to this necessity the Companies Bill, 1993 was formed but was later withdrawn. The Depositories Act, 1996 was introduced in India and later a working Group was constituted to rewrite the Companies Act, 1956. In pursuance to above made effort the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 in order to replace the prior legislation.

The President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998. But this promulgated the Companies (Amendment) Ordinance, 1998 was soon replaced by the Companies (Amendment) Act, 1999.

The objectives of the Companies (Amendment) Act, 1999:

- To surge the capital market by boosting the morale of the National business houses.
- Fostering the FITs and Foreign Direct Investments in the country.

The changes brought by the Companies (Amendment) Act, 1999 are:

- A facility was introduced to allow the Corporate Sector to buy-back company’s own share.
- Provisions relating to investments and loans were liberalised and rationalised.
- Requirement of prior approval of the Central Government on investment decisions was done away with and companies were allowed to issue “sweat equity” in lieu of the intellectual property.
- The compliance of the Indian Accounting Standard was made mandatory and the National Committee on Accounting Standard was also incorporated.

- The benefit of the investors was looked into by setting up "Investor Education and Protection Fund".
- Introduction of the nomination to shareholders, debenture holders, etc.

Later, the Companies (Amendment) Act, 2000 was enacted, which was followed by the Companies (Amendment) Act, 2001 wherein the Section 77A was introduced in relation to buy-back of the shares. This amendment allowed the Board of Directors to buy-back the shares upto 10% of the paid-up capital and free reserves provided not more than one such buy-back is made during the period of 365 days. Then, the Companies (Amendment) Act, 2002 was enacted which was followed by the Companies (Second Amendment) Act, 2002. The first amendment introduced the setting-up and regulation of the Cooperatives as a body corporate under the Companies Act, 1956 to be called 'Producer companies. The Second Amendment was to expedite the winding-up process of the companies to facilitate rehabilitation of the sick companies and protection of workers interest.

The Companies (Amendment) Act, 2006, was brought into force on 1.11.2006 wherein it introduced the Director Identification Number (DIN) and also introduced electronic filing of various returns and forms.

The New Enactment of the New Society

The Companies Act, 2013 replaced the Companies Act, 1956. The legislators introduced ideas of the likes of:

- Corporate Social Responsibility (CSR)
- Class action suits
- Fixed term for the Independent Directors
- The provision of raising money from the public was made little stringent
- Prohibition on insider trading by company directors or key managerial personnel by declaring such activities as a criminal offence
- It permits shareholder agreements providing for the 'Right of First Offer' or 'Right of first Refusal' even in the case of Public Companies

The Companies (Amendment) Act, 2015: It received the presidential assent on May 2015 and became operate on 29th May 2015. It is designed to address the issues of the stakeholders such as Chartered Accountants and other professionals.

Key Amendments brought in by the Companies (Amendment) Act, 2015 may be explained as follows:

No minimum Paid-up share Capital

No minimum paid-up share Capital requirements will now apply for incorporating private as well as Public Companies in India.

Relaxation in relation to related party transaction

In the case of related party transactions which requires stake-holders approval relaxation has been given wherein earlier required special resolution has been replaced by the ordinary resolution.

Inspection of the resolution filed with the Registrar

This Act has limited public access of such resolutions relating mainly to the strategic business matters. Such documents will no longer be available for the public to review or permitted to take copy of.

Common Seal Optional

Under the Act of 2013 it was required to affix common seal on certain documents but, now after the Act of 2015, the use of the common Seal has been made optional although the common seal is one of the integral characteristics of a Company.

Violations of Acceptance of Deposits

Companies Act of 2013 provisions in relation to the Acceptance/ renewal/ repayment of deposits. However no specific penalty prescribed for the new compliance with the relevant provision i.e. Section 13 and Section 76.

A new Section 76A has been introduced for these non-compliances. The defaulting company will be liable for a minimum fine of INR 1 crore and maximum amount of INR 100 crore in addition to the amount of deposit or part thereof along with interest.

Dividend

The Companies Act, 2015 has introduced a proviso which states that a company must set-off the losses and depreciation carried over from past years against the profits of the company before declaring dividend for a financial year.

The Companies (Amendment) Act, 2017

The Companies (Amendment) Bill, 2016 was intended to be passed by the legislature, but after referring it to the Committee this Bill went through a lot of corrections and metamorphosed into The Companies (Amendment) Bill, 2017 which was then passed as the **Companies (Amendment) Act, 2017**. The salient features of the amendments brought by this Act are:

- Synergy with SEBI and RBI Rules: For the first time, several provisions have been amended to align the Act with various rules and regulations of the SEBI (Security Exchange Board of India) and the RBI (Reserve Bank of India). For example, Sections 194 and 195 of the Act, which was dealing with the offence of insider trading and forward dealing, have now been omitted since the SEBI regulations were succinct to cover all.
- The instances of such frauds. Further disclosures to be made in the prospectus have also been aligned with the SEBI's power to regulate IPOs (Initial Public Offering). The definition of 'debenture' has been amended to permit RBI to disqualify certain instruments as debentures.
- Proportionality of penalties: The quantum of penalty will now be levied taking into consideration the size of the company, nature of business, injury to public interest, nature and gravity of default, repetition of default, etc. which is one of the most appreciated amendments. Two new provisions regarding the determining of the level of punishment have been freshly introduced and lesser penalties for one person companies and small companies were inserted. Provisions for small companies and penal vigour has been reduced.
- Placement process made easier in Private Sector: The placement process is rationalised by doing away separate offer letter details to be kept in the records of the Company and hence reducing the number of filings to Registrar. The company is not allowed to use money from private placement unless allotment made and the return of the same filed with the

registrar To make sure that an investors are informed, the disclosures are made under Explanatory Statement as provided in Rule 13(2)(d) of Companies (Share Capital and Debenture) Rules, 2014, embodied in the Private Placement Application Form. Change in definition of private placement is proposed to umbrella all securities offers and invitations other than rights. The Companies would be allowed to make an offer of multiple security instruments simultaneously.

- Standards for Independent Director : Section 149 of the Act deals with the qualifications and disqualifications of independent directors. Sub-Section (6) provides for various disqualifications for becoming an independent director, one of which is, such a person having "pecuniary relationship" with "the company, its holding, subsidiary or associate company, or their promoters, or directors". The amendment clarified that 'pecuniary relationship' excluded the remuneration of director having transaction not exceeding 10% of his total income or such amount as may be prescribed.

The Companies (Amendment) Act, 2019

The Companies (Amendment) Act, 2019 received the assent of the President on the 31st July 2019. While introducing the Bill in the Lok Sabha, the Hon'ble Finance and Corporate Affairs Minister, Nirmala Sitharaman said, "the Bill seeks to ensure more accountability and better enforcement to strengthen the corporate governance norms and compliance management in corporate sector as enshrined in the Companies Act, 2013".

In order to review the Companies Act and to gain better compliance, the Government of India constituted a Committee in July 2018. The said Committee, after taking the opinions of several stakeholders of the Company, submitted its Report in August, 2018. The Committee recommended that serious offences must face rigour of law, but technical mistake be given in-house adjudication for speedy redressal. Accordingly, proposal to amend certain provisions of the Companies Act, 2013 was made, however, in view of the urgency, the Companies (Amendment) Ordinance, 2018 was promulgated on November 2018. To replace the aforesaid Ordinance, the Amendment Bill was introduced in Lok Sabha and passed, but Bill was not taken up in Rajya Sabha. Therefore, to continue the effect of prior ordinance the President promulgated the Companies (Amendment) Ordinance, 2019 on the 12th day of January 2019 and the Companies

(Amendment) Second Ordinance, 2019 on the 21stday of February 2019. Then the Companies (Amendment) Bill, 2019 was passed by both the houses of parliament and became the law.

The Major reforms undertaken by the Ordinance of 2018 and 2019 include the following:

1. Re-categorisation of offences which are in the category of compoundable offences to an in-house adjudication framework. However, no change has been made for any of the non-compoundable offences.
2. Ensuring compliance of the default made and prescribing deterrent penalties in case of repeated defaults.
3. Delegation and De-clogging the NCLT by:
   - Enlarging the jurisdiction of Regional Director ("RD") by increasing the pecuniary limits up to which compounding of offences under Section 441 of the Act can take place.
   - Vesting in the Central Government the power to approve the alteration in the financial year of a company under Section 2(41).
   - Vesting the Central Government, the power to approve cases of conversion of public companies into private companies so as to reduce the burden on the government and developing the sector.
   - Other reforms include re-introduction of declaration of commencement of business provision; greater accountability with respect to filing documents related to creation, modification and satisfaction of charges; non-maintenance of registered office to trigger de-registration process; holding of directorships beyond permissible limits to trigger disqualification of such directors.

**Nature and Characteristics of a Company**

Since a corporate body (i.e. a company) is the creation of law, it is not a human being, it is an artificial juridical person (i.e. created by law); it is clothed with many rights, obligations, powers, and duties prescribed by law; it is called a 'person'.

Being the creation of law, it possesses only the powers conferred upon it by its Memorandum of Association which is the charter of the company. Within the limits of powers conferred by the charter, it can do all acts as a natural person may do.

The most striking characteristics of a company are:

(i) Corporate personality

A company incorporated under the Act is vested with a corporate personality so it redundant bears its own name, acts under a name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different ‘person’ from the members who compose it. Therefore, it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual.

Its members are its owners however they can be its creditors simultaneously. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital.

A Company is an artificial person created by law. It is not a human being, but it acts through human beings. It is considered as a legal person which can enter contracts, possess properties in its own name, sue and can be sued by others etc. It is called an artificial person since it is invisible, intangible, existing only in the contemplation of law. It can enjoy rights and being subject to duties.

(ii) Limited Liability

The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organization. The company, being a separate person, is the owner of its assets and bound by its liabilities.

The liability of a member as a shareholder extends to the contribution to the capital of the company up to the nominal value of the shares held and not paid by him. Members, even as a whole, are neither the owners of the company’s undertakings nor liable for its debts. There are various exceptions to the principle of limited liability.

*In other words, a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited.*

(iii) Perpetual Succession

An incorporated company never dies, except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and it remains the same

entity, despite the total change in the membership. A company's life is determined by the terms of its Memorandum of Association.

It may be perpetual, or it may continue for a specified time to carry on a task or object as laid down in the Memorandum of Association. Perpetual succession, therefore, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

The membership of an incorporated company may change either because one shareholder has sold/transferred his shares to another or his shares devolve on his legal representatives on his death or he ceases to be a member under some other provisions of the Companies Act.

Thus, perpetual succession denotes the ability of a company to maintain its existence by the succession of new individuals who step into the shoes of those who cease to be members of the company. Professor L.C.B. Gower rightly mentions,

*"Members may come and go, but the company can go on forever. During the war, all the members of one private company, while in general meeting, were killed by a bomb, but the company survived — not even a hydrogen bomb could have destroyed it".*

(iv) Separate Property

A company is a legal person and entirely distinct from its members, is capable of owning, enjoying and disposing of property in its own name. The company is the real person in which all its property is vested, and by which it is controlled, managed and disposed of.

*Their Lordships of the Madras High Court in* ***R.F. Perumal v. H. John Deavin, A.I.R. 1960 Mad. 43*** *held that "no member can claim himself to be the owner of the company's property during its existence or in its winding-up". A member does not even have an insurable interest in the property of the company.*

(v) Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be a movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. When the joint-stock companies were established, the object was that their shares should be capable of being easily transferred, **[In *Re. Balia and San Francisco Rly.,* (1968) L.R. 3 Q.B. 588]**.

Section 44 of the Companies Act, 2013 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles.

If the articles do not provide anything for the transfer of shares and the Regulations contained in Table "F" in Schedule I to the Companies Act, 2013, are also expressly excluded, the transfer of shares will be governed by the general law relating to the transfer of movable property.

*A member may sell his shares in the open market and realize the money invested by him. This provides liquidity to a member (as he can freely sell his shares) and ensures stability to the company (as the member is not withdrawing his money from the company). The Stock Exchanges provide adequate facilities for the sale and purchase of shares.*

Further, as of now, in most of the listed companies, the shares are also transferable through Electronic mode i.e. through Depository Participants in dematerialized form instead of physical transfers. However, there are restrictions with respect to transferability of shares of a Private Limited Company which are dealt in chapter 2.

(vi) Common Seal

Upon incorporation, a company becomes a legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all contracts entered by its agents must be under the seal of the company. The Common Seal acts as the official signature of a company. The name of the company must be engraved on its common seal.

*A rubber stamp does not serve the purpose. A document not bearing a common seal of the company, when the resolution passed by the Board, for its execution requires the common seal to be affixed is not authentic and shall have no legal force behind it.*

However, a person duly authorized to execute documents pursuant to a power of attorney granted in his favour under the common seal of the company may execute such documents and it is not necessary for the common seal to be affixed to such documents.

The person, authorized to use the seal, should ensure that it is kept under his personal custody and is used very carefully because any deed, instrument or a document to which seal is improperly or fraudulently affixed will involve the company in legal action and litigation.

(vii) Capacity to sue or be sued

A company is a body corporate, can sue and be sued in its own name. To sue means to institute legal proceedings against (a person) or to bring a suit in a court of law. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name.

A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be [**Floating Services Ltd. v. MV San Fransceco Dipaloa** (2004) 52 SCL 762 (Guj)].

*A company, as a person distinct from its members, may even sue one of its own members. A company has a right to seek damages where a defamatory material published about it, affects its business.*

Where video cassettes were prepared by the workmen of a company showing, their struggle against the company's management, it was held to be not actionable unless shown that the contents of the cassette would be defamatory. The court did not restrain the exhibition of the cassette. [***TVS Employees Federation v. TVS and Sons Ltd., (1996) 87 Com Cases 37****].*

*The company is not liable for contempt committed by its officer. [***Lalit Surajmal Kanodia *v.* Office Tiger Database Systems India (P) Ltd., *(2006) 129 Com Cases 192 Mad]*.

(viii) Contractual Rights

A company, being a legal entity different from its members, can enter into contracts for the conduct of the business in its own name. A shareholder cannot enforce a contract made by his company; he is neither a party to the contract nor be entitled to the benefit derived from of it, as a company is not a trustee for its shareholders.

Likewise, a shareholder cannot be sued on contracts made by his company. The distinction between a company and its members is not confined to the rules of privity but permeates the whole law of contract. Thus, if a director fails to disclose a breach of his duties towards his company, and in consequence, a shareholder is induced to enter into a contract with the director on behalf of the

company which he would not have entered into had there been disclosure, the shareholder cannot rescind the contract.

*Similarly, a member of a company cannot sue in respect of torts committed against the company, nor can he be sued for torts committed by the company. [**British Thomson-Houston Company v. Sterling Accessories Ltd.**, (1924) 2 Ch. 33]. Therefore, the company as a legal person can take action to enforce its legal rights or be sued for breach of its legal duties. Its rights and duties are distinct from those of its constituent members.*

(ix) Limitation of Action

A company cannot go beyond the power stated in its Memorandum of Association. The Memorandum of Association of the company regulates the powers and fixes the objects of the company and provides the edifice upon which the entire structure of the company rests.

*The actions and objects of the company are limited within the scope of its Memorandum of Association.*

In order to enable it to carry out its actions without such restrictions and limitations in most cases, sufficient powers are granted in the Memorandum of Association. But once the powers have been laid down, it cannot go beyond such powers unless the Memorandum of Association, itself altered prior to doing so.

(x) Separate Management

As already noted, the members may derive profits without being burdened with the management of the company. They do not have effective and intimate control over its working, and they elect their representatives as Directors on the Board of Directors of the company to conduct corporate functions through managerial personnel employed by them.

In other words, the company is administered and managed by its managerial personnel.

(xi) Voluntary Association for Profit

A company is a voluntary association for profit. It is formed for the accomplishment of some stated goals and whatsoever profit is gained is divided among its shareholders or saved for the future expansion of the company. Only a Section 8 company can be formed with no profit motive.

(xii) Termination of Existence

A company, being an artificial juridical person, does not die a natural death. It is created by law, carries on its affairs according to law throughout its life and ultimately is effaced by law. Generally, the existence of a company is terminated by means of winding up. However, to avoid winding up, sometimes companies adopt strategies like reorganization, reconstruction, and amalgamation.

**Distinction between Company and Partnership**

The principal points of distinction between a company and a partnership firm are as follows:

A company is a distinct legal person. A partnership firm is not distinct from the several persons who form the partnership.

In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals who are its members.

Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.

Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm’s business. A member of a company has no such power.

A partner cannot contract with his firm, whereas a member of a company can.

A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company’s share can ordinarily be transferred.

Restrictions on a partner’s authority contained in the partnership contract do not bind outsiders whereas such restrictions incorporated in the Articles are effective because the public is bound to acquaint themselves with them.

A partner’s liability is always unlimited whereas that of a shareholder may be limited either by shares or a guarantee.

A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

A company may have any number of members except in the case of a private company which cannot have more than 200 members (excluding past and present employee members). In a public company, there must not be less than seven persons in a private company not less than two. Further, a new concept of one-person company has been introduced which may be incorporated with only one person.

A company is required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.

A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement among the partners.

**Distinction between Company and Hindu Undivided Family Business**

A company consists of heterogeneous (varied or diverse) members, whereas a Hindu Undivided Family Business consists of homogenous (unvarying) members since it consists of members of the joint family itself.

In a Hindu Undivided Family business, the *Karta* (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.

A person becomes a member of a Hindu Undivided Family business by virtue of birth. There is no provision to that effect in the company.

No registration is compulsory for carrying on a business for gain by a Hindu Undivided Family even if the number of members exceeds twenty [***Shyamlal Roy*** **v.** ***Madhusudan Roy***, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

**Kinds of Company**

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

- Private Companies.
- Public Companies; and
- One Person Company (to be formed as Private Limited).

Section 3 (1) of the Companies Act 2013 states that a company may be formed for any lawful purpose by—

- seven or more persons, where the company to be formed is to be a public company.
- two or more persons, where the company to be formed is to be a private company; or
- one person, where the company to be formed is to be One Person Company, that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration

(2) A company formed under sub-section (1) may be either—

- a company limited by shares; or
- a company limited by guarantee; or
- an unlimited company.

There are three ways in which companies may be incorporated.

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

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

Types of Company on the basis of Liability

Under this category there are three types of companies:

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

**Companies limited by guarantee:** A company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount.

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

<u>Other Types of Company</u>

Associations not for profit having a license under Section 8 of the Companies Act, 2013 or under any previous company law; Private Company, Public Companies; and One Person Company

- Government Companies.
- Foreign Companies.
- Holding and Subsidiary Companies.
- Associate Companies/Joint Venture Companies
- Investment Companies
- Producer Companies.
- Dormant Companies

A. Private Companies; Public Companies; and One Person Company

Private Company

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

- restricts the right to transfer its shares.
- except in the case of One Person Company, limits the number of its members to two hundred:

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

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

a. persons who are in the employment of the company; and
b. persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, and
c. prohibits any invitation to the public to subscribe for any securities of the company; It must be noted that it is only the number of members that is limited to two hundred. A private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures is prohibited.

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

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

A private company can only accept deposit from its members in accordance with section 73 of the Companies Act, 2013.

*The words 'Private Limited' must be added at the end of its name by a private limited company. As per section 3 (1), a private company may be formed for any lawful purpose by two or more persons, by subscribing their names to a memorandum and complying with the requirements of this Act in respect of registration.*

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

<u>One Person Company (OPC)</u>

With the implementation of the Companies Act, 2013, a single person could constitute a Company, under the One Person Company (OPC) concept.

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

*The concept of One-person company is quite revolutionary. It gives the individual entrepreneurs all the benefits of a company, which means they will get credit, bank loans, access to the market, limited liability, and legal protection available to companies.*

Prior to the new Companies Act, 2013 coming into effect, at least two shareholders were required to start a company. But now the concept of One Person Company (OPC) would provide tremendous opportunities for small businessmen and traders, including those working in areas like handloom, handicrafts and pottery.

Further, the amount of compliance by a one-person company is much lesser in terms of filing returns, balance sheets, audit etc. Also, rather than the middlemen usurping profits, the one-person company will have direct access to the market and the wholesale retailers. The new concept would also boost the confidence of small entrepreneurs.

<u>Small Company</u>

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

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

*Company law should enable simplified decision-making procedures by relieving such companies from select statutory internal administrative procedures. Such companies should also be subjected to reduced financial reporting and audit requirements and simplified capital maintenance regimes.*

*Essentially the regime for small companies should enable them to achieve transparency at a low cost through simplified requirements. Such a framework may be applied to small companies through exemptions, consolidated in the form of a Schedule to the Act.*

A small company is a new form of a private company under the Companies Act, 2013. A classification of a private company into a small company is based on its size i.e. paid-up capital and turnover. In other words, such companies are small-sized private companies.

As per section 2(85) ''small company'' means a company, other than a public company, —

- paid-up share capital of which does not exceed fifty lakh rupees, or such higher amount as may be prescribed which shall not be more than five crore rupees: or
- turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this definition shall apply to—

- a holding company or a subsidiary company.
- a company registered under section 8; or
- a company or body corporate governed by any special Act.

<u>Public Company</u>

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

- is not a private company;
- has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed.

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

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

*A public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange.*

*The number of members is not limited to two hundred. It may be noted that in the case of a public company, the articles do not contain the restrictions provided in Sections 2(68) of the Act.*

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. However, any contract or arrangement between two or more persons in respect of the transfer of securities shall be enforceable as a contract.

The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of **Western Maharashtra Development Corpn. Ltd. V. Bajaj Auto Ltd** [2010] 154 Com Cases 593 (Bom).

It was held that the Companies Act, makes a clear distinction in regard to the transferability of shares relating to private and public companies. By definition, a "private company" is a company which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest therein, of a company, shall be freely transferable.

*The provision contained in the law for the free transferability of shares in a public company is founded on the principle that members of the public must have the freedom to purchase and, every shareholder the freedom to transfer.*

The incorporation of a company in the public, as distinguished from the private, realm leads to specific consequences and the imposition of obligations envisaged in law. Those who promote and

manage public companies assume those obligations. Corresponding to those obligations are rights, which the law recognizes as inherent in the members of the public who subscribe to shares.

Limited Company

As per section 3(2), a company formed under this Act may be either (a) a company limited by shares; or (b) a company limited by guarantee or (c) an unlimited company.

The term 'Limited Company' means a company limited by shares or by guarantee.

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

Accordingly, a limited company can be further classified into: (a) Company limited by shares, and (b) Company limited by guarantee.

a. Companies Limited by Shares

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

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

But in the case of partly paid shares, the unpaid portion is payable at any time during the existence of the company on a call being made, whether the company is a going concern or is being wound up. This is the essence of a company limited by shares and is the most common form in existence.

b. Companies Limited by Guarantee

As per section 2(21) "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Clubs, trade associations and societies for promoting different objects are examples of such a company.

*It should be noted that a special feature of this type of company is that the liability of members to pay their guaranteed amounts arises only when the company has gone into liquidation and not when it is a going concern. A guarantee company may or may not have a share capital.*

As regards the funds, a guarantee company without share capital obtains working capital from other sources, e.g. fees or grants. But a guarantee company having a share capital raises its initial capital from its members, while the normal working funds would be provided from other sources, such as fees, charges, subscriptions, etc.

The Memorandum of Association of every guarantee company must state that every member of the company undertakes to contribute to assets of the company in the event of its being wound up while he is a member for the payment of the debts and liabilities of the company contracted before he ceases to be a member, and of the charges, costs and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

The Memorandum of a company limited by guarantee must state the amount of guarantee. It may be of different denominations.

Unlimited Company

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

*The liability of the members is only towards the company and in the event of its being wound up, only the Liquidator can ask the members to contribute to the assets of the company which will be used in the discharge of the debts of the company.*

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

or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

B. Government Companies

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

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

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

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

C. Foreign Companies

As per section 2(42), "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 mode; and
- conducts any business activity in India in any other manner

Sections 379 to 393 of the Act deal with such companies. Section 380 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies for registration.

The filing must include:

- a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language.
- the full address of the registered or principal office of the company.
- a list of the directors and secretary of the company containing such particulars as may be prescribed.
- the name and address or the names and address of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company.
- the full address of the office of the company in India which is deemed to be its principal place of business in India.
- particulars of opening and closing of a place of business in India on earlier occasion or occasions.
- a declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from the formation of companies and management in India or abroad; and
- any other information as may be prescribed.

Every foreign company has to ensure that the name of the company, the country of incorporation, the fact of limited liability of members is exhibited in the specified places or documents as required under Section 382.

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

Section 376 of the Companies Act, 2013 provides further that when a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up

as an unregistered company under Sections 375 to 378 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

D. Holding and Subsidiary Company

On the basis of control, companies can be classified into holding, subsidiary and associate companies.

Holding company

As per Section 2 (46), holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary company

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

- controls the composition of the Board of Directors; or
- exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit. (Proviso to be notified)

For the above purpose, —

- a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company.
- the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by the exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- the expression "company" includes any body corporate.

E. Associate Company

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

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

*To add more governance and transparency in the working of the company, the concept of the associate company has been introduced. It will provide a more rational and objective framework of the associated relationship between the companies.*

Further, as per section 2 (76), Related party includes 'Associate Company'. Hence, contract with Associate Company will require disclosure/approval/entry in the statutory register as is applicable to contract with a related party.

F. Investment Companies

As per explanation (a) to section 186, "investment company" means a company whose principal business is the acquisition of shares, debentures or other securities.

*An investment company is a company, the principal business of which consists of acquiring, holding and dealing in shares and securities. The word 'investment', no doubt, suggests only the acquisition and holding of shares and securities and thereby earning income by way of interest or dividend etc.*

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

If a company is engaged in any other business to an appreciable extent, it will not be treated as an investment company.

The following two sets of legal opinions are quoted below as to the meaning of an investment company:

- According to one set of legal opinion, an "investment company" means a company which acquires and holds shares and securities with an intent to earn income only from them by holding them. On the other hand, another school of legal opinion holds that "an Investment Company means a company, which acquires shares and securities for earning income by holding them as well as by dealing in such shares and other securities".
- According to Section 2(10A) of the Insurance Act, 1938, an investment company means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

G. Producer Company

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

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

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

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act.

The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

Objects of Producer Companies

In terms of Section 581B (1) of the Companies Act, 1956, the objects of a producer company registered under this Act may be all or any of the following matters:

- production, harvesting, procurement, grading, pooling, handling, marketing, selling, the export of primary produce of the Members or import of goods or services for their benefit.
- processing including preserving, drying, distilling, brewing, venting, canning and packaging of the produce of its members.
- manufacturing, sale or supply of machinery, equipment or consumables mainly to its members.
- providing education on the mutual assistance principles to its members and others.
- rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its members.
- generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce.
- insurance of producers or their primary produce.
- promoting techniques of mutuality and mutual assistance.
- welfare measures or facilities for the benefit of the members as may be decided by the Board.
- any other activity, ancillary or incidental to any of the activities referred to in clauses (a) to (i) above or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any other manner.
- financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) above, which include extending of credit facilities or any other financial services to its members. Further, under Section 581B (2) it has also been clarified that every producer company shall deal primarily with the production of its active members for carrying out any of its objects specified above.

H. Dormant Companies

The Companies Act, 2013 has recognized a new set of companies called as dormant companies.

*As per section 455 (1) where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.*

Explanation appended to section 455(1) says that for the purposes of this section, —

- "inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;
- "significant accounting transaction" means any transaction other than—
- payment of fees by a company to the Registrar.
- payments made by it to fulfil the requirements of this Act or any other law.
- allotment of shares to fulfil the requirements of this Act; and
- payments for maintenance of its office and records.

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

Section 455(3) provides that the Registrar shall maintain a register of dormant companies in such form as may be prescribed.

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

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

**Corporate Personality**

Corporate Personality is the creation of law. Legal personality of corporation is recognized both in English and Indian law. A corporation is an artificial person enjoying in law capacity to have rights and duties and holding property.

A corporation is distinguished by reference to different kinds of things which the law selects for personification. The individuals forming the corpus of corporation are called its members. The juristic personality of corporations pre-supposes the existence of three conditions:

(1) There must be a group or body of human beings associated for a certain purpose.
(2) There must be organs through which the corporation functions, and
(3) The corporation is attributed will by legal fiction. A corporation is distinct from its individual members.

It has the legal personality of its own and it can sue and can be sued in its own name. It does not come to end with the death of its individual members and therefore, has a perpetual existence. However, unlike natural persons, a corporation can act only through its agents. Law provides procedure for winding up of a corporate body. Besides, corporations the banks, railways, universities, colleges, church, temple, hospitals etc. are also conferred legal personality. Union of India and States are also recognized as legal or juristic persons.

In certain cases, the corpus of the legal person shall be some fund or estate which reserved certain special uses. For instance, a trust – estate or the estate of an insolvent, a charitable fund etc..; are included within the term 'legal personality'.

Corporations are of two kinds:

1. Corporation Aggregate: Is an association of human beings united for the purpose of forwarding their certain interest. A limited Company is one of the best examples. Such a company is formed by a number of persons who as shareholders of the company contribute or promise to contribute to the capital of the company for the furtherance of a common object. Their liability is limited to the extent of their shareholding in the company. A limited liability company is thus formed by the personification of the shareholders. The property is not that of the shareholders, but its own property and its assets and liabilities are different from that of its members. The shareholders have

a right to receive dividends from the profits of the company but not the property of the company. The principle of corporate personality of a company was recognized in the case of Saloman v. Saloman & Co.

2. Corporation Sole: Is an incorporated series of successive persons. It consists of a single person who is personified and regarded by law as a legal person. In other words, a single person, who is in exercise of some office or function, deals in legal capacity and has legal rights and duties. A corporation sole is perpetual. Post – Master- General, Public Trustee, Comptroller and auditor general of India, the Crown in England etc. are some examples of a corporation sole. Generally, corporation sole are the holders of a public office which are recognized by law as a corporation. The chief characteristic of a corporation sole is its "continuous entity endowed with a capacity for endless duration". A corporation sole is an illustration of double capacity. The object of a corporation sole is similar to that of a corporation aggregate. In it a single person holding a public office holds the office in a series of succession, meaning thereby that with his death , his property , right and liabilities etc., do not extinguish but they are vested in the person who succeeds him. Thus, on the death of a corporation sole, his natural personality is destroyed, but legal personality continues to be represented by the successive person. In consequence, the death of a corporation sole does not adversely affect the interests of the public in general.

**Limited Liability**

Limited liability is the extent to which a company shareholder or director is financially responsible for their company's debts.

To benefit from limited liability, a business must be incorporated at Companies House to become a private limited company (LTD), public limited company (PLC) or limited liability partnership (LLP).

Once it has been incorporated, the business becomes a separate legal entity from its owners. That means the finances and assets of the individual and the finances and assets of the company are completely separate. If the company is sued or cannot pay its debts, the owners are only liable for the debt to the value of the money they have already invested in the business.

## What Does Limited Liability Mean?

The clear separation between individuals and their companies is a pivotal aspect of corporate law.

In the case of limited companies, this means that shareholders can only be held liable for company debts up to the value of their shares.

Directors cannot be held personally liable for company debts (unless they are shareholders in which cases the rules already explained apply)

The same goes for legal threats. When a company is sued, it is the legal structure that is the company which is being sued, not the individuals involved.

The same rules apply for members of LLP's (Limited Liability Partnerships) or Limited Partnerships.

## Advantages of a Limited Liability Company

There are a number of compelling advantages associated with a limited liability company. That includes:

No personal liability for company debts

One of the primary reasons the owners choose to incorporate their business is to avoid personal liability for company debts.

This allows the directors to trade without putting their personal property, cash and other assets at risk. As long as they adhere to their duties and responsibilities as directors then in the case of insolvency, the creditors will only be able to recover money they are owed from the bank account and assets of this business.

Tax efficiency

Limited companies are taxed on their profit at a rate of 19 percent. They are not subject to the personal tax rates placed on sole traders and partnerships (unlimited companies) which can be as high as 45 percent.

Directors of limited companies can pay themselves a salary at the personal allowance level and take the rest of their pay as dividends, which are taxed at a lower rate. This will reduce the tax burden and keep more money in their pocket.

Succession planning

As a limited liability company is deemed to be a separate legal entity from its owners, the company will continue to exist beyond the life of its members. That means, if directors or members retire or experience ill-health, the company will continue to exist and operate. This can provide security for employees and other company members.

Employee buy-in

Another benefit of a limited liability company is the ability for key employees to be granted shares via a company share scheme. This can boost employee motivation and provide a monetary reward beyond a mere salary. Having a vested interest in the company's success can also improve employee loyalty.

Protection of the company name

As part of the process of registering a limited liability company, a company name must be chosen. Company names can become valuable assets. Registering a name at Companies House prevents other businesses from using the same name. However, Companies House will accept the registration of a name which is very similar, so it may be worth registering alternative spellings or versions of the same name and keeping those as dormant companies.

Limited Liability Company Agreement

As part of the limited liability company registration process, by law, you have to create certain documents. That includes the Articles of Association, which sets out the rules company officers have to follow in the running of the company, and a Memorandum of Association, which gives notice of an individual's intention to become a company shareholder.

Another document that isn't required by law is a limited liability company agreement.

Also known as a shareholders' agreement or an LLP agreement, this document intends to formalise the relationship between shareholders or partners. It formalises what will happen when there are

differing opinions about the direction the company will take, establishes how the business will be run and sets the ground rules for the relationship.

A simple way to think of a limited liability company agreement is as the terms & conditions for company directors.

Although similar to the Articles of Association in its content, the main difference is that the Articles of Association has to be made public, while the limited liability company agreement is a private contract between shareholders.

Private Company Limited by Guarantee

Companies limited by guarantee are usually not-for-profit organisations like charities, sports clubs, societies and community projects. They are not set up to make a profit for the shareholders. Instead, any money they make is retained within the organisation or used for some other purpose.

A private company limited by guarantee is a separate legal entity that's responsible for its own income, assets, debts and liabilities, just like any other limited liability company.

However, instead of issuing shares, the company is owned by guarantors. Their personal liability for the debts of the organisation is limited to a fixed amount of money called a guarantee. This guarantee is written into the company's Memorandum of Association and requires the guarantors to pay the company's debts up to a fixed sum, which is usually £1.

A company limited by guarantee must have at least one director, although most have several. The directors may also be given some other name like trustees, governors, the board of managers or the management committee. Whatever their title, they are responsible for the day-to-day running of the organisation.

Liability of a Limited Liability Company

The basis of a limited liability company is that all debts incurred are the debts of the company and are not the responsibility of the shareholders or directors. In a company that's limited by shares, the shareholders' obligation is to pay the company for the shares they have. Once those shares have been paid for in full then no further money is payable.

In the case of a company that's limited by guarantee, each guarantor will be liable for the company's debts up to the value written into the Memorandum of Association.

The only way a director or shareholder can become liable for company debts over the value of their original shareholding holding or guarantee is where personal liability is imposed by the court. This can be the case in instances of wrongful or fraudulent trading.

Some creditors such as banks and other finance providers may ask directors to give personal guarantees for loans, overdrafts and a lease of premises. If the business does fail, then the director will be obliged to pay those debts from their personal funds.

Directors Personal Liability in a Limited Company

Although limited liability provides a great deal of protection for company shareholders and directors, there are some circumstances when they can become personally liable for business debts. That includes:

- If they sign a personal guarantee.
- If they continue to trade in the interest of shareholders (instead of the creditors) despite knowing the business is insolvent.
- If they dispose of assets at less than market value.
- If they overpay themselves from the company's account creating an overdrawn director's loan.
- If funds are raised to repay creditors via fraudulent means.

Limited Liability Company Debt Obligations

Despite the protection of limited liability, company debts can still be very stressful and worrying for the directors. Not only is their livelihood at risk, but they also have to be aware of their changing obligations.

Once cash-flow is compromised, a business can decline very quickly. Directors then have to monitor their financial position very carefully. If the business becomes insolvent (you can check using this free insolvency test) then they must prioritise the creditors' interests. Failure to do so could lead to personal liability for a proportion of the company's debts further down the line.

Company debts can include unpaid supplier invoices, unpaid rent and even wages owing to employees. However, one of the most worrying debts of limited liability companies are those owing to HMRC. VAT, PAYE and corporation tax debts are a common issue for company directors. HMRC has its own range of powers to pursue arrears aggressively which can make this situation incredibly stressful.

Obtaining help and support to deal with limited liability company debts, and specifically tax debt, is essential. Being proactive about controlling cash-flow and putting a firm plan in place is an important first step, as is identifying areas of the business where money is being wasted.

Company debt experts can help struggling directors to explore debt refinancing and consolidation options which could provide the working capital required to repay creditors and drive the business forward.

**Lifting of corporate veil**

Company enjoys a separate position from that of position of its owners. It is artificial but yet a person in eyes of law. Problems arise when this position of the company is misused. It is not incorrect to say that, though the company is an unreal person, but still it cannot act on its own. There has to be some human agency involved so that company is able to perform its functions. When this human agency is working, in the name of the company, for achieving goals approved by law, the social order is not disturbed. But when this medium of operations begins to be tainted, conflicts arise. This authority rather becomes firing of bullets from someone else’s gun.

When directors, or whosoever be in charge of the company, start committing frauds, or illegal activities, or even activities outside purview of the objective/articles of the company, principle of lifting the corporate veil is initiated. It is disregarding the corporate personality of a company, in order to look behind the scenes, to determine who the real culprit of the committed offence is. Thus, wherever this personality of the company is employed for the purpose of committing illegality or for defrauding others, Courts have authority to ignore the corporate character and look at the reality behind the corporate veil in order to ensure justice is served. This approach of judiciary in cracking open the corporate shell is somewhat cautious and circumspect.

In the case United States v. Milwaukee Refrigerator Transit Company, it was stated “A corporation will be looked upon as a legal entity, as a general rule, and until sufficient reason to the contrary

appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." Supreme Court of India had adopted the similar thinking in the case Tata Engineering and Locomotive Co. Ltd. vs. State of Bihar & Ors. where the corporations petitioning had joined together and claimed protection under Article 286 of Constitution of India for non-imposition of taxon the sale or purchase of goods, the Apex Court held that "If their contention is accepted, it would really mean that what the corporations or companies cannot achieve directly, they can achieve indirectly by relying upon the doctrine of lifting the veil."

When can be the veil lifted?

The doctrine, though one of the most used doctrines by Courts, is still, however, not running upon a hard-and-fast rule. The basis for invoking such operations does not follow a laid down policy. Howsoever, over the period of time, Courts and Legislatures throughout the globe have attempted to narrow down scope and applicability of the doctrine under following two heads: -

1) Statutory Provisions

The Companies Act, 2013 has been integrated with various provisions which tend to point out the person who's liable for any such improper/illegal activity. These persons are more often referred as "officer who is in default" under Section 2(60) of the Act, which includes people such as directors or key-managerial positions. Few instances of such frameworks are as following: -

A. Misstatement in Prospectus: -

Under Section 26 (9), Section 34 and Section 35 of the Act, it is made punishable to furnish untrue or false statements in prospectus of the company. Through issuing prospectus, companies offer securities for sale. Prospectus issued under Section 26 contains key notes of the company such as details of shares and debentures, names of directors, main objects and present business of the company. If any person attempts to furnish false or untrue statements in prospectus, he is subject to penalty or imprisonment or both prescribed under the aforesaid sections, depending upon the case. Each of these sections create a distinct aspect, that which type of incorrect information furnishing would make such person liable for what amount or serving term.

B. Failure to return application money: -

Under Section 39 (3) of the Act, against allotment of securities, if the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, then such officers in default are to be fined with an amount of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

C. Mis description of Company's name: -

The name of the company is most important. Usage of approved name entitles the company to enter into contracts and make them legally binding. This name should be prior approved under Section 4 and printed under Section 12 of the Act. Thus, if any representative of the company collects bills or sign on behalf of the company, and enter in incorrect particulars of the company, then such persons are to be held personally liable.

Similar things happened in the case Hendon vs. Adelman where signatory directors were held personally liable for stating company's name on a signed cheque as "L R Agencies Ltd" while the original name was "L & R Agencies Ltd."

D. For investigation of ownership of company: -

Under Section 216 of the Act, the Central Government is authorized to appoint inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons who are financially interested in the success or failure of the company; or who are able to control or to materially influence the policies of the company.

E. Fraudulent conduct: -

Under Section 339 of the Act, wherever in case of winding up of the company, it is found that company's name was being used for carrying out a fraudulent activity, the Court is empowered to hold any such person be liable for such unlawful activities, be it director, manager, or any other officer of the company. In the case Delhi Development Authority vs. Skipper Construction Company (P) it was stated that "where, therefore, the corporate character is employed for the purpose of committing illegality or for defrauding others, the court would ignore the corporate

character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned.

F. Inducing persons to invest money in company: -

Under Section 36 of the Act, any person who makes false, deceptive, misleading or untrue statements or promises to any other person or conceals relevant data from other person with a view to induce him to enter into either of following:-

i. An agreement of acquiring, disposing, subscribing or underwriting securities.
ii. An agreement to secure profits to any of the parties from the yield of securities or by reference to fluctuations in the value of securities.
iii. An agreement to obtain credit facilities from any bank or financial institution.

In such circumstances, the corporate personality can be ignored with a view to identify the real culprit and make him personally liable under Section 447 of the Act accordingly.

G. Furnishing false statements: -

Under Section 448 of the Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required, any person makes false or untrue statements, or conceals any relevant or material fact, then he is liable under Section 447 of the Act.

If any document is sent from company to any place else, content of the documents are sent on the letter-head of the company, Now when this letter is received by any other person, he is supposed to be under assumption that he has received the letter from the company. This "any other person" here is persons appointed under the Act, such as Registrar of Companies (ROC). If he is furnished any false or untrue statement, that is also an offence. Thus, in order to determine the real guilty person, who allowed such documents being released in the name of the company is to be found by way of lifting the corporate veil.

H. Repeated defaults: -

Under Section 449 of the Act, if a company or an officer of a company commits an offence punishable either with fine or with imprisonment and this offence is being committed again within period of 3 years, such company and officer are to pay twice the penalty of that offence in addition to any imprisonment provided for that offence.

2) Judicial Pronouncements: -

Though the Legislature has attempted to insert numerous provisions in the Act to make sure guilty person is pointed out as veil is pierced, there are instances where Judiciary has played it's part better and kept a check that no guilty person, due to a mere technicality, walks free. Following are few such scenarios where Court may without any doubt lift the corporate veil: -

A. Tax Evasion: -

It's duty of every earning person to pay respective taxes. Company is no different than a person in eyes of law. If anyone attempts to unlawfully avoid this duty, he is said to be committing an offence. When strict rules are laid down for human being, why leave company? One clear illustration was is Dinshaw Maneckjee Petit re. where the founding person of 4 new private companies, Sir Dinshaw, was enjoying huge dividend and interest income, and in order to evade his tax, he thus found 4 sham companies. His income was credited in accounts of these companies and these amounts were repaid to Sir Dinshaw but in form of a pretended loan. These loans entitled him to have certain tax benefits. It was rather held that purpose of founding these new companies was simple as means of avoiding super-tax.

B. Prevention of fraud/ improper conduct: -

It is obvious that no company can commit fraud on its own. There has to be a human agency involved to commit such acts. Thus, one may make efforts to prevent upcoming frauds. Similar thing was observed in the case Gilford Motor Co Ltd vs. Horne where, Horne was appointed as Managing Director of the company, provided he accepts the condition that he will not attempt to entice or solicit customers of the company while he is holding the post or even afterwards. However, shortly thereafter, he opened a company, in his wife's name, which carried out a competing business to that of the first company, with himself being in management. When the matter was brought into the Court, it was held that the newfound company was mere cloak or sham, for purpose of enabling Sir Dinshaw to commit breach of his covenant against solicitation.

C. Determination of enemy character: -

The purpose behind formation of company is self-profit. A company will not attempt to do good towards society consciously. However, it may opt to cause damage instead. Similar things were

observed in the case Dailmer Co Ltd vs. Continental Tyres & Rubber Co Ltd. The facts were such that a Germany based company was incorporated in England to sell tyres manufactures in Germany. The German company had however held the bulk of shares in this English company. As World War I broke out, the English company commenced an action to recover trade debt. The question was brought before House of Lords which decided the case against the claimant, stating that, company is not a real person but a legal entity, it cannot be a friend or an enemy. However, it may assume an enemy character when persons in de facto control of its affairs are residents of the enemy territory. Thus, the claim was dismissed.

It was rather held in the case Sivfracht vs. Van Udens Scheepvart that, if in such scenarios where a company is suspected to be of enemy character or is proved to be of enemy character, then such granted monetary funds would be used as machinery to destroy the concerned State itself. That would be monstrous and against public policy of that concerned State.

D. Liability for ultra-vires acts: -

Every company is bound to perform in compliance 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 & Iron Company Ltd v. Hector Riche where a company entered into a contract for financing construction of railway 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.

E. Public Interest/Public Policy

Where the conduct of the company is in conflict with public interest or public policies, Courts are empowered to lift the veil and personally hold such persons liable who are guilty of the act. To protect public policy is a just ground for lifting the corporate personality.

One such scenario is Jyoti Limited vs. Kanwaljit Kaur Bhasin & Anr., where it was held that corporate veil maybe ignored if representatives of the company commit contempt of the Court so punishment can be inflicted upon.

F. Agency companies: -

Where it is expedient to identify the principal and agent concerning an improper action performed by the agent, the corporate veil maybe neglected. Such as in the case of Bharat Steel Tubes Ltd vs IFCI where it was held that it doesn't matter, and it isn't necessary that Government should be holding more than 51% of the paid-up capital to be the principal. In fact, in the case New Tiruper Area Development Corporation Ltd vs. State of Tamil Nadu where Government was holding mere 17.4% of the investment funds, it was found that Area Development Corporation was actually a public authority through the Government. It was created under a public-private participation to build, operate and transfer water supply and sewage treatment systems.

G. Negligent activities: -

Every company law distinguishes between holding and subsidiary companies. Holding companies under Indian company law are the companies which have right in composition of Board of Directors, or which have more than 50% of the total share capital of the subsidiary company. For example, Tata Sons is the holding company while Tata Motors, TCS, Tata Steel are its subsidiary companies.

In cases where subsidiary companies have been found with tainted operations, Courts have power to make holding companies liable for actions of their subsidiary companies as well for breach of duty or negligence on their part. Such as in the case of Chandler vs Cape Plc where an employee brought an action against holding company 'Cape Plc' for not taking proper health and safety measures, even though employee was employed in its subsidiary company.

Employee was appointed in the year 1959 in the subsidiary company while he had discovered the fact that he is suffering from asbestosis in year 2007. When he was aware of his condition it was that the subsidiary company was no longer in existence, thus, he brought action against the holding company, which was still in existence. This matter was held to be maintainable. Rather, holding company was held guilty and made liable as it owed duty of care towards employees. It was for the first time where a holding company, despite the fact that it's a legal entity separate from that of its subsidiary, is however liable for actions of its subsidiary.

H. Sham Companies: -

The Courts are also empowered to lift the corporate veil if they are of the opinion that such companies are sham or hoax. Such companies are mere cloaks and their personalities can be ignored in order to identify the real culprit. This principle can be seen in the prior discussed case of Gilford Motor Co Ltd vs. Horne where it was held that the newfound company was mere cloak or sham, for purpose of enabling Sir Dinshaw to commit breach of his covenant against solicitation.

I. Companies intentionally avoiding legal obligations: -

Wherever it is found that an incorporated company is deliberately trying to avoid legal obligations, or wherever it is found that this incorporation of a company is being used to avoid force of law, the Courts have authority to disregard this legal personality of the company and proceed as if no company existed. The liabilities can be straight away imposed on persons concerned.

**Promoters**

When an individual has an idea for a new business venture, he or she may set about interesting others in the venture and persuade them to contribute capital to a company to be incorporate for the purpose of carrying on the venture. The individual will then be described as 'promoter' of the company. A person who acts in a professional capacity is not a promoter. A company is born only when it is duly incorporated. For incorporating a company various documents are to be prepared and other formalities are to be complied with. All this work is done by promoters.

Then the question arises that who really are promoters of a company, the most important work of a promoter is in the formation of a company. The whole process of the formation of a company may be divided into four stages (i) Promotion, (ii) Registration, (iii) Floatation and (iv) Commencement of business. Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. A promoter may be an individual, syndicate, association, partner or company.

The expression 'promoter' has been defined under Section 2(69) in the Companies Act, 2013 as:

"promoter" means a person—

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

- who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

The term is used expressly in sections 35, 39, 300 and 317.

In the case of Bosher v. Richmond Land Co., the term Promoter has been defined as:

"A Promoter is a person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscription, and sets in motion the machinery which leads to the formation itself."

"A promoter is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose."

L.J. Brown in the case of Whaley Bridge printing Co. observed that the term promoter is "a term not of law but of business".

To be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter. However, a person assisting the promoters by acting in a professional capacity do not thereby became promoters themselves. The relationship between a promoter and the company that he has floated must be deemed to be fiduciary relationship from the day the work of floating the company starts and continues up to the time that the directors take into their hands what remains to be done in the way of forming the company.

The status of the promoter is generally terminated when the Board of Directors has been formed and they start governing the company. Chronologically, the first persons who control or influence the company's affairs are its promoters. It is they who conceive the idea of forming the company, and it is they who take the necessary steps to incorporate it, to provide it with share and loan capital etc. when these things have been done, they handover the control of the company to its directors, who are often themselves under a different name. on handling over the control of the company the

promoter's fiduciary and common law duties cease, and he is thereafter subject to no more extensive duties in dealing with the company than a third person who is unconnected with it.

Meaning of Promoter

A promoter is a generic term associated with the person who starts a business. In common parlance, this person is also referred to as the founder of the business. A promoter typically is responsible for raising capital, targeting initial leads and chasing initial business opportunities, entering into the initial contracts for the business formation and incorporating the company.

The Substantial Acquisition of Shares Takeovers (SEBI) Regulation states that the promoter is:

(a) any person who is in control of the target company
(b) any person named as promoter in any offer document of the target company or any shareholding pattern filed by the target company with the stock exchanges pursuant to the listing agreement, whichever is later.

In the old Companies Act, 1956 there was no static definition of promoter although it was mentioned in various section, but in the new Companies Act, 2013 Section 2(69) defines promoter.

Position of promoter in Companies Act, 1956 and in different Statues

The expression 'promoter' has not been defined under the Companies Act, 1956, although the term is used expressly in sections 62, 69, 76, 478 and 519. Section 62 of Companies Act, 1956 defines 'promoter' for the limited purpose of that section only. Section 62(6)(a) defines the expression 'promoter' to mean a promoter who was a party to the preparation of the prospectus or of a portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity in procuring the formation of the company.

In Twycross v. Grant promoter was described as "one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose."

In USA, the Securities Exchange Commission Rule 405(a) defines promoter as a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business enterprise.

In Lagunas Nitrate Co. v. Lagunas Syndicate [1889] 2 Ch. 392 (p. 428, C.A.), it was stated that "to be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.

The difficulties in defining the term led the judges to state that the term promoter is not a term of art, nor a term of law, but of business.

Position of promoters in Companies Act, 2013

The new Companies Act, 2013 has defined promoter in Section 2(69) as;

"promoter" means a person—

a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

A person who acts in a professional capacity is not a promoter. Thus, a solicitor, who prepares on behalf of the promoters the primary documents of the proposed company, is not a promoter. Similarly, an accountant or a valuer who helps the promotion in his professional capacity is not a promoter. But any such person may become a promoter if he helps the formation of the company by doing an act outside the scope of his professional capacity.

A person cannot; however, become a promoter merely because he signs the memorandum as a subscriber for one or more shares.

In conclusion, it may be said that word "promoter" is used in common parlance to denote any individual, syndicate, association, partnership or a company which takes all the necessary steps to create and mould a company and set it going.

**Duties of Promoter**

The promoters occupy an important position and have wide powers relating to the formation of a company. It is, however, interesting to note that so far as the legal position is concerned, he is neither an agent nor a trustee of the proposed company. But it does not mean that the promoter does not have any legal relationship with the proposed company. The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders in it.

Following are the major Duties of the promoter:

Duty to disclose secret profits

A promoter is not forbidden to make profit but to make secret profits. He may make a profit out of promotion with the consent of the company, in the same way as an agent may retain a profit obtained through his agency with his principle’s consent.

A promoter is allowed to make a profit out of a promotion but with the consent of the company.

Duty of disclosure of interest

In addition to his duty for declaration of secret profits, a promoter must disclose to the company any interest he has in a transaction entered into by it. This is so even where a promoter sells property of his own to the company but does not have to account for the profit he makes from the sale because he bought the property before the promotion began. Disclosure must be made in the same way as though the promoter was seeking the company’s consent to his retaining a profit for which he is accountable.

Promoter’s duties under the Indian Contract Act

Promoter’s duties to the company under the Indian Contract Act have not been dealt with by the courts in any detail. They cannot depend on contract, because at the time the promotion begins, the company is not incorporated, and so cannot contract with its promoters. It seems, therefore, that the promoter’s duties must be the same as those or a person, who acts on behalf of another without a contract of employment, namely, to shun from deception and to exercise reasonable skill and care. Thus, where a promoter negligently allows the company to purchase property, including his own, for more than its worth, he is liable to the company for the loss it suffers. Similarly, a

promoter who is responsible for making misrepresentations in a prospectus may be held guilty of fraud under section 17, of the Indian Contract Act and consequently liable for damages under section 19 of the Act.

Termination of Promoter's Duties

A promoter's duties do not come to an end on the incorporation of the company, or even when a Board of directors in appointed. They continue until the company has acquired the property or business which it was formed to manage and has raised its initial share capital and the Board of directors has taken over the management of the company's affairs from the promoters. When these things have been done, the promoter's fiduciary and contractual duties cease.

Remedies available to the company against the promoter for breach of his duties

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

Rescission of contract

So far as the right to rescind is concerned, this must be exercised on normal contractual principles, that is to say, the company must have done nothing to show an intention to ratify the agreement after finding breach involving non-disclosure or misrepresentation.

To recover secret profit

If a promoter makes a secret profit or does not disclose any profit made, the company has a remedy against him.

**Liabilities on Promoter**

A promoter is subjected to liabilities under the various provisions of the Companies Act.

- Section 26 of the Companies Act, 2013 lay down matters to be stated in a prospectus. A promoter may be held liable for non-compliance of the provisions of the section.
- Under section 34 and 35, a promoter may be held liable for any untrue statement in the prospectus to a person who subscribes for shares or debentures in the faith of such

prospectus. However, the liability of the promoter in such a case shall be limited to the original allottee of shares and would not extend to the subsequent allotters.

- According to section 300, a promoter may be liable to examination like any other director or officer of the company if the court so directs on a liquidator's report alleging fraud in the promotion or formation of the company.
- A company may proceed against a promoter on action for deceit or breach of duty under section 340, where the promoter has misapplied or retained any property of the company or is guilty of misfeasance or breach of trust in relation to the company.

The Madras High Court in Prabir Kumar Misra v. Ramani Ramaswamy [2010] 104 SCL 174, has held that to fix liability on a promoter, it is not necessary that he should be either a signatory to the Memorandum/Articles of Association or a shareholder or a director of the company. Promoter's civil liability to the company and also to third parties remain in respect of his conduct and contract entered into by him during pre-incorporation stage as agent or trustee of the company.

Status of pre-incorporation of contracts

The promoter is obligated to bring the company in the legal existence and to ensure its successful running and in order to accomplish his obligation he may enter into some contract on behalf of prospective company. These types of contract are called 'Pre-incorporation Contract.

Nature of Pre-incorporation contract is slightly different to ordinary contract. Nature of such contract is bilateral; be it has the features of tripartite contract. In this type of contract, the promoter furnishes the contract with interested person and it would be bilateral contract between them. But the remarkable part of this contract is that, this contract helps the perspective company, who is not a party to the contract.

One might question that 'why is company not liable, even if it a beneficiary to contact' or one might also question that 'doesn't promoter work under Principal-Agent relationship. Answer to these entire questions would be simple. The company does not in legal existence at time of pre-incorporation contract. If someone is not in legal existence, then he cannot be a party to contract.

Before the passing of the Specific Relief Act 1963, the position in India, regarding pre-incorporation contract, was similar to the English Common Law. This was based on the general rule of contract where two consenting parties are bound to contract, and third party is not connected with the enforcement and liability under the terms of contract. And because company does not come in existence before its incorporation, so the promoter signs contract on behalf of company with third party, and that is why the promoter was solely liable for the pre-incorporation contract.

However, the provisions of the specific relief Act, 1963 makes the pre-incorporation contracts valid. Section 15(h) and Section 19 (e) of the Specific Relief Act of 1963, deviate from the common law principles to some extent,

Under section 15 (h) of the Specific Relief Act, 1963,

Except as otherwise provided by this Chapter, the specific performance of a contract may be obtained by--

(a) any party thereto;
(b) the representative in interest or the principal, of any party thereto

Provided that where the learning , skill, solvency or any personal quality of such party is a material ingredient in the contract, or where the contract provides that his interest shall not be assigned, his representative in interest or his principal shall not be entitled to specific performance his part of the contract, or the performance thereof by his representative in interest, or his principal, has been accepted by the other party; when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of the incorporation, the company.

Under Section 19 (e) of the Specific Relief Act, 1963,

Except as otherwise provided by this Chapter, specific performance of a contract may be enforced against the company, when the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation.

In Weavers Mills Ltd. v. Balkies Ammal [AIR 1969 Mad 462], the Madras High Court extended the scope of this principle through its decision. In this case, promoters had agreed to purchase

some properties for and on behalf of the company to be promoted. On incorporation, the company assumed possession and constructed structures upon it. It was held that even in absence of conveyance of property by the promoter in favor of the company after its incorporation, the company's title over the property could not be set aside.

Promoters are generally held personally liable for pre-incorporation contract. If a company does not ratify or adopt a pre-incorporation contract under the Specific Relief Act, then the common law principle would be applicable, and the promoter will be liable for breach of contract.

In Kelner v Baxter, where the promoter in behalf of unformed company accepted an offer of Mr. Kelner to sell wine, subsequently the company failed to pay Mr. Kelner, and he brought the action against promoters. Erle CJ found that the principal-agent relationship cannot be in existence before incorporation, and if the company was not in existence, the principal of an agent cannot be in existence. He further explain that the company cannot take the liability of pre-incorporation contract through adoption or ratification; because a stranger cannot ratify or adopt the contract and company was a stranger because it was not in existence at the time of formation of contract. So, he held that the promoters are personally liable for the pre-incorporation contract because they are the consenting party to the contract.

In Newborne v Sensolid (Great Britain) Ltd, Court of Appeal interpreted the finding of Kelner v Baxter in a different way and developed the principle further. In this case an unformed company entered into a contract, the other contracting party refused to perform his duty. Lord Goddard observed that before the incorporation the company cannot be in existence, and if it is not in existence, then the contract which the unformed company signed would also be not in existence. So, company cannot bring an action for pre-incorporation contract, and also the promoter cannot bring the suit because they were not the party to contract.

This case created some amount of confusion that, if the contract was sign by the agent or promoter, then he will be liable personally and he has the right to sue or to be sued. But if a person representing him as director of unformed company enters into the contact then the contact would be unenforceable.

These principles were found applicable in Indian case.

In Seth Sobhag Mal Lodha v Edward Mill Co. Ltd., the High Court of Rajasthan followed the approach of Common Law regarding liability of pre-incorporation contract. This case was criticized by A. Ramaiya in Guide to Companies Act (Sixth Edition), he found that learned judges did not noticed the Specific Relief Act.

Although under common law promoter is personally liable for the pre-incorporation contract, but there is some scope where the promoter can shift his liability to company. He can shift to company his liability under the Specific Relief Act 1963 or he can go for novation under contract law. In Howard v Patent Ivory Manufacturing, the English Court accepted the novation of contract.

A promoter is personally liable for the pre-incorporation contract, because at the time of formation of pre-incorporation contract, the company does not come in existence, so neither the principle agent relationship exist not the company become the party. Company is not liable for the pre-incorporation contract when it come in existence, but under the arrangement of section 15(h) and 19(e) of the Specific Relief Act 1963, company can take the rights and liability of promoter. It is also found that promoter is personally liable for the pre-incorporation contract in American Law, English Law and Indian Law.

# UNIT – 2

# INCORPORATION

**Synopsis**

- Procedure of Incorporation
- Certificate of Incorporation
- Memorandum of Association
- Doctrine of Ultra Vires
- Articles of Association
- Provisions for Entrenchment
- Alteration of Articles of Association
- Binding effect of Memorandum and Articles of Association
- The doctrine of Constructive Notice
- Distinction Between Memorandum and Articles of Association
- The doctrine of Indoor Management
- Exceptions to the Doctrine of Indoor Management
- Prospectus

**Procedure of Incorporation**

The Companies Act of 1956 sets down rules for the establishment of both public and private companies. The most commonly used corporate form is the limited company, unlimited companies being relatively uncommon. A company is formed by registering the Memorandum and Articles of Association with the State Registrar of Companies of the state in which the main office is to be located.

Foreign companies engaged in manufacturing and trading activities abroad are permitted by the Reserve Bank of India to open branch offices in India for the purpose of carrying on the following activities in India:

- To represent the parent company or other foreign companies in various matters in India, for example, acting as buying/selling agents in India, etc.

- To conduct research work in which the parent company is engaged provided the results of the research work are made available to Indian companies
- To undertake export and import trading activities
- To promote possible technical and financial collaboration between Indian companies and overseas companies.

Application for permission to open a branch, a project office or liaison office is made via the Reserve Bank of India by submitting form FNC-5 to the Controller, Foreign Investment and Technology Transfer Section of the Reserve Bank of India. For opening a project or site office, application may be made on Form FNC-10 to the regional offices of the Reserve Bank of India. A foreign investor need not have a local partner, whether or not the foreigner wants to hold full equity of the company. The portion of the equity thus not held by the foreign investor can be offered to the public.

Approval of Name

The first step in the formation of a company is the approval of the name by the Registrar of Companies (ROC) in the State/Union Territory in which the company will maintain its Registered Office. This approval is provided subject to certain conditions: for instance, there should not be an existing company by the same name. Further, the last words in the name are required to be "Private Ltd." in the case of a private company and "Limited" in the case of a Public Company. The application should mention at least four suitable names of the proposed company, in order of preference. In the case of a private limited company, the name of the company should end with the words "Private Limited" as the last words. In case of a public limited company, the name of the company should end with the word "Limited" as the last word. The ROC generally informs the applicant within seven days from the date of submission of the application, whether or not any of the names applied for is available. Once a name is approved, it is valid for a period of six months, within which time Memorandum of Association and Articles of Association together with miscellaneous documents should be filed. If one is unable to do so, an application may be made for renewal of name by paying additional fees. After obtaining the name approval, it normally takes approximately two to three weeks to incorporate a company depending on where the company is registered.

Memorandum and Articles

The Memorandum of Association and Articles of Association are the most important documents to be submitted to the ROC for the purpose of incorporation of a company. The Memorandum of Association is a document that sets out the constitution of the company. It contains, amongst others, the objectives and the scope of activity of the company besides also defining the relationship of the company with the outside world.

The Articles of Association contain the rules and regulations of the company for the management of its internal affairs. While the Memorandum specifies the objectives and purposes for which the Company has been formed, the Articles lay down the rules and regulations for achieving those objectives and purposes.

The ROC will give the certificate of incorporation after the required documents are presented along with the requisite registration fee, which is scaled according to the share capital of the company, as stated in its Memorandum. A private company can commence business on receipt of its certificate of incorporation.

A public company has the option of inviting the public for subscription to its share capital. Accordingly, the company has to issue a prospectus, which provides information about the company to potential investors. The Companies Act specifies the information to be contained in the prospectus.

The prospectus has to be filed with the ROC before it can be issued to the public. In case the company decides not to approach the public for the necessary capital and obtains it privately, it can file a "Statement in Lieu of Prospectus" with the ROC.

On fulfillment of these requirements, the ROC issues a Certificate of Commencement of Business to the public company. The company can commence business immediately after it receives this certificate.

Miscellaneous Documents

The documents/forms stated below are filed along with Memorandum of Association and Articles of Association on payment of filing fees (depending on the authorised capital of the company):

- Declaration of compliance, duly stamped

- Notice of the situation of the registered office of the company
- Particulars of Directors, Manager or Secretary
- Authority executed on a non-judicial stamp paper, in favour of one of the subscribers to the Memorandum of Association or any other person authorizing him to file the documents and papers for registration and to make necessary corrections, if any
- The ROC's letter (in original) indicating the availability of the name.

Tax Registration

Businesses liable for income tax must obtain a tax identification card and number [known as Permanent Account Number (PAN)] from the Revenue Department. In addition to this, businesses liable to withhold tax must necessarily obtain a Tax Deduction Account Number (TAN). Both the PAN and the TAN must be indicated on all the returns, documents and correspondence filed with the Revenue Department. The PAN is also required to be stated in various other documents such as the documents pertaining to sale or purchase of any immovable property (exceeding Rs. five lakh), sale or purchase of a motor vehicle, time deposit (exceeding Rs. 5 lakh), contract for sale or purchase of securities (exceeding Rs. 10 lakh), to name a few.

Rules Applicable

- Companies (Central Governments') General Rules and Forms,1956
- Filing Registering/Approving Authority
- One copy has to be submitted along with a forwarding letter addressed to the concerned Registrar of Companies.

Enclosures

The declaration must be submitted with the following annexure

- Document evidencing payment of fee
- Memorandum and Articles of Association
- Copy of agreement if any, which the proposed company wishes to enter into with any individual for appointment as its managing or whole-time director or manager
- Form 18
- Form 32 (except for section 25 company)

- Form 29 (only in case of public companies)
- Power of Attorney from subscribers
- Letter from Registrar of Companies making names available
- No objection letters from directors/promoters
- Requisite fees either in cash or demand draft

Fees

Fee payable depends on the nominal capital of the company to be registered and may be paid in one of the following modes. Cash/postal order (upto Rs.501-), demand draft favouring Registrar of Companies/Treasury Challan should be payable into specified branches of Punjab National Bank for credit

Time-Limit

It should be submitted before incorporation or within 6 months of the name being made available. Top

Requirements

The declaration has to be signed by an advocate of Supreme Court or High Court or an attorney or pleader entitled to appear before the High Court or a secretary or chartered accountant in whole-time practice in India who is engaged in the formation of the proposed company or person named in the articles as director, manager or secretary.

The Registrar of Companies has to be satisfied that not only the requirements of section 33(1) and (2) have been complied with but be also satisfied that provisions relating to number of subscribers, lawful nature of objects and name are complied with.

The Registrar will check whether the documents have been duly stamped and also whether the requirements of other laws are met.

Any defect in any of the documents filed has to be rectified either by all the subscribers or their attorney, or by any one subscriber holding the power of attorney on behalf of other subscribers.

This form is to be presented to the Registrar of Companies within three months from the date of letter of Registrar allowing the name.

This declaration is to be given on a non-judicial stamp paper of the requisite value. The stamp paper should be purchased in the name of the person signing the declaration.

This declaration is to be given by all the companies at, the time of registration, public or private.

The place of Registration No. of the company should be filled up by mentioning New Company therein.

The Registrar of Companies will now accept computer laser printed documents for purposes of registration provided the documents are neatly and legibly printed and comply with the other requirements of the Act. This will be an additional option available to the public to use laser print besides offset printing for submitting the memorandum and articles for the registration of companies.

Where the executants of a memorandum of association is illiterate, he shall give his thumb impression or marks which should be described as such by the subscriber or person writing for him.

An agent may sign a memorandum on behalf of a subscriber if he is authorised by a power-of-attorney to do so. In the case of an illiterate subscriber to the memorandum and articles of association, the thumb impression or mark duly attested by the person writing for him should be given. The person attesting the thumb mark should make an endorsement on the document to the effect that it has been read and explained to the subscriber. The Registrar of Companies will not accept zerox copies of the memorandum and articles of association for the purposes of registration of companies.

This declaration is to be presented by the person signing the declaration or by his bearer at the counter of the Registrar of Companies office.

Managerial Remuneration

- Any person in order to be appointed as the Managing Director of the company should be a resident of India. Any person, being a non-resident in India, must obtain an Employment Visa from the concerned Indian mission abroad at the time of their appointment as the Managing Director.

- Whereas private companies are free to pay any remuneration to its directors, public companies can remunerate their directors only within the specified limits.
- In case of public companies, in the event of absence or inadequacy of net profits in any financial year, managerial remuneration is limited to amounts varying from Rs 75,000 to Rs 2,00,000 per month, depending on the effective capital of the company. In case of an expatriate managerial person, perquisites in the form of children's education allowance, holiday passage money and leave travel concession provided to him would not form part of the said ceiling of remuneration.
- In case of a managerial position in two companies, remuneration can be drawn from one or both companies provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

<u>With whom to be filed</u>

With the Registrar of Companies of the State in which the company is to be registered.

<u>Documents required to be submitted</u>

- A printed copy each of the Memorandum and Articles of Association of the proposed company filed along with the declaration duly stamped with the requisite value of adhesive stamps from the State/ Union Territory Treasury (For value of stamps to be affixed see Schedule printed in Part III Chapter 23). Below the subscription clause the subscribers to the Memorandum should write in his own handwriting his full name and father's, or husband's full name in block letters, full address, occupation, e.g., ‘business executive, engineer, housewife, etc. and number of equity shares taken and then put his or her signatures in the column meant for signature. Similarly, at the end of the Articles of Association the subscriber should write in his own handwriting: his full name and father's full name in block letters, full address, occupation. The signatures of the subscribers to the Memorandum and the Article of Association should be witnessed by one person preferably by the person representing the subscribers, for registration of the proposed company before the Registrar of Companies. Under column 'Total number of equity shares' write the total

of the shares taken by the subscribers e.g., 20 (Twenty) only. Mention date e.g. 5th day of August 1996. Place-e.g., 'New Delhi'.

- With the stamped copy, one spare copy each of the Memorandum and Articles of Association of the proposed company.
- Original copy of the letter of the Registrar of Companies intimating the availability of name.
- Form No. 18 - Situation of registered office of the proposed company.
- Form No. 29-Consent to act as a director etc. Dates on the consent Form and the undertaking letters should be the same as is mentioned in the Memorandum of Association signed by the director himself. A private company and a wholly owned Government company are not required to file Form No. 29.
- Form No. 32 (in duplicate). Particulars of proposed, directors, manager or secretary.
- Power of attorney duly typed on a non-judicial stamp paper of the requisite value. The stamp paper should be purchased in the name of the persons signing the authority.
- No objection letter from the persons whose name has been given in application for availability of name in Form No. 1-A as promoters/directors but are not interested at a later stage should be obtained filed with the Registrar at the time of submitting documents, for registration
- The agreements, if any, which the company proposes to enter with any individual for, appointment as managing or whole-time director or manager are also to be filed.

Fee payable

Cash or a bank draft/ pay order treasury challan should be drawn in the name of the Registrar of Companies of the State in which the Company is proposed to be registered as per Schedule X.

Reporting Requirements

Annual Accounts

The Indian company law does not prescribe the books of accounts required to be maintained by a company. It, however, provides that the same should be kept on accrual basis and according to the double entry system of accounting and should be such as may be necessary to give a true and fair state of affairs of the company.

The Indian company law requires every company to maintain proper books of account with respect to the following:

- All sums of money received and expended and the matters in respect of which the receipt and expenditure take place
- All sales and purchases of goods by the company
- The assets and liabilities of the company
- In case of companies engaged in manufacturing, processing, mining etc., such particulars relating to utilization of material or labour or other items of cost.

The first annual accounts of a newly incorporated company should be drawn from the date of its incorporation upto to the day not preceding the AGM date by more than 9 months. Thereafter, the accounts should be drawn from date of last account upto the day not preceding the AGM date by more than 6 months subject to the extension of the time limit in certain cases. The accounts of the company must relate to a financial year (comprising of 12 months) but must not exceed 15 months. The company can obtain an extension of the accounting period to the extent of 18 months by seeking a prior permission from the ROC.

The annual accounts must be filed with the ROC within 30 days from the date on which the Annual General Meeting (AGM) of the company was held or where the AGM is not held, then within 30 days of the last date on which the AGM was required to be held.

Books of accounts to be kept by company

Every company is required to maintain proper books of account with respect to all sums of money received and expended, all sales and purchases of goods, the assets and liabilities. Central Government may also specifically require the maintenance of certain additional particulars with respect to certain classes of Companies. The books of account relating to eight years immediately preceding the current year together with supporting vouchers are required to be preserved in good order. Every profit and loss account and balance sheet of the company (together referred to as financial statements) is required to comply with the accounting standards issued by the Institute of Chartered Accountants of India. Any deviations from the accounting standards, including the reasons and consequent financial effect, is required to be disclosed in the financial statements.

The responsibility for the preparation of financial statements on a going concern basis is that of the management. The management is also responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards. The management is also responsible for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

Annual Return

Every company having a share capital is required to file an annual return with the ROC within 60 days from the date on which the AGM of the company was held or where the AGM is not held, then within 60 days of the last date on which the AGM was required to be held.

Certain Accounting related issues

Depreciation

The company law in India permits the use of depreciation rates according to the nature of the classes of assets. Assets can be depreciated either on the basis of straight-line method (based on the estimated life of the asset) or on the basis of reducing balance method. The law prescribes the minimum rates of depreciation. A company may, however, provide for a higher rate of depreciation, based on a bonafide technological evaluation of the asset. Adequate disclosure in the annual accounts must be made in this regard.

Dividend

There is no limit on the rate of dividend but there are certain conditions prescribed with regard to computation of profits that can be distributed as dividend. Generally, no dividend can be paid for any financial year except out of the profits of that year after making an adequate provision for depreciation subject to certain conditions. Dividends may also be distributed out of accumulated profits.

Repatriation of profits

A company has to retain a maximum of 10% of the profits as reserves before the declaration of dividends. These reserves, inter alia, can be subsequently converted into equity by way of issue of bonus shares. Dividends are freely repatriable once the investment approval is granted.

Imposition of taxes

Currently, domestic companies are taxable at the rate of 35.875% (inclusive of surcharge of 2.5%) on its taxable income. Foreign companies are taxed at a marginally higher rate of 41% (including surcharge of 2.5%). However, in case where the income tax liability of the company under the provisions of the domestic tax laws works out to less than 7.5% of the book profits (derived after making the necessary adjustments), a Minimum Alternate Tax of 7.6875% (including a surcharge of 2.5%) on the book profits, would be payable. Domestic companies are required to pay a dividend distribution tax of 12.8125% (including surcharge of 2.5%) on the dividends distributed during the year.

Companies are required to withhold tax under the domestic law from certain payments including salaries paid to employees, interest, professional fee, payments to contractors, commission, winnings from games / lottery / horse races etc. Moreover, taxes have to be withheld from all payments made to non-residents at the lower of rates specified under the domestic law or under the applicable tax treaty, if any.

Penalty

- Imprisonment up to two years and fine
- Person liable for default
- Person signing the declaration

**Certificate of Incorporation**

After the duly stamped Memorandum of Association and Articles of Association, documents and forms are filed and the filing fees are paid, the ROC scrutinizes the documents and, if necessary, instructs the authorised person to make necessary corrections. Thereafter, a Certificate of Incorporation is issued by the ROC, from which date the company comes into existence. It takes one to two weeks from the date of filing Memorandum of Association and Articles of Association

to receive a Certificate of Incorporation. Although a private company can commence business immediately after receiving the certificate of incorporation, a public company cannot do so until it obtains a Certificate of Commencement of Business from the ROC.

**Memorandum of Association**

A company is formed when a number of people come together for achieving a specific purpose. This purpose is usually commercial in nature. Companies are generally formed to earn profit from business activities. To incorporate a company, an application has to be filed with the Registrar of Companies (ROC). This application is required to be submitted with a number of documents. One of the fundamental documents that are required to be submitted with the application for incorporation is the Memorandum of Association.

Definition of Memorandum of Association

Section 2(56) of the Companies Act, 2013 defines Memorandum of Association. It states that a "memorandum" means two things:

- Memorandum of Association as originally framed.

Memorandum as originally framed refers to the memorandum as it was during the incorporation of the company.

- Memorandum as altered from time to time.

This means that all the alterations that are made in the memorandum from time to time will also be a part of Memorandum of Association.

The section also states that the alterations must be made in pursuance of any previous company law or the present Act.

In addition to this, according to Section 399 of the Companies Act, 2013, any person can inspect any document filed with the Registrar in pursuance of the provisions of the Act. Hence, any person who wants to deal with the company can know about the company through the Memorandum of Association.

Meaning of Memorandum of Association

Memorandum of Association is a legal document which describes the purpose for which the company is formed. It defines the powers of the company and the conditions under which it operates. It is a document that contains all the rules and regulations that govern a company's relations with the outside world.

It is mandatory for every company to have a Memorandum of Association which defines the scope of its operations. Once prepared, the company cannot operate beyond the scope of the document. If the company goes beyond the scope, then the action will be considered ultra vires and hence will be void.

It is a foundation on which the company is made. The entire structure of the company is detailed in the Memorandum of Association.

The memorandum is a public document. Thus, if a person wants to enter into any contracts with the company, all he has to do is pay the required fees to the Registrar of Companies and obtain the Memorandum of Association. Through the Memorandum of Association, he will get all the details of the company. It is the duty of the person who indulges in any transactions with the company to know about its memorandum.

Object of registering a Memorandum of Association or MOA

Memorandum of Association is an essential document that contains all the details of the company. It governs the relationship between the company and its stakeholders. Section 3 of the Companies Act, 2013 describes the importance of memorandum by stating that, for registering a company,

(a) In case of a public company, seven or more people are required.
(b) In case of a private company, two or more people are required.
(c) In case of a one-person company, only one person is required.

In all the above cases, the concerned people should first subscribe to a memorandum before registering the company with Registrar.

Thus, Memorandum of Association is essential for registration of a company. Section 7(1)(a) of the Act states that for incorporation of a company, Memorandum of Association and Articles of

Association of the company should be duly signed by the subscribers and filed with the Registrar. In addition to this, a memorandum has other objects as well. These are,

1. It allows the shareholders to know about the company before buying it shares. This helps the shareholders determine how much capital will they invest in the company.
2. It provides information to all the stakeholders who are willing to associate with the company in any way.

Format of Memorandum of Association

Section 4(5) of the Companies Act states that a memorandum should be in any form as given in Tables A, B, C, D, and E of Schedule 1. The Tables are of different kinds because of different kinds of companies.

Table A – It is applicable to a company limited by shares.

Table B – It is applicable to a company limited by guarantee and not having a share capital.

Table C – It is applicable to a company limited by guarantee and having a share capital.

Table D – It is applicable to an unlimited company not having a share capital.

Table E – It is applicable to an unlimited company having a share capital.

The memorandum should be printed, numbered and divided into paragraphs. It should also be signed by the subscribers of the company.

Content of Memorandum of Association

Section 4 of the Companies Act, 2013 states the contents of the memorandum. It details all the essential information that the memorandum should contain.

Name Clause

The first clause states the name of the company. Any name can be chosen for the company. But there are certain conditions that need to be complied with.

Section 4(1)(a) states:

- If a company is a public company, then the word ‘Limited’ should be there in the name. Example, “Robotics”, a public company, its registered name will be “Robotics Limited”.
- If a company is a private company, then ‘Private Limited’ should be there in the name. “Secure “a private company, its registered name will be “Secure Private Limited”.
- This condition is not applicable to Section 8 companies.

What are Section 8 companies?

Section 8 Company is named after Section 8 of the Companies Act,2013. It describes companies which are established to promote commerce, art, sports, education, research, social welfare, religion etc. Section 8 companies are similar to Trust and Societies, but they have a better recognition and legal standing than Trust and Societies.

What kind of names are not allowed?

The name stated in the memorandum shall not be,

- Identical to the name of another company.
- Too nearly resembling the name of an existing company.

According to Rule 8 of the Company (Incorporation) Rules,2014.

- If a company adds ‘Limited’, ‘Private Limited’, ‘LLP’, ‘Company’, ‘Corporation’, ‘Corp’, ‘inc’ and any other kind of designation to its name to differentiate it from the name of the other company, the name would still not be accepted.

Illustration: Precious Technology Limited is same as Precious Technology Company.

- If plural or singular forms are added to differentiate between names.

Illustrations: Greentech Solution is same as GreenTech Solutions.

- If type, and case of letters, or punctuation marks are added.

Illustration: Wework is same as We.work.

- Different tenses are used in names.

Illustration: Ascend Solution is same as Ascended Solutions.

- If there is an intentional spelling mistake in the name or phonetic changes in the name.

Illustrations: Greentech is same as Greentek.

- Internet related designations are used like .org, .com, etc.

Illustration: Greentech Solution Ltd. is same as Greentech Solutions.com Ltd.

Exception: The name will not be disregarded if the existing company by a board of resolution allows it.

- Change in order of combination of words.

Illustration: Shah Builders and Contractors is same as Shah Contractors and Builders.

Exception: The name will not be disregarded if the existing company by a board of resolution allows it.

- Addition of a definite or indefinite article.

Illustration: Greentech Solutions Ltd is same as The Greentech Solutions Ltd.

Exception: The name will not be disregarded if the existing company by a board of resolution allows it.

- Slight variation in spelling of two names, including a grammatical variation.

Illustration: Colours TV Channel is same as Colors TV Channel.

- Translation of a name, from one language to another.

Illustration: Om Electricity Corporation is same as Om Vidyut Nigam.

- Addition of the name of a place to the name.

Illustration: Greentech Solutions Ltd. Is same as Greentech Mumbai Solutions Ltd.

Exception: The name will not be disregarded if the existing company by a board of resolution allows it.

- Addition, deletion or modification of numericals in the name.

Illustration: Greentech Solutions Ltd. Is same as 5 Greentech Solutions Ltd.

Exception: The name will not be disregarded if the existing company by a board of resolution allows it.

In addition to this, an undesirable name will also not be allowed to be chosen.

Undesirable names are those names which in the opinion of the Central Government are:

1. Prohibited under the Provisions of Section 3 of Emblems and Names (Prevention and Improper Use) Act, 1950.
2. Names which resemble each other, which are chosen to deceive.
3. The name includes a registered trademark.
4. The name includes any word or words which are offensive to a section of people.
5. Name which is identical to or too nearly resembles the name of an existing Limited Liability Partnership.

Furthermore, statutory names such as the UN, Red Cross, World Bank, Amnesty International etc. are also not allowed to be chosen.

Names which in any way indicate that the company is working for the government are also not allowed.

Reservation of a Name

Section 4(5)(i) of the Act states that for formation of the Company, the Registrar on receiving the required documents can reserve a name for 20 days. If the application is made by an existing company, then once the application is accepted, the name will be reserved for 60 days from the date of application. The company should get incorporated with the reserved name in these 60 days.

If after making the reservation of a name, it is found that some wrong information is given. Then two cases arise.

- In case the company has not been incorporated. In this case, the Registrar can cancel the reservation of the name and impose a fine of Rupees 1,00,000.

- In case the company has been incorporated. In this case, after hearing the reasons of the company, the Registrar has 3 options. These are,
  - On being satisfied, he can give 3 months' time to the company to change the name by passing an ordinary resolution.
  - He can strike off the name from the Register of Companies.
  - He can file a petition of winding up of the company.

Rule 8 and 9 of the Company (Incorporation) Rules, 2014 state that the application for reservation of name under section 4(4) should be filed on Form INC – 1.

Registered Office Clause

The Registered Office of a company determines its nationality and jurisdiction of courts. It is a place of residence and is used for the purpose of all communications with the company.

Section 12 of the Companies Act, 2013 talks about Registered Office of the company.

Before incorporation of the company, it is sufficient to mention only the name of the state where the company is located. But after incorporation, the company has to specify the exact location of the registered office. The company has to then get the location verified as well, within 30 days of incorporation.

It is mandatory for every company to fix its name and address of its registered office on the outside of every office in which the business of the company takes place. If the company is a one-person company, then "One-person Company" should be written in brackets below the affixed name of the company.

Change in place of Registered Office should be notified to the Registrar within the prescribed time period.

Object Clause

Section 4(c) of the Act details the object clause. The Object Clause is the most important clause of Memorandum of Association. It states the purpose for which the company is formed. The object clause contains both, the main objects and matters which are necessary for achieving the stated objects also known as incidental or ancillary objects. The stated objects must be well defined and lawful according to Section 6(b) of the Companies Act, 2013.

By limiting the scope of powers of the company. The object clause provides protection to:

Shareholders – The object clause clearly states what operations will the company perform. This helps the shareholders know their investment in the company will be used for what purpose.

Creditors – It ensures the creditors that capital is not at risk and the company is working within the limits as stated in the clause.

Public Interest – The object clause limits the number of matters the company can deal with thus, prohibiting diversification of activities of the company.

Doctrine of Ultra Vires

If the company operates beyond the scope of the powers stated in the object clause, then the action of the company will be ultra vires and thus void.

Consequences of Ultra Vires

1. Liability of Directors: The directors of the company have a duty to ensure that company's capital is used for the right purpose only. If the capital is diverted for another purpose not stated in the memorandum, then the directors will be held personally liable.
2. Ultra Vires Borrowing by the Company: If a bank lends to the company for the purpose not stated in the object clause, then the borrowing would be Ultra Vires and the bank will not be able to recover the amount.
3. Ultra Vires Lending by the Company: If the company lends money for an ultra vires purpose, then the lending would be ultra vires.
4. Void ab initio – Ultra Vires acts of the company are considered void from the beginning.
5. Injunction – Any member of the company can use the remedy of injunction to prevent the company from doing ultra vires acts.

Liability Clause

The Liability Clause provides legal protection to the shareholders by protecting them from being held personally liable for the loss of the company.

There are two kinds of limited liabilities:

Limited by Shares – Section 2(22) of the Companies Act, 2013 defines a company limited by shares. In a company limited by shares, the shareholders only have to pay the price of the shares they have subscribed to. If for some reason they have not paid the full amount for the shares and the company winds up, then their liability will only be limited to the unpaid amount.

Limited by Guarantee – It is defined in Section 2(21) of the Companies Act, 2013.A company limited by guarantee has members instead of shareholders. These members undertake to contribute to the assets of the company at the time of winding up. The members give guarantee of a fixed amount that they will be liable for.

Non-profit Organizations and other charities usually have a structure of companies limited by guarantee.

Capital Clause

It states the total amount of share capital in the company and how it is divided into shares. The way the amount of capital is divided into what kind of shares. The shares can be equity shares or preference shares.

Illustration: The share capital of the company is 80,00,000 rupees, divided into 3000 shares of 4000 rupees each.

Subscription Clause

The Subscription Clause states who are signing the memorandum. Each subscriber must state the number of shares he is subscribing to. The subscribers have to sign the memorandum in the presence of two witnesses. Each subscriber must subscribe to at least one share.

Association Clause

In this clause, the subscribers to the memorandum make a declaration that they want to associate themselves to the company and form an association.

Memorandum of Association for One-Person-Company

A one-person company is called so because it can be formed by one person. The minimum capital required to form a one-person company is 1,00,000 Rupees.

It is a new concept which has been introduced to promote entrepreneurship. All the laws which are applicable on private companies will be applicable on one-person company.

Section 2(62) of the Companies Act, 2013 defines one-person company.

A one-person company is a separate legal entity from its owner. It is mandatory for the company to be converted into a private limited company in case its annual turnover crosses the 2 Crore mark.

In case of one-person-company, in addition to all the other clauses, the Memorandum of Association contains a clause called the Nomination Clause. This clause mentions the name of an individual who will become the member in case the subscriber dies or becomes incapacitated. The nominee must be an Indian citizen and resident of India i. e. he must have been living in India for at least 182 days in the preceding year. A minor cannot be a nominee.

The individual whose name is mentioned should give his consent in written form and it is required to be filed with the Registrar of Companies at the time of incorporation.

If the nominee wants to withdraw, he shall give it in writing and the owner of the company will have to nominate a new person within 15 days.

<u>What's the use of Memorandum of Association?</u>

1. It defines the scope & powers of a company, beyond which the company cannot operate.
2. It regulates company's relation with the outside world.
3. It is used in the registration process; without it the company cannot be incorporated.
4. It helps anyone who wants to enter into a contractual relationship with the company to gain knowledge about the company.
5. It is also called the charter of the Company, as it contains all the details of the company, its members and their liabilities.

<u>Subscription of Memorandum of Association</u>

Subscribers are the first shareholders of the company. They are the people who agreed to come together and form the company. The name of each subscriber along with their particulars are mentioned in the memorandum.

Different kinds of companies require different number of subscribers for incorporation.

- Private Company: In case of a private company, the minimum number of subscribers required are 2.
- Public Company: In case of a public company, 7 or more subscribers are required.
- One-Person-Company: In case of one-person-company, only one person is required.

Who can Subscribe?

Rule 13 of the Companies (Incorporation) Rules, 2014 describes the provisions of subscribing to the memorandum.

There are specific kinds of persons (natural or artificial) who can subscribe to the memorandum. These are:

- Individuals – An individual or a group of individuals can subscribe to the memorandum.
- Foreign citizens and Non-Resident Indians – Rule 13(5) of the Companies (Incorporation) Rules, states that for a foreign citizen to subscribe to a company in India, his signature, address and proof of identity will need to be notarized.

The foreign national must have visited India and should have a Business Visa.

For a Non-Resident Indian, the photograph, address and identity proof should be attested at the Embassy with a certified copy of a passport. There is no requirement of Business Visa.

1. Minor – A minor can only be a subscriber through his guardian.
2. Company incorporated under the Companies Act – The company can be a subscriber to the memorandum. The Director, officer or employee of the company or any other person authorized by the board of resolution.
3. Company incorporated outside India – Foreign Company is defined in Section 2(42) of the act; it states that a foreign company is a company incorporated outside India. A company registered outside India can also subscribe to the memorandum by fulfilling the additional formalities.
4. Society registered under the Societies Registration Act, 1860.
5. Limited Liability Partnership – A partner of a limited liability partnership can sign the memorandum with the agreement of all the other partners.

6. Body corporate incorporated under an Act of Parliament or State Legislature can also be a subscriber to the memorandum.

Subscription to Memorandum of Association

Every subscriber should sign the memorandum in presence of at least one witness. The following particulars of the witness should also be mentioned.

1. Name of the witness
2. Address
3. Description
4. Occupation

If the signature is in any other language then, then an affidavit is required that declares that the signature is the actual signature of the person.

According to Circular No. 8/15/8, dated 1-9-1958. The subscriber can also authorize another person to affix the signature by granting a power of attorney to the person. Department Circular No. 1/95, dated 16th February 1995 states that only one power of attorney is required.

The person who is granted the power of attorney may be known as an agent.

He should also state the following particulars in the memorandum:

1. Name of the agent
2. Address
3. Description
4. Occupation

Particulars to be Mentioned in Memorandum of Association

Rule 16 of the Companies (Incorporation) Rules, 2014 details the particulars that are to be mentioned in the memorandum.

Every Subscriber's following details should be mentioned.

1. Name (includes last name and family name), a photograph should be affixed and scanned with the memorandum.
2. Father's Name and Mother's Name

3. Nationality
4. Date of Birth
5. Place of Birth
6. Qualifications
7. Occupation
8. Permanent Account Number
9. Permanent and Current Address
10. Contact Number
11. Fax Number (Optional)
12. 2 Identity Proofs in which Permanent Account Number is mandatory.
13. Residential Proof (not older than 2 months)
14. Proof of nationality, if subscriber is a foreign national
15. If the subscriber is a current director or promoter, then his designation along with Name and Company Identity Number

If a body corporate is subscribing to the memorandum then the following particulars should be mentioned.

1. Corporate identity number of the company or registration number of the body corporate.
2. Global location number, which is used to identify the location of the legal entity. (Optional)
3. The name of the body corporate.
4. The registered address of the business.
5. Email address.

In case the body corporate is a company, then a certified copy of Board resolution which authorizes the subscription to the memorandum. The particulars required in this case are,

1. Number of shares to be subscribed by a body corporate.
2. Name, designation and address of the authorized person.

In case the body corporate is a limited liability partnership. The particulars required are,

1. A certified copy of the resolution.
2. The number of shares that the firm is subscribing to.
3. The name of the authorized partner.

In case the body corporate is registered outside the country. The particulars required are,

1. The copy of certificate of incorporation.
2. The address of the registered office.

Printing and Signing of Memorandum of Association

Section 7(1)(a) states that the memorandum should be duly signed by all the subscribers and should be in a manner prescribed by the Act.

Rule 13 of the Company (Incorporation) Rules, 2014 describes the manner in which the memorandum should be signed.

1. The Memorandum of Association should be signed by each subscriber to the memorandum. The subscriber shall mention his name, address, occupation and the number of shares he is subscribing to. The documents should be signed in the presence of at least one witness. The witness would also mention his name, address, and occupation. By signing the memorandum, the witness states that, "I witness to subscriber/subscriber(s)who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in."
2. If the person subscribing to the document is illiterate, he can either authorize an agent to sign the document through Power of Attorney or he can put his thumb impression on the column for signatures. The person's name, address, occupation and the number of shares he is subscribing to should be written by a person who has been allowed to write for him. The person who is writing for the illiterate person should read and explain the contents of the document to an illiterate person.
3. Where the person subscribing to the memorandum is an artificial person i. e. a body corporate the memorandum shall be signed by the employee, officer or any person authorized by the Board of Resolution.
4. Where the person subscribing to the memorandum is a foreign national who does not reside in India but in a country,

- in any part of the Commonwealth, his signatures and address on the memorandum and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.
- in a country which is a signatory to the Hague Apostille Convention, 1961, his signature and proof of identity and address on the memorandum shall be notarized before the Notary (Public) of the country of his origin and be duly approved in accordance with the said Hague Convention.
- in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948).

Section 3 of the Diplomatic and Consular Officers states that, every Diplomat or any officer in a foreign country can perform the functions of a notary public.

- Where there is no Diplomatic or Consular officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889.
- If the foreign national visited India and intended to incorporate a company, in such a case the incorporation shall be allowed if, he is having a valid Business Visa.

Section 15 of the Companies Act, 2013 states that the memorandum should be in printed form.

The Ministry of Corporate Affairs has clarified that a document printed in form laser printers will be considered valid provided it is legible and fulfills other requirements as well.

The submission of xerox copies is not allowed. The xerox copies can be submitted to the members of the company.

<u>Alteration, Amendment & Change in Memorandum of Association under Companies Act, 2013</u>

The term “alter” or “alteration” is defined in Section 2(3) of the Act, as any additions, omissions or substitutions. A company can alter the memorandum only to the extent as permitted by the Act.

According to Section 13, the company can alter the clauses in the memorandum by passing a special resolution.

A resolution is a formal decision taken in a meeting. There are two kinds of resolutions, ordinary and special. A special resolution is one which requires at least 2/3rd majority to be effective. The alteration to the clauses also requires the approval of the Central Government in writing.

The alteration of memorandum can happen for a variety of reasons. The alteration can be made if,

1. Enables the company to carry its business more effectively.
2. Helps to achieve the objectives.
3. Helps the company to amalgamate with another company.
4. Helps the company dispose off any undertaking.

Alteration of Memorandum

The alteration of various clauses of the memorandum have different procedures:

1. Alteration to the Name Clause: To alter the name of the company, a special resolution is required. After the resolution is passed, the copy is sent to the registrar. For changing the name, the application needs to be filed in Form INC- 24 with the prescribed fees. After the name is changed, a new certificate of incorporation is issued.
2. Alteration to the Registered Office Clause: The application for changing the place for Registered Office of the company shall be filed with the Central Government in Form INC-23 with the prescribed fees.

If the company is changing its Registered Office from one to another, then the approval of the Central Government is required. The Central Government is required to dispose off the matter within 60 days and should ensure that the change of place has the consent of all the stakeholders of the company.

- Alteration to the Object Clause: To alter the object clause, a special resolution is required to be passed. The changes must be confirmed by the authority. The document which confirms the changes by authority with a printed copy of the altered memorandum should be filed with the Registrar.

If the company is a public company, then the alteration should be published in the newspaper where the Registered Office of the company is located. The changes to the object clause must also mentioned on the company's website.

- Alteration to the Liability Clause: The Liability clause of the memorandum cannot be altered except with the written consent of all the members of the company. By altering the liability clause, the liability of the directors of the company can be made unlimited. In any case, the liability of the shareholders cannot be made unlimited. Changes in the liability clause can be made by passing a special a special resolution and sending a copy of the resolution to the Registrar of Companies.

Alteration to the Capital Clause: The capital clause of a company can be altered by an ordinary resolution.

The company can,

1. Increase its authorised share capital.
2. Convert the shares into stock.
3. Consolidate and divide all of its shares.
4. Cancel the shares which have not been subscribed to.
5. Diminish the share capital of the shares cancelled.

The altered Memorandum of Association should be submitted to the Registrar within 30 days of passing the resolution.

**Articles of Association**

The Companies Act, 2013 defines 'articles' as the "articles of association of a company originally framed, or as altered from time to time in pursuance of any previous company laws or of the present." The Articles of Association of a company are that which prescribe the rules, regulations and the bye-laws for the internal management of the company, the conduct of its business, and is a document of paramount significance in the life of a company. The Articles of a company have often been compared to a rule book of the company's working, that regulates the management and powers of the company and its officers. It prescribes several details of the company's inner

workings such as the manner of making calls, director's/employees' qualifications, powers and duties of auditors, forfeiture of shares etc.

In fact, the articles of association also establish a contract between the members and between the members and the company. This contract is established, governs the ordinary rights and obligations that are incidental to having membership in the company.

It must be noted, however, that the articles of association, are subordinate to the memorandum of association of a company, which is the dominant, fundamental constitutional document of the company. Further, as laid down in Shyam Chand v. Calcutta Stock Exchange, any and all articles that go beyond the memorandum of association will be deemed ultra vires. Therefore, there should not be any provisions in the articles that go beyond the memorandum. In the event of a conflict between the memorandum and the articles, the provisions in the memorandum will prevail. In case of any ambiguity or uncertainty regarding details in the memorandum, it should be read along with the articles.

Nature and Content of Articles of Association

As per the Companies Act, 2013, the articles of association of different companies are supposed to be framed in the prescribed form, since the model form of articles is different for companies limited by shares, companies limited by guarantee having share capital, companies limited by guarantee not having share capital, an unlimited company having share capital and an unlimited company not having share capital.

The signing of the Articles of Association

The Companies (Incorporation) Rules, 2014 prescribes that both the Memorandum and the Articles of a company are to be signed in a specific manner.

- Memorandum and Articles of a company, are both required to be signed by all subscribers, who are further required to add their names, addresses and occupation, in the presence of at least one witness, who must attest the signatures with his own signature and details.
- Where a subscriber is illiterate, he must affix a thumb impression in place of his signature and appoint a person to authenticate the impression with his signature and details. This

appointed person should also read out the content of the documents to the illiterate subscriber for his understanding.

- Where a subscriber is a body corporate, the memorandum and articles must be signed by any director of the body corporate who is duly authorised to sign on behalf of the body corporate, by a passing a resolution of the board of directors of the body corporate.
- Where the subscriber is a Limited Liability Partnership, the partner of the LLP who is duly authorised to sign on the behalf of the LLP by a resolution of all the partners shall sign.

Provisions for Entrenchment

The concept of Entrenchment was introduced in the Companies Act, 2013 in Section 5(3) which implies that certain provisions within the Articles of Association will not be alterable by merely passing a special resolution and will require a much more lengthy and elaborate process. The literal definition of the word “entrench” means to establish an attitude, habit, or belief so firmly that bringing about a change is unlikely. Thus, an entrenchment clause included in the Articles is one which makes certain changes or amendments either impossible or difficult.

Provisions for entrenchment can only be introduced in the articles of a company during its incorporation, or an amendment to the articles brought about by a special resolution in case of a public company, and an agreement between all the members in case of a private company.

Alteration of Articles of Association

Section 14 of the Companies Act, 2013, permits a company to alter its articles, subject to the conditions contained in the memorandum of association, by passing a special resolution. This power is extremely important for the functioning of the company. The company may alter its articles to the effect that would turn:

A public company into a private company

For a company wanting to convert itself from public to a private company simply passing a special resolution is not enough. The company will have to acquire the consent and approval of the Tribunal. Further, a copy of the special resolution must be filed with the Registrar of Companies within 30 days of passing it. Further, a company must then file a copy of the altered, new articles

of association, as well as the approval order of the Tribunal with the Registrar of Companies within 15 days of the order being received.

A private company into a public company

For a company wanting to convert from its private status to public, it may do so by removing/omitting the three clauses as per section 2(68) which defines the requisites of a private company. Similar to the conversion of the public to a private company, a copy of the resolution and the altered articles are to be filed with the Registrar within the stipulated period of time.

Limitations on power to alter articles

- The alteration must not contravene provisions of the memorandum, since the memorandum supersedes the articles, and the memorandum will prevail in the event of a conflict.
- The alteration cannot contravene the provisions of the Companies Act, or any other company law since it supersedes both the memorandum and the articles of the company.
- Cannot contravene the rules, alterations or suggestions of the Tribunal.
- The alteration cannot be illegal or in contravention with public policy. Further, it must be for the bona fide benefit and interest of the company. The alterations cannot be an effort to constitute a fraud on the minority and must be for the benefit of the company as a whole.
- Any alteration made to convert a public company into a private company, cannot be made until the requisite approval is obtained from the Tribunal.
- A company may not use the alteration to cover up or rectify a breach of contract with third parties or use it to escape contractual liability.
- A company cannot alter its articles for the purpose of expelling a member of the board of directors is against company jurisprudence and hence cannot occur.

Binding effect of Memorandum and Articles of Association

After the Articles and the Memorandum of a company are registered, they bind the company and its members to the same extent as if they had been signed by each of the members of the company. However, while the company's articles have a binding effect, it does not have as much force as a statute does. The effect of binding may work as follows:

Binding the company to its members

The company is naturally completely bound to its members to adhere to the articles. Where the company commits or is in a place to commit a breach of the articles, such as making ultra vires or otherwise illegal transaction, members can restrain the company from doing so, by way of an injunction. Members are also empowered to sue the company for the purpose of enforcement of their own personal rights provided under the Articles, for instance, the right to receive their share of declared divided.

It should be noted, however, that only a shareholder/member, and only in his capacity as a member, can enforce the provisions contained in the Articles. For instance, in the case of Wood v. Odessa Waterworks Co., the articles of Waterworks Co. provided that the directors can declare a dividend to be paid to the members, with the sanction of the company at a general meeting. However, instead of paying the dividend to the shareholders in cash a resolution was passed to give them debenture bonds. It was finally held by the court, that the word "payment" referred to payment in cash, and the directors were thus restrained from acting on the resolution so passed.

Members bound to the company

Each member of the company is bound to the company and must observe and adhere to the provisions of the memorandum and the articles. All the money that may be payable by any member to the company shall be considered as a debt due. Members are bound by the articles just as though each and every one of them has signed and contracted to conform to their provisions. In Borland's Trustees v. Steel Bros. & Co. Ltd., the articles the company provided that in the event of bankruptcy of any member, his shares would be sold at a price affixed by the directors. Thus, when Borland went bankrupt, his trustee expressed his wish to sell these shares at their original value and contended that he could do so since he was not bound by the articles. It was held, however, that he was bound to abide by the company's articles since the shares were bought as per the provisions of the articles.

Binding between members

The articles create a contract between and amongst each member of the company. However, such rights can only be enforced by or even against a member of the company. Courts have been known to make exceptions and extend the articles to constitute a contract even between individual

members. In the case of Rayfield v Hands Rayfield was a shareholder in a particular company., who was required to inform directors if he intended to transfer his shares, and subsequently, the directors were required to buy those shares at a fair value. Thus, Rayfield remained in adherence to the articles and informed the directors. The directors, however, contended that they were not bound to pay for his shares and the articles could not impose this obligation on them. The courts, however, dismissed the directors' argument and compelled them to buy Rayfield's shares at a fair value. The court further held that it was not mandatory for Rayfield to join the company to be allowed to bring a suit against the company's directors.

No binding in relation to outsiders

Contrary to the above conditions, neither the memorandum nor the articles constitute a contract between the company and any third party. The company and its members are not bound to the outsiders with respect to the provisions of the memorandum and the articles. For instance, in the case of Browne v La Trinidad, the articles of the company included a clause that implied that Browne should be a director that should not be removed or removable. He was, however, removed regardless and thus brought an action to restrain the company from removing him. Held that since there was no contract between Browne and the company, being an outsider, he cannot enforce articles against the company even if they talk about him or give him any rights. Therefore, an outsider may not take undue advantage of the articles to make any claims against the company.

The doctrine of Constructive Notice

When the Memorandum and Articles of Association of any company, are registered with the Registrar of Companies they become "public documents" as per section 399 of the Act. This implies that any member of the general public may view and inspect these documents at a prescribed fee. A member of the public may make a request to a specific company, and the company, in turn, must, within seven days send that person a copy of the memorandum, the articles and all agreements and resolutions that are mentioned in section 117(1) of the Act.

If the company or its officers or both, fail to provide the copies of the requisite documents, every defaulting officer will be liable to a fine of Rs. 1000, for every day, until the default continues, or Rs. 1,00,000 whichever is less.

Therefore, it is the duty of every person that deals with the company to inspect these public documents and ensure in his own capacity that the workings of the company are in conformity with the documents. Irrespective of whether a person has actually read the documents or not, it is assumed that he familiar with the contents of these documents, and that he has understood them in their proper meaning. The memorandum and articles of association are thus deemed as notices to the public, hence a 'constructive notice'.

Illustration: If the articles of Company A, provided that any bill of exchange must be signed by a minimum of two directors, and the payee receives a bill of exchange signed only by one, he will not have the right to claim the amount.

Distinction Between Memorandum and Articles of Association

| Sl.No. | Memorandum of Association | Articles of Association |
|---|---|---|
| 1 | Contains fundamental conditions upon which the company is incorporated. | Contain the provisions for internal regulations of the company. |
| 2 | Meant for the benefit and clarity of the public and the creditors, and the shareholders. | Regulate the relationship between the company and its members, as well amongst the members themselves. |
| 3 | Lays down the area beyond which the company's conduct cannot go. | Articles establish the regulations for working within that area. |
| 4 | Memorandum lays down the parameters for the articles to function. | Articles prescribe details within those parameters. |
| 5 | Can only be altered under specific circumstances and only as per the provisions of the Companies Act, 2013. Permission of the Central Government is also required in certain cases. | Articles can be altered a lot more easily, by passing a special resolution. |

| | | |
|---|---|---|
| 6 | Memorandum cannot include provisions contrary to the Companies Act. Memorandum is only subsidiary to the Companies Act. | Articles cannot include provisions contrary to the memorandum. Articles are subsidiary to both the Companies Act and the Memorandum. |
| 7 | Acts done beyond the memorandum are *ultra vires* and cannot be ratified even by the shareholders. | Acts done beyond the Articles can be ratified by the shareholders as long as the act is not beyond the memorandum. |

**The doctrine of Indoor Management**

The concept of the Doctrine of Indoor Management can be most elaborately explained by examining the facts of the case of Royal British Bank v. Turquand, which in fact, first laid down the doctrine. It is due to this that the doctrine of indoor management is also known as the "Turquand Rule".

The directors of a particular company were authorised in its articles to engage in the borrowing of bonds from time to time, by way of a resolution passed by the company in a general meeting. However, the directors gave a bond to someone without such a resolution being passed, and therefore the question that arose was whether the company was still liable with respect to the bond. The company was held liable, and the Chief Justice, Sir John Jervis explained that the understanding behind this decision was that the person receiving the bond was entitled to assume that the resolution had been passed, and had accepted the bond in good faith.

However, the judgement, in this case, was not fully accepted into in law until it was accepted and endorsed by the House of Lords in the case of Mahony v East Holyford Mining Co.

Therefore, the primary role of the doctrine of indoor management is completely opposed to that of constructive notice. Quite simply, while constructive notice seeks to protect the company from an outsider, indoor management seeks to protect outsiders from the company. The doctrine of constructive notice is restricted to the external and outside position of the company and, hence, follows that there is no notice regarding how the internal mechanism of the company is operated by its officers, directors and employees. If the contract has been consistent with the documents on

public record, the person so contracting shall not be prejudiced by any and all irregularities that may beset the inside, or "indoor" operation of the company.

This doctrine has since then been adopted into Indian Law as well in cases such as Official Liquidator, Manabe & Co. Pvt. Ltd. v. Commissioner of Police and more recently, in M. Rajendra Naidu v. Sterling Holiday Resorts (India) Ltd. wherein the judgment was that the organizations lending to the company should acquaint themselves well with the memorandum and the articles, however, they cannot be expected to be aware of every nook and corner of every resolution, and to be aware of all the actions of a company's directors. Simply put, people dealing with the company are not bound to inquire into every single internal proceeding that takes place within the company.

Exceptions to the Doctrine of Indoor Management

Where the outsider had knowledge of the irregularity— Although people are not expected to know about internal irregularities within a company, a person who did, in fact, have knowledge, or even implied notice of the lack of authority, and went ahead with the transaction regardless, shall not have the protection of this doctrine. Illustration: In Howard v. Patent Ivory Co. (38 Ch. D 156), the articles of a company only allowed the directors to borrow a maximum amount of one thousand pounds, however, they could exceed this amount by obtaining the consent of the company in a general meeting. However, in this case, without obtaining this requisite consent, the directors borrowed a sum of 3,500 Pounds from one of the directors in exchange for debentures. The company then refused to pay the amount. It was eventually held that the debentures were only good to the extent of one thousand pounds since the director had full knowledge and notice of the irregularity since he was a director himself involved in the internal working of the company.

Lack of knowledge of the articles— Naturally, this doctrine cannot and will not protect someone who has not acquainted himself with the articles or the memorandum of the company for example in the case of Rama Corporation v. Proved Tin & General Investment Co. wherein the officers of Rama Corporation had not read the articles of the investment company that they were undertaking a transaction with.

Negligence— This doctrine does not offer protection to those who have dealt with a company negligently. For example, if an officer of a company very evidently takes an action which is not

within his powers, the person contracting should undertake due diligence to ensure that the officer is duly authorized to take that action. If not, this doctrine cannot help the person so contracting, such as in the case of Al Underwood v. Bank of Liverpool.

Forgery— Any transaction which involves forgery or is illegal or void ab initio, implies the lack of free will while entering into the transaction, and hence does not invoke the doctrine of indoor management. For example, in the case of Ruben v. Great Fingal Consolidated, the secretary of a company illegally forged the signatures of two directors on a share certificate so as to issue shares without the appropriate authority. Since the directors had no knowledge of this forgery, they could not be held liable. The share certificate was held to be in nullity and hence, the doctrine of indoor management could not be applied. The wrongful an unauthorized use of the company's seal is also included within this exception.

Further, this doctrine cannot include situations where there was third agency involved or existent. For example, in the case of Varkey Souriar v. Keraleeya Banking Co. Ltd. this doctrine could not be applied where there was any scope of power exercised by an agent of the company. The doctrine cannot be implied even in cases of Oppression

**Prospectus**

The Companies Act, 2013 defines a prospectus under section 2(70). Prospectus can be defined as "any document which is described or issued as a prospectus". This also includes any notice, circular, advertisement or any other document acting as an invitation to offers from the public. Such an invitation to offer should be for the purchase of any securities of a corporate body. Shelf prospectus and red herring prospectus are also considered as a prospectus.

<u>Essentials for a document to be called as a prospectus</u>

For any document to considered as a prospectus, it should satisfy following conditions.

- The document should invite the subscription to public share or debentures, or it should invite deposits.
- Such an invitation should be made to the public.
- The invitation should be made by the company or on the behalf company.
- The invitation should relate to shares, debentures or such other instruments.

Statement in lieu of prospectus

Every public company either issue a prospectus or file a statement in lieu of prospectus. This is not mandatory for a private company. But when a private company converts from private to public company, it must have to either file a prospectus if earlier issued or it has to file a statement in lieu of prospectus.

The provisions regarding the statement in lieu of prospectus have been stated under section 70 of the Companies Act 2013.

Advertisement of prospectus

Section 30 of the Companies Act 2013 contains the provisions regarding the advertisement of the prospectus. This section states that when in any manner the advertisement of a prospectus is published, it is mandatory to specify the contents of the memorandum of the company regarding the object, member's liabilities, amount of the company's share capital, signatories and the number of shares subscribed by them and the capital structure of the company. Types of the prospectus as follows.

- Shelf Prospectus
- Red Herring Prospectus
- Abridged prospectus
- Deemed Prospectus

Shelf Prospectus

Shelf prospectus can be defined as a prospectus that has been issued by any public financial institution, company or bank for one or more issues of securities or class of securities as mentioned in the prospectus. When a shelf prospectus is issued then the issuer does not need to issue a separate prospectus for each offering, he can offer or sell securities without issuing any further prospectus.

The provisions related to shelf prospectus has been discussed under section 31 of the Companies Act, 2013.

The regulations are to be provided by the Securities and Exchange Board of India for any class or classes of companies that may file a shelf prospectus at the stage of the first offer of securities to the registrar.

The prospectus shall prescribe the validity period of the prospectus and it should be not be exceeding one year. This period commences from the opening date of the first offer of the securities. For any second or further offer, no separate prospectus is required.

While filing for a shelf prospectus, a company is required to file an information memorandum along with it.

Information Memorandum [Section 31(2)]

The company which is filing a shelf prospectus is required to file the information memorandum. It should contain all the facts regarding the new charges created, what changes have undergone in the financial position of the company since the first offer of the security or between the two offers.

It should be filed with the registrar within three months before the issue of the second or subsequent offer made under the shelf prospectus as given under Rule 4CCA of section 60A(3) under the Companies (Central Government's) General Rules and Forms, 1956.

When any company or a person has received an application for the allotment of securities with advance payment of subscription before any changes have been made, then he must be informed about the changes. If he desires to withdraw the application within 15 days, then the money must be refunded to them.

After the information memorandum has been filed, if any offer or securities is made, the memorandum along with the shelf prospectus is considered as a prospectus.

Red herring prospectus

Red herring prospectus is the prospectus which lacks the complete particulars about the quantum of the price of the securities. A company may issue a red herring prospectus prior to the issue of prospectus when it is proposing to make an offer of securities.

This type of prospectus needs to be filed with the registrar at least three days prior to the opening of the subscription list or the offer. The obligations carried by a red herring prospectus are same

as a prospectus. If there is any variation between a red herring prospectus and a prospectus then it should be highlighted in the prospectus as variations.

When the offer of securities closes then the prospectus has to state the total capital raised either raised by the way of debt or share capital. It also has to state the closing price of the securities. Any other details which have not been included in the prospectus need to be registered with the registrar and SEBI.

The applicant or subscriber has right under Section60B (7) to withdraw the application on any intimation of variation within 7 days of such intimation and the withdrawal should be communicated in writing.

Abridged Prospectus

The abridged prospectus is a summary of a prospectus filed before the registrar. It contains all the features of a prospectus. An abridged prospectus contains all the information of the prospectus in brief so that it should be convenient and quick for an investor to know all the useful information in short.

Section33(1) of the Companies Act, 2013 also states that when any form for the purchase of securities of a company is issued, it must be accompanied by an abridged prospectus.

It contains all the useful and materialistic information so that the investor can take a rational decision and it also reduces the cost of public issue of the capital as it is a short form of a prospectus.

Deemed Prospectus

A deemed prospectus has been stated under section 25(1) of the Companies Act, 2013.

When any company to offer securities for sale to the public, allots or agrees to allot securities, the document will be considered as a deemed prospectus through which the offer is made to the public for sale. The document is deemed to be a prospectus of a company for all purposes and all the provision of content and liabilities of a prospectus will be applied upon it.

In the case of SEBI v. Kunnamkulam Paper Mills Ltd., it was held by the court that where a rights issue is made to the existing members with a right to renounce in the favour of others, it becomes a deemed prospectus if the number of such others exceeds fifty.

Process for filing and issuing a prospectus

Application forms

As stated under section 33, the application form for the securities is issued only when they are accompanied by a memorandum with all the features of prospectus referred to as an abridged prospectus.

The exceptions to this rule are:

- When an application form is issued as an invitation to a person to enter into underwriting agreement regarding securities.
- Application issued for the securities not offered to the public.

Contents

For filing and issuing the prospectus of a public company, it must be signed and dated and contain all the necessary information as stated under section 26 of the Companies Act,2013:

1. Name and registered address of the office, its secretary, auditor, legal advisor, bankers, trustees, etc.
2. Date of the opening and closing of the issue.
3. Statements of the Board of Directors about separate bank accounts where receipts of issues are to be kept.
4. Statement of the Board of Directors about the details of utilization and non-utilisation of receipts of previous issues.
5. Consent of the directors, auditors, bankers to the issue, expert opinions.
6. Authority for the issue and details of the resolution passed for it.
7. Procedure and time scheduled for the allotment and issue of securities.
8. The capital structure of the in the manner which may be prescribed.
9. The objective of a public offer.
10. The objective of the business and its location.

11. Particulars related to risk factors of the specific project, gestation period of the project, any pending legal action and other important details related to the project.
12. Minimum subscription and what amount is payable on the premium.
13. Details of directors, their remuneration and extent of their interest in the company.
14. Reports for the purpose of financial information such as auditor's report, report of profit and loss of the five financial years, business and transaction reports, statement of compliance with the provisions of the Act and any other report.

Filing of copy with the registrar

As stated under sub-section 4 of section26 of the Companies Act, 2013, the prospectus is not to be issued by a company or on its behalf unless on or before the date of publication, a copy of the prospectus is delivered to the registrar for registration.

The copy should be signed by every person whose name has been mentioned in the prospectus as a director or proposed director or the assigned attorney on his behalf.

Delivery of copy of the prospectus to the registrar

As per section26(6) of the Companies Act 2013, the prospectus should mention that its copy has been delivered to the registrar on its face. The statement should also mention the document submitted to the registrar along with the copy of the prospectus.

Registration of prospectus

Section26(7) states about the registration of a prospectus by the registrar. According to this section, when the registrar can register a prospectus when:

- It fulfils the requirements of this section, i.e., section 26 of the Companies Act, 2013; and
- It contains the consent of all the persons named in the prospectus in writing.

Issue of prospectus after registration

If a prospectus is not issued before 90 days from the date from which a copy was delivered before the registrar, then it is considered to be invalid.

Contravention of section

If a prospectus is issued in contravention of the provision under section 26 of the Companies Act 2013, then the company can be punished under section 26(9). The punishment for the contravention is:

- Fine of not less than Rs. 50,000 extending up to 3,00,000.

If any person becomes aware of such prospectus after knowing the fact that such prospectus is being issued in contravention of section 26 then he is punishable with the following penal provisions.

- Imprisonment up to a term of 3 years, or
- Fine of more than Rs. 50,000 not exceeding Rs. 3,00,000.

# UNIT – III

# MANAGEMENT AND CONTROL OF COMPANIES

**Synopsis**

- Introduction to Company Meetings
- Board of Directors
- Committee Meetings
- Members' meetings
- Distribution of powers between Board of Directors and Shareholders
- Directors
- Corporate Social Responsibility
- Oppression and Mismanagement
- Class Actions

**Introduction to Company Meetings**

A number of meetings are convened in a company and are generally classified as members' meetings, directors' meetings and other meetings. Members' meetings include the annual general meeting, which is the mandatory meeting of the members that every company is required to convene each year. However, there exists no embargo on holding more than one general meeting of the members, which are called the extra-ordinary general meetings. The meetings of the directors are called the Board meetings and the meetings of the committees of the directors are the Committee meetings. Other meetings include creditors meetings and class meetings.

The focus of the Companies Act, 2013 has been on enhancing transparency, shareholders' democracy and protection of the interest of the investors. It has made few changes for regulating meetings for example, the requirement of holding a statutory meeting of members at the time of commencement of business of a company for any public company (required under the Companies Act, 1956) has been done away with, the concepts of video-conferencing and e-voting have been introduced.

**Board of Directors**

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. The Board of Directors oversees how the management serves and protects the long-term interests of all the stakeholders of the company. The institution of Board of Directors is based on the premise that a group of trustworthy people look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The Board formulate policies and establish organisational set up for implementing those policies and to achieve the objectives contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company. Section 2(10) of the Companies Act, 2013 defines that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company. The term 'Board of Directors' means a body duly constituted to direct, control and supervise the affairs of a company. As per Section 149 of the Companies Act, 2013, the Board of Directors of every company shall consist of individual only. Thus, no body corporate, association or firm shall be appointed as director.

**Directors' Meetings**

**Board Meetings [Section 173 read with Rules 3 and 4 of the Companies (Meetings of Board and its Powers), 2014]**

The Board of directors of a company are responsible for overseeing the management of the company and thereby exercise their power of day-to-day decision making by convening and holding Board meetings.

Within 30 days of their incorporation, the companies must hold their first board meeting. Thereafter, the companies must hold at least four board meetings in a year, where there must not be more than 120 days' gap between two consecutive meetings.

One of the striking features of the present legislation is that it allows the directors to take part in the board meeting through videoconferencing or any other audio-visual means. However, there is an embargo from dealing certain matters through the video-conferencing or audio-visual mode.

A notice of at least seven days must be given to each of the director for a board meeting. In case of urgency a shorter notice may be given where at least one independent director is present at such meeting.

The notice of a board meeting must be sent to all the directors, otherwise the proceedings of the meeting and the resolution passed thereat may be declared as invalid by the Court of law.

Also, it has been held in the case of *Dankha Devi Agarwal* v. *Tara Properties Private Limited* that a decision taken in a meeting without due notice of such meeting for removal or induction would be instance of oppression and mismanagement.

At least two directors or one-third of the total strength (higher of the two) constitutes quorum for a board meeting. Here the directors, both personally attending or through the audio-video means would be counted for the purposes of the quorum (section 174).

**Board Composition**

Minimum/Maximum Number of Directors in a Company [Section 149(1)] Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors without any specific compliance. A company may appoint more than fifteen directors after passing a special resolution in general meeting.

The restriction of maximum number of directors shall not apply to section 8 companies. Minimum number of directors;

- Public Company - 3 Directors
- Private Company - 2 directors
- One Person Company (OPC) - 1 Director

Maximum Number of Director is 15, which can be increased by passing a special resolution. Section 8 companies can have more than 15 directors.

Section 149(3) provides that every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year. Further, Second proviso to Section 149(1) read Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014 following class of companies must have at least one Women Director. Alternate directorship shall also be included while calculating the directorship of 20 companies. Section 8 company will not be counted for the purpose of maximum number of Directorship

**Maximum limit on total number of directorship** has been fixed at 20 companies and the maximum number of public companies in which a person can be appointed as a director shall not exceed ten. The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.

**Quorum for Board meeting Requirement**

- Quorum for Board Meeting = 1/3rd of its Total strength or two directors, whichever is higher
- A Director participating through video conferencing/audio visual modes will also be counted for quorum
- Any fraction of a member will be rounded off as one
- Total strength shall not include directors whose places are vacant.

**Power of Board [Section 179]** Section 179 of the Act deals with the powers of the board; all powers to do such acts and things for which the company is authorised is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting.

The following [Section 179(3) read with Rule 8 of Companies (Management & Administration) Rules, 2014] powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

3. to make calls on shareholders in respect of money unpaid on their shares;
4. to authorise buy-back of securities under section 68;
5. to issue securities, including debentures, whether in or outside India;
6. to borrow monies;

7. to invest the funds of the company;
8. to grant loans or give guarantee or provide security in respect of loans;
9. to approve financial statement and the Board’s report;
10. to diversify the business of the company;
11. to approve amalgamation, merger or reconstruction;
12. to take over a company or acquire a controlling or substantial stake in another company;
13. to make political contributions; Lesson 15 Board Constitution and its Powers 533
14. to appoint or remove key managerial personnel (KMP);
15. to appoint internal auditors and secretarial auditor; The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify. The banking company is not covered under the purview of this section.

**Restriction on Powers of Board**

[Section 180] The board can exercise the following powers only with the consent of the company by special resolution, namely – (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings. (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation; (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium apart from temporary loans obtained from the company’s bankers in the ordinary course of business; (d) to remit, or give time for the repayment of, any debt due from a director

**Contributions to Charitable Funds and Political Parties [Section 181]** The power of making contribution to ‘bona fide’ charitable and other funds is available to the board subject to certain limits

**Prohibitions and Restrictions Regarding Political Contributions [Section 182]** According to Section 182 of the Act, a company, other than a government company which has been in existence

for less than three financial years, may contribute any amount directly to any political party. Further, the limit of contribution to political parties is 7.5% of the average net profits during the three immediately preceding financial years.

**Power of Board and other Persons to make Contributions to National Defence Fund, etc. [Section 183]** The Board is authorised to contribute such amount as it thinks fit to the National Defence Fund or any other fund approved by the Government for the purpose of national defence. The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year.

In **P.S Offshore Interland Services P Ltd v. Bombay Offshore Suppliers Ltd**, it was held that a closed or out of function unit of a company may be an undertaking. Also in **Pramod Kumar Mittal v. Andhra Steel Corpn Ltd**, 11 it was held that an undertaking in a complete and complex weft and the various types of business and assets are threads which cannot be taken a part from the weft. ( b) To remit or give time for payment of any debt to the company by a director,12 except in the case of renewal or continuance of an advance made by a banking company to its directors in the ordinary course of business. (c) To invest (excluding trust securities) the amount of compensation received in respect of the compulsory acquisition of any undertaking or property of the company. (d) To borrow moneys and where the moneys to be borrowed (together with the moneys already borrowed by the company) are more than paid up capital of the company and its free reserves. That is to say reserves in the share premium account, general reserve, profit and a loss account, and capital redemption account).The amount of temporary loans raised from banks in the ordinary course of business is excluded. This, however, does not include loans raised for the purpose of financing expenditure of a capital-' nature. (e) To contribute to charitable and other funds not directly relating to the business of the company or the welfare of its employees, amounts exceeding in any financial year, fifty thousand or 5 percent of the average net profits of the three preceding financial years, whichever is greater.

**Power of directors to allot the shares**

Directors of a company have powers to allot shares but this power must be exercised bonafide for the benefit of the company as a whole because this power is t / a fiduciary one. **In Grant v. John Grant& Sons Ltd**, it was held that when the company not in need of further capital and the directors issued shares only to maintain their control or for defeating the wishes of the existing

majority of the shareholders, the allotment was improper. In another case of **Punt v. Symons &Co Ltd**, the directors used the shares with the object of creating a sufficient majority to enable them to pass a special resolution depriving other shareholders special rights conferred on them by the company's articles. It was held that when issue of shares to persons who are, obviously meant and intended to secure the necessary statutory majority in a particular interest, it could not be fair and bonafide exercise of the power.

Similarly, in the case **of Pierey v. S Mills &Co Ltd**, the directors had issued shares to enable them to resist the election of three additional directors which would have put the existing directors in a minority on the board. The issue was held to be improper.

**Power of Directors to Make Calls on Shares**

The Articles of Association of companies generally provide that the power to make calls in advance from the shareholders in respect of unpaid amount on shares vest in the directors. The power to make calls is a fiduciary one and shall not be used by the directors for their own benefit. This power cannot be delegated by the directors to any committee of directors, the managing agent, secretaries, treasurers or the manager, In **Poiner Alkali Works Ltd v. Amiruddins**. Tayyabji, it was held that where the articles provide that every shareholder shall be liable to pay the amount of every call to the persons and at the time and place appointed by the directors, the resolution should specify the time, place and amount of the payment of the call. **In East and West Insurance Co Ltd v. Mrs. Kamla Jayanti Lsl Mehta**, it was held that when the time for the payment of the call is not fixed by the board of directors, the call is valid although there was an omission in specifying the place and person whom the call is to be paid. A valid resolution making a call must state; (a) The amount of the call, (b) The time when the call should be paid, (c) The person to whom the payment is to be made and (d) The place where the payment is to be made.

**Committee Meetings**

The Companies Act, 2013 provides for four mandatory committees of the board of directors under the Act which are namely, Audit Committee, Nomination & Remuneration Committee, Stakeholders Relationship Committee and Corporate Social Responsibility Committee. The committees so formulated are not to be appointed by every company but they get triggered or are required to be formulated based on certain thresholds.

**i. Audit Committee meeting** is required to be convened by every listed company and only those public companies which have a paid up share capital of Rs. 10 crore or more or have a turnover of Rs. 50 crore or more or have aggregate outstanding loan, debenture and deposit exceeding INR 50 Crore or more. The terms of reference of such a committee include monitoring auditor's appointment, remuneration and his performance etc. Every minutes of the meeting of the Audit Committee shall be noted in the ensuing meeting of the Board of Directors and also, a distinct minutes' book shall be maintained for the meeting of the Committee. The Chairman of the Audit Committee is required to address the concerns of the shareholders at the Annual General Meeting.

**ii. Nomination and Remuneration Committee meeting** are also a mandate for every listed company and only those public company which have a paid-up share capital of Rs. 10 crore or more or have a turnover of R. 100 crore or more having aggregate outstanding loan, debenture and deposit exceeding INR 50 Crore or more. The committee is required to ensure that the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully.

**iii. Stakeholders Relationship Committee meetings** are required to address the grievances of the stakeholders of the company. This committee is to be constituted by every company which has the strength of more than 1000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during the financial year.

**iv. Corporate Social Responsibility Committee meeting** shall take all decisions as regards the CSR policy of the company in its meetings. Such committee shall consist of at least three directors, of which at least one director shall be an independent director.

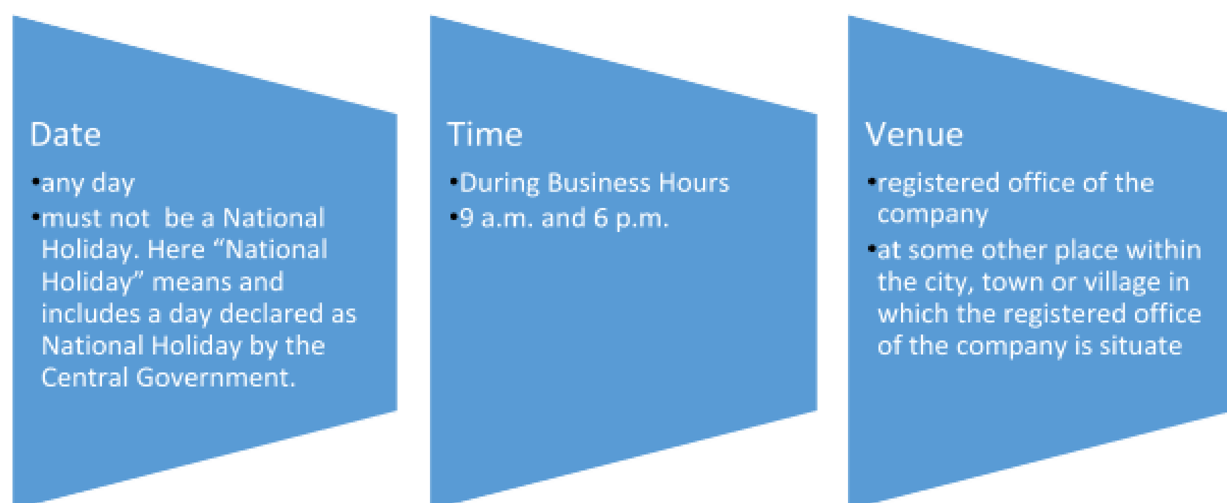
**Members' meetings**

**Annual General Meeting (Section 96)**: One of the opportunities annually given to the members of a company is to take part in the business of the company by exercising their power to take decisions. For this purpose, each year every company is required to hold at least one meeting of its members' which is known as an annual general meeting (AGM). An exemption from holding an annual general meeting is only given to a one-person company.

The first general meeting of a company must be held within nine months from the date of closing the financial year of the company, and then the company need not hold any annual general meeting

in its year of incorporation. The subsequent annual general meetings shall take place within six months of the date of closing of the financial year. The time prescribed for the first annual general meeting cannot be extended, however, the time period for subsequent annual general meetings may be extended to a maximum of three months with the leave of the Registrar of companies.

Following chart depicts the date, time and venue for holding an annual general meeting. Here the Central Government is empowered to exempt, subject to conditions, any company from the holding such meeting in accordance with the date, time and venue as prescribed.



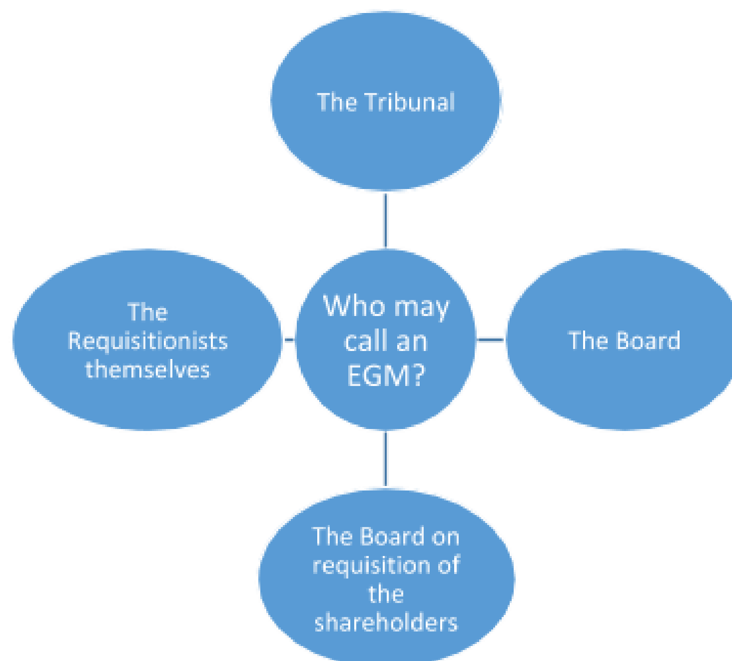

When a company defaults in holding an annual general meeting as required, the Tribunal has the power to call such meeting upon receipt of an application from any member of the company. The Tribunal may even direct to hold a one-member meeting. Such meetings shall be deemed as an annual general meeting as per provisions of this Act. Upon such default, the company and every officer in default would be liable for punishment as prescribed.

**Business to be transacted at an annual general meeting (section 102)**

The business transacted at the annual general meeting is called the ordinary business (this is the reason a general meeting is also referred to as an ordinary meeting). Items of ordinary business constitutes consideration of financial statements, Board reports and auditor's report, declaring

dividends, appointment of directors and appointment and salary fixation of the auditors of the company.

**Extra-Ordinary general meeting (Section 100)**: All other general meetings convened and held in a company besides the annual general meeting are regarded as extraordinary general meetings. All the business transacted at an extra-ordinary general meeting is called special business (all other businesses except ordinary business). The following diagram illustrates, who all can call an extra-ordinary general meeting:




The shareholders making a requisition must possess at least one-tenth of the paid up share capital of the company and where the company is without the share capital, the shareholders must possess at least one-tenth of the voting powers of the company. Such share-holders, requisitioning a general meeting, must sign upon the matters required to be addressed at the meeting. The Board upon receipt of such valid requisition must call a general meeting within 21 days. The date of the meeting in any case must not be later than 45 days from such requisition.

In case these dead-lines are not met by the Board, the shareholders making requisition may go ahead to call and hold a general meeting themselves. They can do so within 3 months from the requisition date. All the reasonable expenses incurred by the shareholders on holding such meeting,

are to be reimbursed to them by the company by deducting such amounts from the fees of the defaulting directors.

In *LIC of India* v. *Escorts Ltd*, the Supreme Court observed that every shareholder of a company possesses a right to call/requisition an extra-ordinary general meeting, subject to the provisions of the Act. Once the requisition is made in compliance of the prescribed law, the shareholder cannot be restrained from calling such meeting.

In another case, *Rathnavelu Chettiar* v. *M.Chettiar*, the shareholders gave a requisition in compliance of the provision of the Act for removing the MD of the company. Where the directors failed to call a meeting within the prescribed time, the shareholders themselves requisitioned the meeting. The venue of the meeting was decided as the registered office of the company. However, on the day of the meeting, the registered office was locked, thus the meeting was held at some other place. The court held such meeting to be a validly convened meeting.

The Tribunal may also, under certain circumstances order to hold and convene a meeting (other than an annual general meeting). Here the Tribunal may on its own motion or upon the application made by any director or members having voting rights may call such a meeting. The Tribunal may give necessary directions for conduct of the meeting including the permission for holding one - member meeting in person or through proxy (section 98).

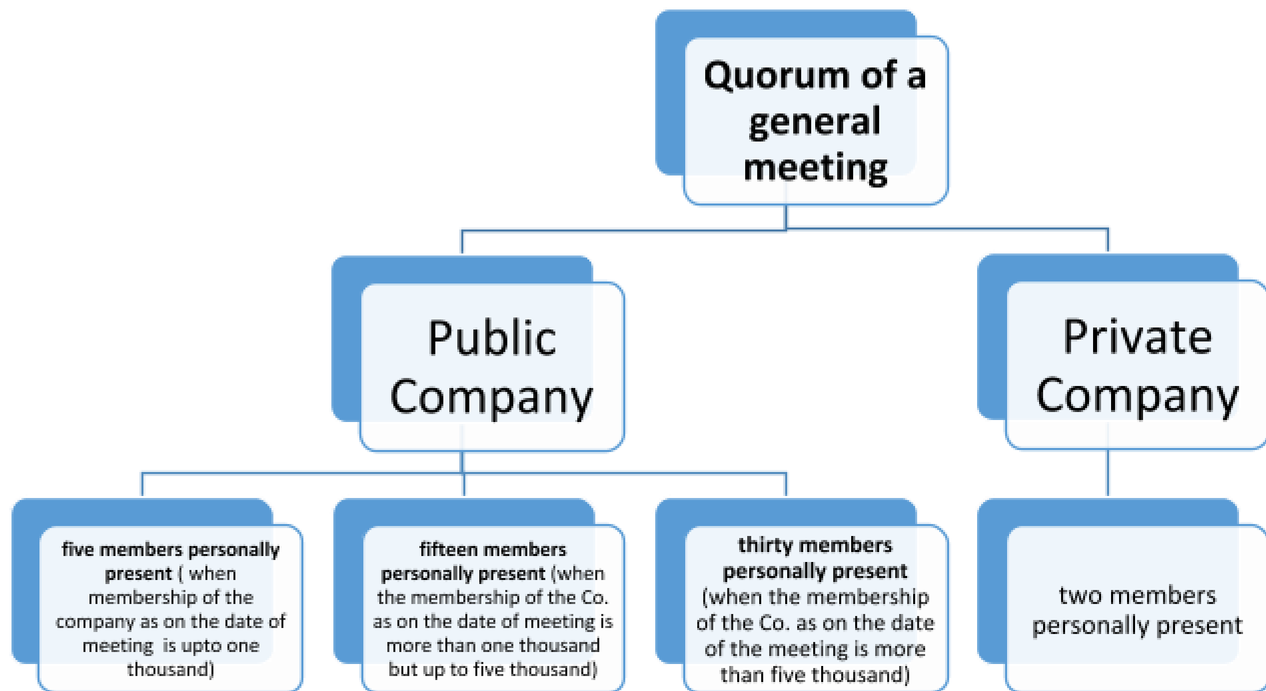
**Notice of the meeting (Section101)**

For calling a general meeting a notice is required to be given to every member of the company or to his legal representative (in case of a deceased member), every director and auditor of the company. Such notice must be given to the aforesaid parties at least 21 clear days before the meeting. The notice can be sent either in writing or through electronic means. The requirement of 21 days' notice can be done away with, if at least 95 percent of the members voting at the meeting agree to a shorter notice for such meeting.

The notice of a meeting must provide for the date, time and venue of the meeting along with the statement of the business to be dealt at the meeting. It is necessary to send such notice of the meeting as prescribed, however inadvertent failure to send notices or in case any member or other persons do not receive the notice shall not *per se* affect the validity of the meeting.

**Quorum (Section 103)**

For holding a valid meeting, a minimum requisite number of members must attend the meeting to transact the business, which constitutes quorum of the meeting. Following charts, provides at a glance, the quorum required to be present at general meetings:




**Adjournment of a meeting**

Where the requisite number of members are not present within half an hour of the allotted time of the meeting, such meeting is adjourned to be held on the same day next week at same time and venue or as scheduled by the Board. The only exception to the rule is, when the meeting is called by the requisitionists, in such a case the meeting is not adjourned for the want of quorum and is cancelled. In other cases, members present within half an hour of the adjourned meeting shall constitute the quorum.

**Chairman of a meeting (section 104)**

A chairman is elected by the members personally present at a meeting by the show of hands. Such chairman is required for orderly conduct of the meeting. In case a poll is demanded for electing a

Chairman, the provisions of the Act shall apply and the earlier chairman shall continue unless a new one is appointed.

**Proxies (section 105)**

Members entitled to attend and vote at the meeting, may participate in the decision making process by voting in the meeting, either personally or through a duly appointed proxy. The proxy is another person, whom a member appoints to attend and vote at the meeting on his behalf. However, such a proxy does not possess the right to speak at such meeting on behalf of the member, nor is he entitled to vote except in case of a voting by poll. Section 105 of the Act, further deliberates upon the provisions for appointing a proxy. A member can revoke his proxy by a notice in writing.

A member can appoint more than one proxies for the same meeting, in case he possesses different shares of that company. But in case, the said member appoints more than one proxies for the same bunch of shares, then all the proxies shall be jointly and severally liable.

**Voting at a meeting (section106)**

A member can participate in the decision-making process of the company by voting at the meetings. Such a right to vote can only be restricted by the articles of a company, where it stipulates that the shares in respect of which any call money or sums remains due or shares upon which the company has exercised any lien, such shareholders do not have right to vote.

**Voting by show of hands (Section 107)**

When a resolution is to be passed at a general meeting, voting takes place by show of hands unless the members ask for a poll or voting happens electronically. Such voting is evidenced though the Chairman’s declaration and an entry to this effect in the minutes of the meeting.

**Voting through electronic means [Section 108 read with Rule 20 Companies (Management and Administration) Rules, 2014]**

The Central Government may prescribe in accordance with the Rule 20, certain class or classes of companies and also the manner in which a member may vote by the electronic means.

**Demand for a Poll (Section 109 read with Rule 21 Companies (Management and Administration) Rules, 2014):** A poll may be either ordered by the chairman *suo moto* or may be demanded by such number of members prescribed under this section.

Where a resolution is to be passed through poll, the Chairman shall require the assistance of certain persons for scrutinising the poll and the votes and to prepare a report in accordance with the Rule 21 of Companies (Management and Administration) Rules, 2014). The Chairman has the power to regulate the poll in accordance with the said rules.

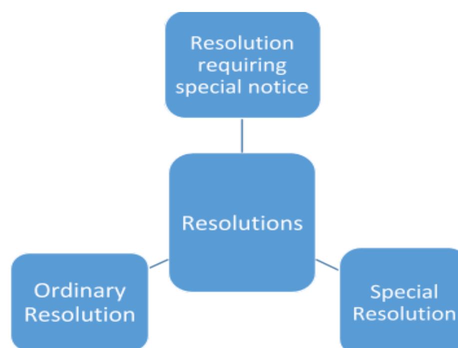
**Postal Ballot (Section 110 read with Rule 22 Companies (Management and Administration) Rules, 2014):** A Central Government notification may declare certain business items (excluding the items of ordinary business) to be dealt vide the postal ballot. A resolution passed by the required majority by a postal ballot shall be deemed to be passed at a duly convened general meeting.

**Ordinary and Special resolution (Section 114)**

Decisions in a company are taken by passing resolutions to that regard. The resolutions can be ordinary, special and resolutions requiring special notice, depending upon the nature of the decision to be taken.

**Ordinary resolution** is said to be passed when the votes cast by the eligible members in favour exceed the votes casted against any resolution. Here the members can either vote in person or through proxy. The Chairman of the meeting possesses a casting vote in case of a tie.

Whereas a **special resolution** is said to be passed for a resolution when a notice duly given for the purpose clearly specifies that the resolution to be passed is a special one. Such resolutions require that the votes by the eligible members must be three times in favour in comparison to the votes cast against the resolution. Here the person can either vote in person or through a proxy.



**Resolutions requiring special notice (Section 115 read with Rule 23 Companies (Management and Administration) Rules, 2014)**

There are certain resolutions which require special notice. According to section 115, any such notice required to be given shall be brought at the instance of member(s) holding not less than one percent of total voting power (in case of company not having share capital) or member(s) holding shares on which an aggregate sum of *not exceeding* five lakh rupees, paid up on the date of notice. Rule 23 further provides the time and means of sending such special notice.

**Minutes of the meeting (section 118 read with Rule 25 Companies (Management and Administration) Rules, 2014)**

Companies are required to maintain and keep the records of the proceedings of every meeting called the minutes of the meeting, which are to be prepared according to the provisions of this Act and the Secretarial Standards. The minutes of each of the meeting are to be recorded succinctly including all the details like the new appointments made. The minutes prepared in the loose sheets must be signed by the Chairman within 30 days of the meeting in the form of a book with pages consecutively numbered. The minute book of each kind of company viz. the general meetings, creditors' meetings are to be kept separately.

The minutes of the meetings shall have an evidentiary value for the proceedings mentioned therein.

**Distribution of powers between Board of Directors and Shareholders**

Company's powers can be exercised by the board of directors and at meetings of members of a company. Except for the powers which are expressly required to be exercised by the company in general meeting, in all other cases the directors can exercise all the company's powers. This division of company's powers has been dealt with Greer L J, in John Shaw and Sons {Salford Ltd), v. Shaw, in the following words: "A company is an entity distinct from its shareholders and its directors. Some of its powers may according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in

the directors is by altering the articles, or if the opportunity arises under the articles by refusing to re -elect the directors whose actions they disapprove."

The shareholders cannot usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in general body of shareholders. The powers of directors include to issue preference shares, borrow money by mortgaging the company's property and to do acts necessary for the management of the company. The power to sell the assets of the company is vested in the board and if the board thinks that it is not for the interest of the company to sell its assets, it is not bound to do so, notwithstanding a resolution to 2 contrary in the general meeting.

The directors are the only persons who can bring an action on behalf of the company. They may also compromise a suit in the interest of the company. The directors cannot by contract deprive themselves of the power to control a manager so as to confer powers on him to the exclusion of himself. While the directors are to follow the directions given by the general meeting, they are not bound to act or adopt a particular line of action at the instance of the shareholders. The exercise by the directors of discretionary powers will not be interfered with unless it is proved that they have acted for some improper motive or arbitrary or capriciously. The following are some of the important powers of the board of directors of companies in India.

**Directors**

The Companies Act 2013 does not contain an exhaustive definition of the term "director". Section 2(34) of the Act prescribed that "director" means a director appointed to the Board of a company. Section 2(10) of the Companies Act, 2013 defined that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company. The term 'Board of Directors' means a body duly constituted to direct, control and supervise the affairs of a company. As per Section 149 of the Companies Act, 2013, the Board of Directors of every company shall consist of individual only. Thus, no body corporate, association or firm shall be appointed as director. Again Section 166 (6) of Companies Act, 2013, prohibits assignment of office of director to any other person. Any assignment of office made by a director shall be void.

As per Section 153 of the Act, every individual intending to be appointed as director of a company shall make an application electronically in Form DIR-3 for allotment of Director Identification

Number to the Central Government along with the prescribed fees. Further, DINs to the proposed first Directors in respect of new companies would be mandatorily required to be applied for in SPICe forms (subject to a ceiling of 3 new DINs) only.

**Types of Director**

A director so appointed may either be executive director or non-executive director. An Executive Director can be either a Whole-time Director of the company (i.e., one who devotes his whole time of working hours to the company and has a significant personal interest in the company as his source of income), or a Managing Director (i.e., one who is employed by the company as such and has substantial powers of management over the affairs of the company subject to the superintendence, direction and control of the Board). They are generally responsible for overseeing the administration, programs and strategic plan of the organization. Other key duties include fund raising, marketing, and community out reach. The position reports directly to the Board of Directors. In contrast, a non-executive Director is a Director who is neither a Whole-time Director nor a Managing Director. A director to the Board may be appointed as

• **First Director**

Section 152 of the Act provides for the appointment of first directors, accordingly, where there is no provision made in Articles of Association of the company for appointment of first directors then the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

**• Resident Director**

Section 149(3) provides that every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days during the financial year Provided that in case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated.

• **Women Director**

Second proviso to Section 149(1) read Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014 following class of companies must have at least one Women Director.

All Listed Companies Public companies with paid up capital of `100 crore or more or with turnover of `300 crore or more. Additionally for listed entities SEBI vide recent notification provides that the Board of directors of the top 500 listed entities shall have at least one independent woman director by April 1, 2019 and the Board of directors of the top 1000 listed entities shall have at least one independent woman director by April 1, 2020. The top 500 and 1000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

• **Alternate Director**

Section 161(2) of the Act empowers the Board, if so authorized by its articles or by a resolution passed by the company in general meeting, to appoint a director (termed as 'alternate director) to act in the absence of a original director during his absence for a period of not less than three months from India.

• **Additional Director**

Section 161(1) of the Companies Act, 2013, provides that the articles of a company may confer on its Board Lesson 16 Directors 569 of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time who shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier. In case of default in holding annual general meeting, the additional director shall vacate his office on the last day on which the annual general meeting ought to held. A person who fails to get appointed as a director in a general meeting cannot be appointed as Additional Director. Section 161(1) of the Act applies to all companies, whether public or private.

• **Small Shareholder Director**

According to section 151 of the Act every listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as may be prescribed. "Small shareholder" means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014 laid down the following terms and conditions for appointment of small shareholder's director, which are as under: (i) Election of small shareholders' director: A listed company, may upon notice of not less than (a) One thousand small shareholders; or (b) one-tenth of the total number of such shareholders, whichever is lower; have a small shareholder's director elected by the small shareholder. A 'Small Shareholders' Director' may be elected voluntarily by any listed company. Thus, a listed company, may, on its own, act to appoint a Small Shareholders' Director. In such a case, no notice from small shareholder(s) is required.

• **Nominee Director**

Section 161(3) of the Companies Act, 2013, provides that subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company

• **Casual Vacancy**

Section 161(4) provides that If any vacancy is caused by death or resignation of a director appointed by the shareholders in General meeting, before expiry of his term, the Board of directors can appoint a director to fill up such vacancy. The appointed director shall hold office only up to the term of the director in whose place he is appointed. Section 161(4) in the case of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall subsequently approved by the members in the immediate next general meeting. The person so appointed shall hold office only upto the day upto which the director in whose place he has been appointed, would have held office if he had not vacated as aforesaid. Where a person appointed by the Board vacates his office it is not a case of casual vacancy and cannot be filled by the Board in the place.

- **Independent director**

Section 149(4) read with Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 provides the rules for companies to have specified number of independent directors.

All listed public companies should have At least 1/3rd of total number directors as independent Directors, Other public companies with paid up capital of `10 crore or more or with turnover of `100 crore or more or with outstanding loans, debentures and deposits of `50 crore or more should have At least 2 independent Directors

However, the following classes of unlisted public company shall not be covered under sub-rule as above (a) a joint venture; (b) a wholly owned subsidiary; and (c) a dormant company as defined under section 455 of the Act. In case a company covered under this rule is required appoint higher number of independents directors due to composition of its audit committee and then they shall appoint such higher number of independent directors. Further if there is any intermittent vacancy of an independent director then it shall be filled up by the board of directors within 3 months from the date of such vacancy or not later than immediate next board meeting, whichever is later. Once the company covered under above sub-rule (i) to (iii) of Rule 4, ceases to fulfill any of three conditions for three consecutive years then it shall not be required to comply these provisions until such time as it meets any of such conditions. The definition of Independent directors is provided in section 149(6).

**Disqualifications for appointment of Director- Section 164**

Section 164(1) Provides that a person shall not be eligible for appointment as a director of a company, if –

(a) He is of unsound mind and stands so declared by a competent court;

(b) He is an undischarged insolvent;

(c) He has applied to be adjudicated as an insolvent and his application is pending;

(d) He has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence. Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company.

(e) An order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(f) He has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

(g) He has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

(h) He has not complied with sub-section (3) of section 152.

(i) if he accepts directorships exceeding the maximum number of directorships provided in section 165.

Whenever a company fails to file the financial statements or annual returns, or fails to repay any deposit, interest, dividend, or fails to redeem its debentures, as specified in sub-section (2) of section 164, the company shall immediately file Form DIR-9, to the Registrar furnishing therein the names and addresses of all the directors of the company during the relevant financial years. When a company fails to file the Form DIR-9 within a period of thirty days of the failure that would attract the disqualification under sub-section (2) of section 164, officers of the company specified in clause (60) of section 2 of the Act shall be the officers in default. Upon receipt of the Form DIR-9 under sub-rule (2), the Registrar shall immediately register the document and place it in the document file for public inspection. Any application for removal of disqualification of directors shall be made in Form DIR-10. However, a private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2).The disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

**Removal of Directors**

Under section 169 of the Act, a company may, by ordinary resolution remove a director before the expiry of the period of his office. The provisions of section 169 shall apply regardless of the way in which the director concerned was appointed and notwithstanding anything contained in the articles of the company or any agreement with the director concerned.

**Rights and duties of Directors**

The duties of directors as contained in section 166 of the Companies Act, 2013 are described as follows

1. Duty to act as per the articles of the company The director of a company shall act in accordance with the articles of the company.

2. Duty to act in good faith A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

3. Duty to exercise due care A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

4. Duty to avoid conflict of interest A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

5. Duty not to make any undue gain A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

6. Duty not to assign his office A director of a company shall not assign his office and any assignment so made shall be void.

**Corporate Social Responsibility**

India`s new Companies Act 2013 (Companies Act) has introduced several new provisions which change the face of Indian corporate business" Companies Act 2013 (Companies Act) has introduced several new provisions which change the face of Indian corporate business. One of such new provisions is Corporate Social Responsibility (CSR). The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc. from the society. By performing the task of CSR activities, the companies are giving something back to the society.

Ministry of Corporate Affairs has recently notified Section 135 and Schedule VII of the Companies Act as well as the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CRS Rules) which has come into effect from 1 April 2014.

*Applicability*: Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company i.e. (a) net worth of the company to be Rs 500 crore or more; (b) turnover of the company to be Rs 1000 crore or more; (c) net profit of the company to be Rs 5 crore or more. Further as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies, but also applicable to branch and project offices of a foreign company in India.

*CSR Committee and Policy*: Every qualifying company requires spending of at least 2% of its average net profit for the immediately preceding 3 financial years on CSR activities. Further, the qualifying company will be required to constitute a committee (CSR Committee) of the Board of Directors (Board) consisting of 3 or more directors. The CSR Committee shall formulate and recommend to the Board, a policy which shall indicate the activities to be undertaken (CSR Policy); recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR Policy of the company. The Board shall take into account the recommendations made by the CSR Committee and approve the CSR Policy of the company.

*Definition of the term CSR*: The term CSR has been defined under the CSR Rules which includes but is not limited to:

- Projects or programs relating to activities specified in the Schedule; or

Projects or programs relating to activities undertaken by the Board in pursuance of recommendations of the CSR Committee as per the declared CSR policy subject to the condition that such policy covers subjects enumerated in the Schedule.

This definition of CSR assumes significance as it allows companies to engage in projects or programs relating to activities enlisted under the Schedule. Flexibility is also permitted to the companies by allowing them to choose their preferred CSR engagements that are in conformity with the CSR policy.

*Activities under CSR*: The activities that can be done by the company to achieve its CSR obligations include eradicating extreme hunger and poverty, promotion of education, promoting

gender equality and empowering women, reducing child mortality and improving maternal health, combating human immunodeficiency virus, acquired, immune deficiency syndrome, malaria and other diseases, ensuring environmental sustainability, employment enhancing vocational skills, social business projects, contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women and such other matters as may be prescribed.

*Local Area*: Under the Companies Act, preference should be given to local areas and the areas where the company operates. Company may also choose to associate with 2 or more companies for fulfilling the CSR activities provided that they are able to report individually. The CSR Committee shall also prepare the CSR Policy in which it includes the projects and programmes which is to be undertaken, prepare a list of projects and programmes which a company plans to undertake during the implementation year and also focus on integrating business models with social and environmental priorities and process in order to create share value.

The company can also make the annual report of CSR activities in which they mention the average net profit for the 3 financial years and also prescribed CSR expenditure but if the company is unable to spend the minimum required expenditure the company has to give the reasons in the Board Report for non compliance so that there are no penal provisions are attracted by it.

**Prevention of Oppression and Mismanagement**

Shareholders and creditors are those two groups who has given or invested their money in corporate bodies. However, it is not necessary that all the shareholders have the controlling power in the company. The group of shareholders is divided into two parts i.e. Majority Shareholders and Minority Shareholders. Minority shareholders are those who have invested their money in the company but they are not holding so many shares that can give them controlling powers; and because of this their interest in the company and its affairs sometimes get neglected. The first is the positive acts done by the management which result in prejudice being caused to the company; secondly, even where no action at all is taken by the management, such non-action results in prejudice being caused to the company

"The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern company law. The aim must be to strike a balance between the effective control of the company and the interest of the small individual shareholders"

**Rule of *Foss v. Harbottle*** *[(1843) 67 ER 189]*

The basic rule laid down in this case was that "the courts will not, in general, intervene at the instance of shareholders in matters of internal administration; and, will not interfere with the management of a company, by its directors so long as they are acting within the powers conferred on them under the articles of the company". However, the Court has also given certain exceptions to this rule, among which one is "oppression and mismanagement". It has been stated by SINHA J of the Calcutta High Court in ***Kanika Mukherji v. Rameshwar Dayal Dubey [(1966) 1 Comp LJ 65 Cal.]*** that the principle embodied in Sections 397 and 398 of the Indian Companies Act, 1956 which provide for prevention of oppression and mismanagement is an exception to the rule in ***Foss v. Harbottle*** which lays down the sanctity of the majority rule.

Exceptions to the rule of Foss v. Harbottle

1. Act is Ultra vires
2. Fraud on minority
3. Acts requiring special Majority
4. Wrongdoers in control
5. Oppression and mismanagement

**Meaning of 'Oppression' and 'Mismanagement'**

The meaning of the term 'oppression' as explained by Lord COOPER in the Scottish case of ***Elder v. Elder & Watson Ltd [(1952) SC49 Scotland]*** was cited with approval by WANCHOO J of the Supreme Court of India in ***Shanti Prasad Jain v. Kalinga Tubes Ltd. [1965) 1 Comp LJ 193],*** "The essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely."

'Mismanagement' again is an atrocious act of the majority shareholders. An illustration explaining the conduct of mismanagement is the case of ***Rajahmundry Electric Supply Corpn v. Nageshwara Rao [AIR 1956 SC 213],*** in this, a petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the Vice Chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and "a powerful local junta was ruling the roost" and that the shareholders outside the group of the Chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement.

**Remedies**

Sec. 241 of the Companies Act, 2013 provides that, any member of a company who complains regarding any oppression or mismanagement being occurred in a company, may apply to the Tribunal. Moreover, even the Central Government, if of the opinion that the affairs of the company are being conducted in a manner prejudicial to the public interest, then it may itself apply to the Tribunal for an order.

S. 241 has been amended in 2019 and new sub-s (3), (4) and (5) have been newly inserted in the section as given below:

S. 241 provides that

(1) Any member of a company who complains that-

(a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or (b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members,

may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter.

**Personal Action**

In this, the shareholder claims their personal rights which arise from the constitution of the company i.e. Memorandum of Association and Articles of Association. However, in Indian Companies Law, personal actions of the shareholders aggrieved from the acts of oppression or management do not possess any statutory provision.

**Derivative Action**

An interesting area of law is the law governing derivative action mechanism which enables the shareholders of a company to bring an action on behalf of the company against a third party before a regular civil court. Again, there is no specific statutory provision for derivative action in the Indian companies law. However, the doctrine of derivative action is recognised by the Indian courts. If a shareholder alleges that a wrong has been done to the company by persons in control thereof, he may bring a derivative action where he derives the authority from his corporate right to sue on behalf of the company. The premise on which the court entertains this extraordinary form of action is upon the complaining shareholder's assertion that the company cannot sue as the persons in control would not bring an action on its behalf or for its benefit.

Derivative action is defined as an action by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf. Since the company has a distinct legal personality with its own rights and liabilities which are different from those personal rights of individual shareholders, this action is brought by a shareholder not to enforce his or her own personal rights but, rather, the rights and liabilities of the company on its behalf and for the benefit of the company; which the company cannot itself do, as it is controlled by the 'wrong-doers'.

In order to be classified as a derivative action, the following aspects must be satisfied:

It must be brought in a representative form, even though it is the company, rather than the other shareholders, whom the person initiating the legal action / proceedings seeks to represent. Thus, by implication, all the other shareholders are bound by the result of the action.

Although the action is brought on behalf of the company, the company appears as a defendant, so that the action takes the form of a representative action by the initiating shareholder on behalf of himself and all the other shareholders (other than the alleged 'wrong-doers'), against the alleged 'wrong-doers' (who are, in fact, in control of the company) and the company. Derivative claims may be brought by a shareholder or shareholders in the following instances, as described as follows:

**Ultra Vires**

A shareholder may bring an action against the company and its Directors in respect of matters which are ultra vires the Memorandum or the Articles of the company and which no majority shareholders can sanction. For example, Directors of the company sanctioning an action that is contrary to the objects of the company.

**Fraud on Minority**

Directors and the company would also be liable if the conduct of the majority of the shareholders constitutes a "fraud on minority", i.e., a

discriminatory action. For example, where the shareholders have passed a special resolution with an effect of discriminating between the majority shareholders and minority shareholders, so as to give the former an advantage of which the latter were deprived.

Required Resolution

Certain actions of the company can be approved only by passing a special resolution at a general meeting of shareholders. If the majority seek to circumvent this legal requirement and pass only an ordinary resolution, or do not pass such a special resolution in the manner required by law, any member or members can bring an action to restrain the majority.

To safeguard Interests of the Company

For instance, an obvious wrong may have been done to the company by the Directors, but because of the control of such Directors on the majority shareholders, such shareholders may not permit an action to be brought against the 'wrong-doer' Directors. Therefore, to safeguard the interests of the company, any member or members may bring a derivative action.

**Individual Membership Rights**

As a general rule, personal rights per se are not to be enforced through derivative actions; however, some exceptions have been recognized. These exceptions often arise in cases of rights that have been conferred upon the shareholders by the Companies Act itself or the respective Articles (commonly known as "individual membership rights"). For example, the right to vote, the right to have one's vote recorded, or the right to be nominated as a candidate for the post of a Director during the election of Directors at a general meeting of the shareholders.

**Prevention of Oppression and Mis-management:** A representative action may be brought for prevention of oppression and mismanagement, which are cases where the majority acts in a manner that oppresses the minority; or where the affairs of the company are being conducted in a manner prejudicial to public interests or oppressive to any member(s) or in a manner prejudicial to the interests of the company including an adverse material change in the management or control of the company. Since these proceedings are initiated for the benefit of the company, it can be considered a form of derivative action and find specific place in the scheme of the Indian company law under the Companies Act. In order to obtain relief, the NCLT can be approached by:

**S. 244, Comapanies Act, 2013 gives the right to apply to NCLT:**

S. 244 (1) provides that the following members of a company shall have the right to apply under section 241, namely-

(a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b)so as to enable the members to apply under section 241.

This power of waiver of requirements of s. 244 is very important and was used by NCLAT in the case of accepting Cyrus Mistry's application for oppression and mismanagement.

**Class Actions**

The provision for class actions was recommended in the Companies Bill, 2012. The J J Irani committee recommended in its report as follows:

"In case of fraud on the minority by wrongdoers, who are in control and prevent the company itself bringing an action in its own name, derivative actions in respect of such wrong non-rectifiable decisions have been allowed by courts. Such derivative actions are brought out by shareholder(s) on behalf of the company, and not in their personal capacity, in respect of wrong done to the company. Similarly the principles of "Class/Representative Action" by one shareholder on behalf of one or more of the shareholders of the same kind have been allowed by courts on the grounds of persons having same locus standi."

Class suit is not limited to corporate law but extends to the whole realm of civil procedures. In fact, class suits are not so much a provision of law as a procedure. For example, Order 1 Rule 8 of the Civil Procedure Code, 1908 provides that where there are numerous persons having the same interest in a suit, one or more persons may, with the permission of the court, either sue, or defend the suit, for the benefit of all interested. Sub-rule (2) provides for the power of the court to publicize a representative suit either by service, or depending on the number of persons involved, by public advertisement. The procedure has widely been used in India for what is commonly termed as public interest litigation.

The Companies Act, 2013 in its Sec. 245 contains the provision with regard to 'class actions'.

The concept of class actions and derivative actions are very close to each other. In fact, at the time of proposing the addition of this provision in Companies Law Bill, it was not clear that whether the Parliament was seeking to introduce the 'class action' provision or the 'derivative action' provision.

# UNIT – 4

# FINANCIAL STRUCTURE OF COMPANY

**Synopsis**

- Introduction
- Further issue of Shares and Right issue
- Rights of shareholders
- Buy-Back of Shares
- Issue of Securities
- Private Placement
- Debentures
- Company Deposits
- Charge on Assets
- Effect of non-registration of charge

## Introduction

The words 'capital' and 'share capital' are synonymous. Although requirement of share capital is not compulsory for the purposes of incorporation but companies prefer to get incorporated with share capital because of their objectives of running business requiring capital. S. 13(4)(a) of the Companies Act, 1956 (CA, 1956) provided that the last clause i.e the capital clause of the memorandum of association must state the amount of nominal capital of the company and the number and value of shares into which it is divided. S. 4 (e) of the Companies Act, 2013 (CA, 2013) provides that in case of a company having a share capital, the amount of share capital with which the company is being registered should be stated. Division of the share capital into shares of a fixed amount and the number of shares which each subscriber to memorandum has agreed to subscribe should also be stated. In no case a subscriber should agree to have less than one share.

It is also necessary to know here that the company law also prescribes the minimum capital requirement for incorporating a company as a public or a private company. The Companies Act, 2013 provided that a public company must have a minimum paid-up share capital of a five lakh rupees or such higher paid-up share capital as may be prescribed [s. 2(71), CA, 2013). Similarly,

a private company was also defined as a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as would be prescribed [s. 2(68), CA, 2013)]. However, such requirements of minimum paid-up capital has been removed by the amendment in view of facilitating ease of incorporating companies to encourage business and startup companies. Only a public company can raise funds from the public through public offerings and increase its share capital. Private companies can raise finance through private placement of securities. Even a public company can raise capital through private placement of securities. A company may meet its fund requirements either through raising share capital or through borrowings. Such a decision depends upon the business of the company and its requirement of capital, existing interest rates, and availability of assets with the company to give as security for borrowing, profitability of the company and the number of shareholders etc. The company does a proper financial analysis before making such a decision. Similarly, the company also has to make a choice between issue of equity shares and preference shares in case it decides to raise capital through share capital.

**a. Share Capital:**

As we discussed earlier, for a company to have share capital, it is necessary that its memorandum should state the amount and its division. The amount that is stated in the memorandum is known as the 'authorized capital' of the company. 'Authorised capital' or 'nominal capital' means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company [s. 2(8), CA, 2013]. Whole of the authorized share capital or any part of it can be issued by the company depending upon fund requirement of the company. Part of the share capital which is issued to the public is called 'issued capital' of the company. 'Issued capital' means such capital as the company issues from time to time for subscription [s. 2(50), CA, 2013]. Whole of the issued capital may be subscribed by the public. That part of the issued capital which is subscribed by the public or allotted to the public is known as 'subscribed capital' of the company. As per s. 2(86), CA, 2013, 'subscribed capital' means such part of the capital which is for the time being subscribed by the members of a company. Minimum subscription requirement presently is ninety percent of the issued capital. The company has the flexibility of calling the subscribed capital wholly or partially. The actual amount received by the company from the subscribed capital is called the 'paid-up capital' of the company. The un-called capital of the company can be converted into reserve capital by passing a special resolution.

**b. Shareholders and Members:**

In relation to a company, a 'member' under s. 2(55), CA, 2013 means:

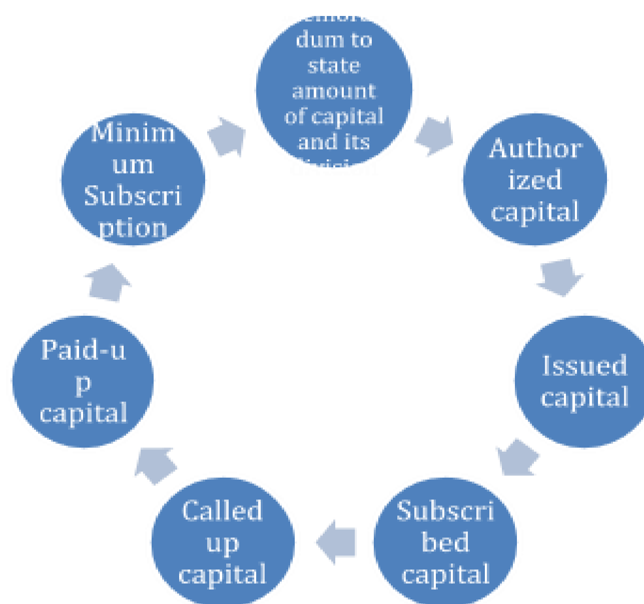
i. the subscribers to the memorandum of the company. They are deemed to have agreed to become members of the company and after registration of the company; their name is entered in register of members.

ii. every other person who agrees to become a member of a company in writing and whose name is entered on the register of members.

iii. every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

Therefore, a shareholder is also a member of the company. Although the terms 'shareholder' and 'member' are used interchangeably, member is a broader term. Companies limited by guarantee and unlimited companies may not have shareholders as such companies may not have share capital. However, they have members.

A person may become member of a company by subscribing to memorandum, by allotment of shares or by agreeing in writing to become a member and whose name is entered on register of members, beneficial owners in depository records, by transfer or transmission of shares.



- **Nominal, Authorised or Registered Capital: 2(8)**

Such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.

- **Issued Capital 2(50)**

Such capital as the company issues from time to time for subscription. It is that part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.

- **Subscribed Capital 2(86)**

Such part of the capital which is for the time being subscribed by the members of a company. It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. It is clear that the entire issued capital may or may not be subscribed.

- **Paid-up Share Capital 2(64)**

Such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.

**c. Kinds of share capital:**

Share capital must be divided into shares of a fixed amount. The CA, 1956 permitted only two kinds of share to be issued, namely, ‘equity share capital’ (ordinary shares) and “preference share capital” (preference shares). S. 86 of the CA, 1956 provided that equity share capital shall be issued with voting rights or with differential rights as to dividend, voting or otherwise. Two other categories of shares namely, ‘derivative’ and ‘hybrid’ were also introduced by the Companies (Amendment) Act, 2000. ‘Derivative’ was given the same meaning as in s. 2 of the Securities Contracts (Regulation) Act, 1956. ‘Hybrid’ meant any security which has the characteristics of more than one type of security, including their derivatives.

Chapter IV of the CA, 2013 deals with share capital. S. 43 deals with kinds of share capital and it provides that the share capital of a company limited by shares can be of two types, namely, equity share capital and preference share capital.

- **‘‘equity share capital’’**, with reference to any company limited by shares, means all share capital which is not preference share capital;
- **Preference share,** which receive dividends before ordinary shares but which have no voting rights, it must satisfy the following conditions:

• As regards dividends, it must carry a preferential right to fixed amount or amount calculated at a fixed rate and

• As regards the capital, in the event of a winding up or other arrangement to repayment of capital, there must be a preferential right to be repaid the amount of the capital paid up on such share. A Preference share capital may or may not carry such other rights as specified. All share capital, not falling within the above description of preference capital, is equity share capital, which has no guaranteed amount of dividend but carries voting rights.

Equity capital is also known as "Common Stock" or common share capital that represents ownership in a company. Common share capital is generally divided into units known shares. These unit holders are called equity shareholders. They are the real owners of the company and policy makers of the company. However, they do not have access to the day to day affairs of the company. They appoint their representatives called board of directors to look after the affairs of the company. Equity shareholders are entitled to vote on resolutions of the company, get a return by way of dividend if declared and take part in surplus in assets of the company at time of winding-up.

**d. Preference share capital:**

It means that part of the issued share capital of the company which either carries or would carry a preferential right with respect to payment of dividend and a preferential right of repayment in case of winding up or repayment of capital. Dividend may be paid as a fixed amount or amount calculated at a fixed rate. Right of repayment would be irrespective of preferential right to the payment of any fixed premium or premium on a fixed scale specified in memorandum or articles

of the company. Apart from these two preferential rights, preference shares can be of participating or non-participating type depending upon their right to participate in dividend payment with capital not entitled to the preferential right. That means that if shareholders are participating type they will have the right to extra dividend apart from their preferential dividend in case the company decides to distribute more profits as dividend. Similarly, preferences shareholders may have also the right to participate in any surplus capital which may remain after the entire capital has been repaid.

S. 55 of the CA, 2013 provides for issue and redemption of preference shares. It prohibits issue of irredeemable preference shares by any company limited by shares. A company may, if it is authorised by its articles, issue preference shares liable to be redeemed within a period not exceeding twenty years. Only for infrastructure projects, a company may issue such shares for a period of more than twenty years but not exceeding thirty years. This is subject to redemption of minimum of 10% of such shares per year from twenty first year onwards or earlier at the option of preference shareholders. This redemption will be on proportionate basis. Redemption will be subject to the conditions that only fully paid shares can be redeemed. Redemption can be made only from company's profits available for dividend or out of the proceeds of a fresh issue made for this purpose. A sum equal to nominal value of shares to be redeemed should be transferred to a reserve known as Capital Redemption Reserve Account from the profits out of which redemption will take place. Capital Redemption Reserve is to be preserved with same sanctity as share capital. Redemption of preference shares is not treated as reduction of share capital. Premium on redemption can be paid from profits of the company or securities premium account. If a company is not in a position to redeem preference shares or to pay dividend, it may with the consent of holders of three-fourths in value of such preference shares and with the approval of the Tribunal further issue redeemable preference shares of the same value including dividend. This will be deemed redemption of unredeemed preference shares. A company has to notify the Registrar about the redemption of preference shares within a period of thirty days of redemption.

**e. Bonus shares:**

A bonus share is an accretion. A bonus share is issued when a company capitalizes its profits by transferring an amount equal to the face value of the share from its reserves to the nominal capital. If the articles of accompany authorize, it may convert its accumulated undivided profits into bonus shares. This is a mechanism to provide capital to the company by utilizing its own

accumulated profits instead of public offering or borrowing by the company. S. 63, CA, 2013 provides that a company may issue bonus shares to its members in any manner whatsoever, out of its free reserves or amount lying in the securities premium account or capital redemption reserve. Reserves created from revaluation of assets cannot be utilized or capitalized for the purpose of issuing bonus shares. Bonus shares cannot be issued in lieu of dividend.

**f. Sweat Equity Shares:**

Sweat equity shares are equity shares issued by the company at a discount or for consideration other than cash. They are issued only to directors or employees of the company for providing technical know-how to the company or making available intellectual property rights to the company or for any value addition to company.

**g. 'Employee Stock Option' (ESOP)**

has been defined under sub-section (37) of Section 2 of the Companies Act, 2013, according to which "employees' stock option" means 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. As discussed earlier, Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed. In case of private company special resolution has been substituted by ordinary resolution.

**Further issue of Shares and Right issue**

A rights issue is a direct offer of shares to all the existing shareholders of the Company in proportion to their current holding. The company also sets a time limit for the shareholder to buy the shares. Companies pursue Rights Issue as an avenue to raise funds for various reasons, ranging from expansion or acquisitions to paying down debts.

Section 62 of Companies Act, 2013 contains provisions on "further issue of capital", and enacts the principle of pre-emptive rights of shareholders of a company to subscribe to new shares of the company

Provisions of Section 62 of Companies Act, 2013 are mandatory for all Private companies, public companies, and listed as well as unlisted companies.

**a. Relevant Provisions of Companies Act, 2013**

Sec 62 (1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered:

a. to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

i. the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

ii. unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

iii. after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company;

**b. Procedure for allotment of shares on right issue basis**

i. Issue notice in writing to every Director at least seven days' before convening the Board meeting. [Sec 173 (3)]

ii. Convene a Board Meeting

iii. Pass a Board resolution for approving "Letter of offer". The offer letter shall include right of renunciation also.

iv. Dispatch Letter of offer to all existing shareholders through registered post or speed post or through electronic mode at least three days before the opening of the issue.

v. Receive acceptance, renunciations, rejection of rights from shareholders.

vi. Issue notice in writing to every Director at least seven days' before convening the Board meeting. [Sec 173 (3)]

vii. Convene a Board Meeting

viii. Pass Board resolution for approving allotment and issue of shares.

ix. File E-form MGT 14 within 30 days of Issue of securities.

x. File with Registrar a return of allotment in E-Form PAS-3 within 30 days of allotment of shares.

**Nanalal Zaver v. Bombay Life Assurance Co. Ltd.**, AIR 1950 SC 172: (1950) 20 Com Cases 179: Section 81 (Corresponding to section 62 of the Companies Act, 2013) is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the directors decide to increase the capital within the authorised limit, by issue of further shares.

**Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.** (1981) 51 Com Cases 743 at 816: AIR 1981 SC 1298: (1982) 1 Comp LJ1. The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they does not exercise powers for the benefit of the company but simply and solely for personal aggrandizement and to the detriment of the company, the court will interfere and prevent the directors from doing so; (B) See Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd. The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers or to enable it to comply with statutory requirements. The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time;

**Balkrishan Gupta v. Swadeshi Polytex Ltd**. (1985) 58 Com Cases 563: AIR 1985 SC 520]. Although the term 'holders of the equity shares' is used in Sub-section (1)(a) and 'members' in Subsection (1A)(b) of Section 81 (Corresponding to section 62 of the Companies Act, 2013), the two terms are synonymous and mean persons whose names are entered in the register of members;

**Rights of shareholders:**

Important rights of shareholders or members of a company are as under:

1. Voting Rights: Section 47, CA, 2013 provides that every equity shareholder of a company has the right to vote on every resolution placed before the company. Equity shareholder's voting right on a poll will be in proportion to his share in the paid-up equity share capital of a company.

Every preference shareholder of a company will have a right to vote only on resolutions placed before the company directly affecting his rights attached to the preference shares and any resolution for winding up of the company or for repayment or reduction of its equity or preference share capital. Voting rights of every preference shareholder on a poll shall be in proportion to his share in the paid-up preference share capital of the company. Proportion of the voting rights of the equity shareholders to preference shareholders will be in the proportion of the paid-up equity share capital and paid-up preference share capital held by them. If dividend in respect of a class of preference shares is not paid for a period of two years or more, such class of preference shareholders will have the right to vote on all the resolutions placed before the company.

Voting rights under s. 47 are subject to provisions of s. 43 (kinds of share capital), s. 50 (2) (company to accept unpaid share capital, although not called up) and s. 188(1) (related party transactions).

Where the company accepts unpaid share capital which is not yet called up by the company, such shareholders will not be entitled to any voting rights in respect of such share capital paid by them.

2. Dividend: Every equity shareholder has the right to receive dividend declared by directors of the company yearly as well as interim dividend if declared by the directors in accordance with s. 143 of the CA, 2013. Every preference shareholder has the right to receive preferred dividend as per the terms of issue of preference shares. Participating preference shareholders have also the

right to receive extra dividend from surplus profits. A company may pay dividends in proportion to the amount paid-up on each share if its articles authorize it to do so.

3. Right to uniform calls on shares: Where any calls are made by the company for a class of shares from uncalled capital of the company, such calls should be made uniformly for all shares of that class.

4. Right to be paid at winding up of the company: Every preference shareholder has the preferred right of payment at the winding up of the company or repayment of capital. They may also have the right to participate in surplus capital if they are participating type. Equity shareholders also have the right of payment from the capital of the company left after repaying creditors and preference shareholders of the company at the winding up of the company.

5. Variation of shareholder' rights: S. 48, CA, 2013 restricts the variation of shareholders' rights except with the consent in writing of the holders of not less than three-fourths of the issued shares of the class of shares whose rights are being modified. Such a variation may also be made by means of a special resolution passed at a separate meeting of shareholders of that class if provision in respect of such variation is contained in memorandum or articles of the company or in its absence such variation is not prohibited by terms of issue of shares of that class.

If variation by one class of shareholders affects the rights of any other class of shareholders, consent of three-fourths of such other class of shareholders shall also be obtained.

Dissenting shareholders by not less than ten percent of the issued shares of that class whose shares are under variation may apply to Tribunal for cancellation of variation.

6. Right of participation in Annual General Meeting: Shareholders have the right to receive notice for attending the AGM of the company. Each shareholder has the right to receive financial statements, including auditors' report and other documents annexed to financial statements, along with directors' report presented by Board of directors at AGM.

7.Right to transfer shares/securities or other interest in company: Securities or other interest of any member in a public company are freely transferable under s. 44, CA, 2013. Shareholders of a public company have freely transferable shares/ securities without any restriction on transferability of shares. In case of private companies, approval of the Board of directors may be necessary before

any transfer of shares. Members also have the right of transmission of shares/securities or other interest in the company. The company has the power to register on receipt of intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted under s. 56, CA, 2013. Every holder of securities has also been given the power to nominate any person to whom his securities will vest in the event of his death. In case the nominee is a minor, holder has to appoint a person who will be entitled to securities of the company in the event of death of nominee during his minority [s. 72, CA, 2013].

8. Rights Issue: Every equity shareholder of a company has a right to be offered shares when the company goes for further issue of capital. Such right falls under pre-emptive rights of existing shareholders of any company having a share capital and is protected by s. 62 of the Companies Act, 2013.

**Duties and Liabilities of shareholders/ members:** All rights and liabilities of shareholders are subject to terms and conditions contained in the articles of the company. The provisions of the CA, 2013 are also applicable. The members are under a duty to participate in the meetings of the companies and vote on resolutions of the companies. They should not merely be 'functionless rentiers' of capital. They should not only be bothered about their dividend but also take active interest in the decision-making. Appointment of directors, auditors, alteration of memorandum and articles of company are few of the important resolutions where their participation is necessary.

Minority shareholders should also be vigilant for their rights in the company. Shareholders of companies are under a liability to pay the full amount of their shareholding.

The Companies (Amendment) Act, 2017 added s. 3-A about members' several liabilities after section 3 relating to formation of companies in case the number of members is reduced below the statutory requirement but the company continues with its business. Public companies and private companies are required to have minimum seven and two members respectively. S. 3-A provides that if any time the number of members of a company is reduced below statutorily required in case of a public or private company and the company carries on business for than six months while the number of members is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and is cognizant of the fact that it is carrying on business with less than seven or two members, shall be severally liable for the whole debts of the company contracted during that time, and may be severally sued therefor.

Shareholders, if required, may also pledge or mortgage their shares since shares are a movable property. Where share certificate is in physical form, it can be pledged for raising a loan. Where it is given as security, pledge retains possession of it till the loan amount is repaid. In case some right or interest in shares is transferred to the creditor, then it amounts to mortgage of shares. Where shares are in dematerialized form and with the depositories, pledge or mortgage of shares has to be registered with the depository.

**Dividend**

Every Company requires funds to operate its business successfully. Shareholders are an integral part of every company where they raise funds and in the process of same become its stakeholders. They have a control over the share of profits in proportion to the money they invest. This share of profit by shareholders is termed as dividend.

The word "Dividend" has origin from the Latin word "Dividendum" Dividend refers to that portion of profit that is paid to the shareholders of the company. It is often paid in one financial year to the shareholders after the final accounts of profit are ready and the same has to be distributed. Section 2 of the Act defines that 'includes any interim dividend'.

The rights of shareholders on profits as dividends only arise after the declaration of dividends by the company done generally on the approval of board of directors. The amount paid of the dividend

is in proportion to the amount paid on the share by the shareholder as provided in section 51 of the Act. There are two types of dividends: Interim dividends and Final dividends.

**Interim dividend**

The Act defines Dividend in terms of interim dividends which refer to the dividend declared by company's board during any time of the year before official closing of financial year and calling of Annual General Meeting. According to the Act the company can declare interim dividend out of profits accumulated of current or previous financial years. The provisions of the Act which are generally for final dividend are applicable to interim dividends also.

**Features of interim dividend**

- It is declared by board of directors in one financial year out of surplus generated in profit and loss accounts and out of profits in which interim dividend is bound to be declared. It has been held in Judgments that mere declaration by the directors in a general meeting does not obligate them to pay dividends as the decision can be rescinded.
- If the company registers loss before the stipulated declaration of dividends, it has to be declared at an average rate calculated on the basis of dividends declared in previous 3 financial years.
- It is deposited in a scheduled bank account within five days of the declaration. The same is irrespective of intervening holidays.

**Final dividends**

The dividends declared by the company after closing of the financial year and approval of Board of Directors in AGM. The term Dividend used except in the definition in Companies Act, 2013 refers to final dividends only. Majority of the provisions for both Interim and Final are same but there are some differentiated provisions for the Interim dividends in the Act. The liability on default arises only in case of declaration of Final Dividend and not Interim dividend.

**Declaration of dividends**

Section 123 of Companies Act 2013 lays down guidelines for the conditions when the companies are permitted to declare or pay dividends in a financial year:

- Source of dividend: The dividends can be declared out of –

1. It can be paid after providing for depreciation fund out of the profits of the current or previous financial year.
2. It can also be paid out of the money which Central or State Governments provide against a guarantee for the payment of dividend.

- Transfer of reserves: The Company before declaring the dividends has to reserve the required amount of cash to run the affairs of the company. These are the appropriate reserves of the company to manage its affairs.
- Declaration of dividends: If the company decides to declare dividend on the basis of profit accumulated in the previous years, such declaration has to be made on the basis of prescribed rules and the dividend paid has to be from free reserves only. The dividends can be declared only after approval of board of directors generally done in a 'general meeting'. There cannot be any declaration of dividend unless the same is approved by Board and by General body of the company.
- Separate account for dividends: The amount of dividends has to be kept in a separate bank account within 5 days from the date of declaration.
- To be paid only in cash: The dividend has to be paid only in cash (includes payment by cash or other electronic means) and is payable only to the registered shareholder himself or to his banker. The objective of specifying payment in cash is to necessitate that some assets of the company have flown out to the shareholder.
- Failure of section 73&74: If a company fails to adhere to provisions in section 73 and 74 which are related to borrowings from public and repayment of deposits, such company cannot declare any dividend as long as failure continues.

**Unpaid Dividend Account**

Sometimes, there may arise a situation that after declaration of dividend, the dividends remain unpaid or unclaimed and the amount may be unused in the bank. The Act well defines provisions in case such situation arises:

- Transfer of unclaimed dividend: When the dividend has been declared by the company but has not been claimed by the shareholder within thirty days, then within 7 days of expiry of period of 30 days (that is within 30-37 days of the declaration), the company has to transfer

the unpaid amount to the special account in the bank known as Unpaid Dividend Account. If the company defaults on transferring the amount to unpaid dividend account within specified time period, the company has to pay a set interest on the sum unpaid at 12 %per annum.

- Notification of it on the website: After transferring money to unpaid dividend account, within the period of ninety days, the company is required to prepare a statement containing names of, addresses of (last known) and the amount of dividend to be paid to the shareholder and put the same on its website and on any other website provided by central government for the same. The person claiming the amount transferred has to apply to the company for payment of dividend. If such claim is not paid in required time (generally 7 years), than the company is 'relieved of the responsibility of holding the shares or reflecting it in its list of shareholders'
- Transfer of unpaid dividend to Investor Education and Protection Fund: The Act provides for a fund which has to be established by central government. If any amount remains unclaimed for more than 7 years has to be transferred to the company under this Investor Education and Protection Fund and the declaration of same has to be made to the authority maintaining the fund. Moreover the authority also has to issue a receipt as evidence of such transfer. But there has to be a condition that the claimant can obtain it back from the fund whenever required by him.
- Note – the fund also includes grants by governments, donations made to the company, matured debentures and various other funds in the requirements of the Act.
- Penalty in case of default: The Company is liable to be penalised with fine extending from 5 lakh to 25 lakh and every particular officer responsible for it is to be punished individually with a fine from one lakh to 5 lakhs.

**Right to Dividend**

Section 126 of the Act provides that if the instrument of shares has not been registered with the company, than the dividend against such shares is to be transferred to Unpaid Dividend Account under Section 124 of the Act. Those dividends have to be kept pending until specified by the registered holder of such shares to transfer as specified. 'The dividend has to be paid by the

company in the name of the registered shareholders and it is the registered shareholders alone who claim dividend'

**Failure to distribute dividends**

There arises a penalty if the company fails to comply with the provisions of the Act:

- After the declaration of dividend the company has to pay it within 30 days from the date of declaration. 'It becomes a debt against the company and it is deemed to be receivable by the members only in the year at which the members declared the dividend.'
- If there is default then the directors are liable to be punished with imprisonment which may extend to two years and with fine which won't be less than Rs. 1000 per day which might continue till the default continues with a simple interest of 18%.
- Exceptions to default: no offence or default would have been committed in case of any of the following:
  a. If the dividend could not be paid by reason of operation of law.
  b. If the shareholder has given some special directions for payment of dividend which could not be complied and same has been communicated to him.
  c. If there is a dispute regarding right to receive dividend and same delays it payment.
  d. If the dividend has been adjusted against any due of shareholder that he had to pay to the company.
  e. If the delay in payment was not due to the fault of the company.

**Procedure of Declaration and Payment of Dividend**

There has to be a well-defined procedure to be followed by companies to declare and pay dividends which is follows:

- Notification of Meeting of directors: Under section 173 of the Act, the matter related to dividends has to be declared in a meeting of Board of Directors. The same has to be notified to the directors concerned.
- Hold required meetings – All the resolutions related to dividends have to be discussed and passed in board meetings. The resolutions may include approving the annual accounts of loss and profit; deciding the final amount of dividend; determining the date of book closure

and approving the notice of AGM as the same has to be discussed and approved in annual general meeting of the company.

- Declaration of dividends– After careful consideration and approval of resolutions, the company has to declare dividends after compulsorily abiding by provisions of section 123. It is not mandatory for companies to declare dividends every year and 'the board of directors has a discretion to declare dividend…There is no company law…obliges a board of directors to use up all its profits by declaring dividend.
- Open bank account – related to dividends a separate bank account has to be opened for making dividend payment and credit the total amount payable within five days of declaration.
- Payment of dividend– The dividend has to be paid to the shareholders in cash within 30 days of declaration. The company has to also comply with section 73 and 74 of the Act.
- Processing of unpaid dividend – the company has to transfer the amount left in the dividend account which has not been laimed to the unpaid dividend account under section 124? After 7 years same amount has to be transferred to Investor Education and Protection Fund if not claimed.

**Buy-Back of Shares**

Buy-back is the process by which Company buy-back it's Shares from the existing Shareholders usually at a price higher than the market price. When the Company buy-back the Shares, the number of Shares outstanding in the market reduces/fall. It is the option available to Shareholder to exit from the Company business. It is governed by section 68 of the Companies Act, 2013.

**Reasons of Buy-back:-**

To improve Earning per Share;

- To use ideal cash;
- To give confidence to the Shareholders at the time of falling price;
- To increase promoters shareholding to reduce the chances of takeover;
- To improve return on capital ,return on net-worth;
- To return surplus cash to the Shareholder.

Modes of Buy-back:- A Company may buy-back its Shares or other specified Securities by any of the following method- From the existing shareholders or other specified holders on a proportionate basis through the tender offer;

From the open market through

1. Book-Building process
2. Stock Exchange Provided that no buy-back for fifteen percent or more of the paid up capital and reserves of the Company can be made through open market.

**Sources of Buy-back:-**

A Company can purchase its own shares and other specified securities out of – its free reserve; or the securities premium account; or the proceeds of the issue of any shares or other specified securities.

However, Buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of the earlier issue of same kind of shares or same kind of other specified securities.

Conditions of Buy-back:- As per Section 68 of the Companies Act, 2013 the conditions for Buy-back of shares are- Articles must authorise otherwise Amend the Article by passing Special Resolution in General Meeting. For buy-back we need to pass Special Resolution in General Meeting, but if the buy-back is upto 10%, then a Resolution at Board Meeting need to be passed.

Maximum number of Shares that can be brought back in a financial year is twenty-five percent of its paid up share capital. Maximum amount of Shares that can be brought back in a financial year is twenty-five percent of paid up share capital and free reserves (where paid up share capital includes equity share capital and preference share capital; & free reserves includes securities premium). Post buy-back debt-equity ratio cannot exceed 2:1. And only fully paid up shares can be brought back in a financial year.

The notice of the meeting for which the Special Resolution is proposed to be passed shall be accompanied by a explanatory statement stating

1. a full and complete disclosure of all the material facts;
2. the necessity of buy-back;
3. the class of shares intended to be bought back;

4. the amount invested under the buyback;
5. the time limit for completion of buyback;

The Company must maintain a Register of buy-back in Form SH-10. Now, Submit Return of buy-back in Form SH-11 Annexed with Compliance Certificate in Form SH-15, Signed by 2 Directors out of which One must be a Managing Director, if any. A Company should extinguish and physically destroy shares bought back within 7 days of completion of the buy-back. Observe 6 months cooling period i.e. no fresh issue of share is allowed.

No offer of buy-back should be made by a company within a period of one year from the date of the closure of the preceding offer of buy-back. The buy-back should be completed within a period of one year from the date of passing of Special Resolution or Board Resolution, as the case may be. Transfer of certain sum to Capital Redemption Reserve Account (CRR) According to section 69 of the Companies Act, 2013, where a Company brought back shares out of free reserves or out of the securities premium account, then an amount equal to the nominal value of the shares need to be transferred to the Capital Redemption Reserve Account. Such transfer detailed to be disclosed in the Balance sheet.

The Capital Redemption Reserve account may be utilized for paying unissued shares of the company to the members as fully paid bonus shares. Restrictions on Buy-back of Securities in certain circumstances According to section 70 of the Companies Act, 2013, A Company should not buy-back its securities or other specified securities , directly or indirectly - Through any subsidiary including its own subsidiaries; or Through investment or group of investment Companies; or When Company has defaulted in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan.

The prohibition is lifted if the default has been remedied and a period of 3 years has elapsed after such default ceased to subsist. When Company has defaulted in filing of Annual Return, declaration of dividend & financial statement. Conclusion Thus, it can be concluded that Indian companies announce buyback in response to undervaluation position of their stocks in capital markets and they are well supported by availability of sufficient cash balance available for the same. Thus, on one hand, premium offered in terms of buyback prices announced offers an exit opportunity for shareholders and on the other hand, it offers an opportunity for the company to use its liquidity position to extinguish its shares today and issue them again in future. It prevents

takeovers and mergers thus preventing monopolization and aiding the survival of consumer sovereignty. On the other hand Buy back can help in manipulating the records in flatting share prices Price-Earning Ratio, Earning per share, thus misleading shareholders. Thus, knowledge of the impacts of Buy-back becomes vital and every shareholder must reconsider all his views before purchasing the shares of companies involved in the process of Buyback

**SIEL Ltd., In re.** [(2008) 144 Com Cases 469 (Del)], the view was that reduction of the share capital of a company is a domestic concern of the company and the decision of the majority would prevail. If the majority by special resolution decides to reduce the share capital of the company, it has the right to decide to reduce the share capital of the company and it has the right to decide how this reduction should be effected. While reducing the share capital, the company can decide to extinguish some of its shares without dealing in the same manner with all other shares of the same class. A selective reduction is permissible within the frame work of law for any company limited by shares.

**Indian National Press (Indore) Ltd., In re**. (1989) 66 Com Cases 387, 392 (MP): The need for reducing capital may arise in various circumstances for example trading losses, heavy capital expenses and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a capital may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.

**Elpro International Ltd., In re** [(2009) 149 Com Cases 646 (Bom.)], a company proposed to extinguish and cancel 8, 89,169 shares held by shareholders constituting 25 per cent of the issued and paid up share capital and return capital to such shareholders at Rs. 183 per equity share of Rs. 10 each so cancelled and extinguished in accordance with Section 100 of the Act (corresponds to section 66 of the Companies Act, 2013). According to the scheme as approved by the shareholders, the reducing of 25 percent of the issued and paid up capital was to take place from amongst 3,835 shareholders which included 112 shareholders who voted for the resolution, and 3,723 shareholders who did not object to the resolution. It was held that a selective reduction of share capital is legally permissible. The shareholders who did not cast their votes were those who had abstained from voting at the meeting. Moreover, there was no objection from any of the shareholders to the proposed reduction.

**Issue of Securities**

Primarily, issues can be classified as a Public, Rights or preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler.

Chapter III of the Companies Act, 2013 deals with "Prospectus and allotment of securities", the chapter is divided into two parts, Part I deals with Public Offer and Part II deals with Private Placement. Section 23 of the Companies Act, 2013 provides that a company whether public or private may issue securities. A public company may issue securities:

(a) to public through prospectus ("public offer") by complying with the provisions of Part I of Chapter III of the Act; or (b) through private placement by complying with the provisions of Part II of Chapter III of the Act; or (c) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the SEBI Act, 1992 and the rules and regulations made thereunder.

For a private company the section provides that a private company may issue securities (a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or (b) through private placement by complying with the provisions of Part II Chapter III of the Act. The section deals with issue of securities, which is a wider term not restricted to equity, preference or debentures. Securities has been defined under section 2(81) to mean the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956. The relevant section lays that securities include:- As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956, 'securities' include— (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate; (ia) derivative; (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes; (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (id) units or any other such instrument issued to the investors under any mutual fund scheme; (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt

or receivable including mortgage debt, as the case may be; (ii) Government securities; (iia) such other instruments as may be declared by the Central Government to be securities; and (iii) rights or interests in securities. Thus, the word ‘securities’ includes shares and other instruments. A public company may issue any of the aforesaid securities by way of a public offer or rights/ bonus issue or private placement. Public Offer here includes initial public offer (IPO) or further public offer (FPO) of securities to the public by a company, or an offer for sale (OFS) of securities to the public by an existing shareholder, through issue of a prospectus. Public offer has been defined for the first time Explanation to Section 23 states that "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus. To increase the accountability of companies and enhance protection to small investors the term private placement has been defined for the first time in the Act. Explanation I to Section 42 defines private placement as any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in this section.

**Private Placement**

PRIVATE PLACEMENT OF SHARES As per Explanation I to Section 42(3), "private placement" means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in this section.

Private Placement Offer – cum Application Section 42(1) provides that a company may, subject to the provisions of this section, make a private placement of securities. Section 42(3) reads, a company making private placement shall issue private placement offer and application in such form and manner as may be prescribed to identified persons, whose names and addresses are recorded by the company in such manner as may be prescribed. The private placement offer and application shall not carry any right of renunciation.

Maximum number of persons to whom offer can be made and other incidental matters As per section 42(2), a private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed fifty or such higher number as may be prescribed [excluding the qualified institutional buyers and

employees of the company being offered securities under a scheme of employees stock option in terms of provisions of clause (b) of sub-section (1) of section 62], in a financial year subject to such conditions as may be prescribed. "qualified institutional buyer" has been defined under the section to mean that the qualified institutional buyer as defined in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time. Accordingly any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the number of identified persons. Where a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be the public offer and shall be accordingly dealt.

Applying to private placement As per section 42(4) states that every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash: Hence all the payments have to be made either by cheque or demand draft or other banking channel and not by cash. However, a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar. According to subsection (5) the company shall make any fresh offer or invitation with respect to private placement unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company. A company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed subject to the maximum number of identified persons as stated above.

**Prospectus**

In general parlance prospectus refers to an information booklet or offer document on the basis of which an investor invests in the securities of an issuer company. It has been defined under section 2(70) so as to mean any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice,

circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate. Red herring Prospectus under Explanation to section 32 has been referred to mean a prospectus which does not include complete particulars of the quantum or price of the securities included therein. Shelf Prospectus under Explanation to section 31 has been referred to mean 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. The definition clarifies that any notice, circular, advertisement or any other document inviting offers from public for the subscription or purchase of securities shall be included in the definition of Prospectus

**Matters to be stated in the prospectus**: Every Prospectus shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government: Provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

**SHELF PROSPECTUS:** 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. In simple terms Shelf Prospectus is a single prospectus for multiple public. Issuer is permitted to offer and sell securities to the public without a separate prospectus for each act of offering for a certain period. Under the Act any class or classes of companies, as the Securities and Exchange Board (SEBI) may provide by regulations in this behalf, may file a shelf prospectus with the Registrar. Such prospectus is to be submitted at the stage of the first offer of securities which shall indicate a period not exceeding one year as the period of validity of such prospectus. The validity period shall commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required. An information memorandum is required to be filed by a company filing a shelf prospectus which shall contain all material facts relating to • new charges created, • changes in the financial position of the company as have occurred between the first offer of securities or the

previous offer of securities and the succeeding offer of securities and • such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus. According to the rules the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus. The section also provides a benefitting provision for the investors, the proviso provides that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

**RED HERRING PROSPECTUS** Red herring Prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein. In simple terms a red herring prospectus contains most of the information pertaining to the company's operations and prospects, but does not include key details of the issue such as its price and the number of shares offered. According to section 32 a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. Such company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer. A red herring prospectus shall carry the same obligations as are applicable to prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus. Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

**ABRIDGED PROSPECTUS** According to section 2(1) of the Act "abridged prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. Section 33 of the Act provides that no form of application for the purchase of any of the securities of a company shall be issued

unless such form is accompanied by an abridged prospectus. A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him. Nothing aforesaid shall apply if it is shown that the form of application was issued— (a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or (b) in relation to securities which were not offered to the public. The penal provisions provide that a company which makes any default in complying with the provisions shall be liable to a penalty of fifty thousand rupees for each default

**OFFER FOR SALE** Public Offer includes or an offer for sale (OFS) of securities to the public by an existing shareholder, through issue of a prospectus. Under section 25 of the Act where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company. In simple terms any document by which the offer or sale of shares or debentures to public is made shall for all purposes be treated as prospectus. The document "Offer for sale" is an invitation to the general public to purchase the shares of a company through an intermediary, such as an issuing house or a merchant bank. A company may allot or agree to allot any shares or debentures to an "Issue house" without there being any intention on the part of the company to make shares or debentures available directly to the public through issue of prospectus. The issue house in turn makes an "Offer for sale" to the public. All enactments and rules of law as to the contents of prospectus and as to liability in respect of misstatements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply to Offer for sale. Following additional information to the matters required to be stated in a prospectus: (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected; According to the section in order to construe "Offer for Sale" either of the following conditions needs to be fulfilled: (a) "Offer for sale" to the public was made within six months after the allotment or agreement to allot; or (b) at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it. As for the signing of the Prospectus the section provides that where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the Offer

document is signed on behalf of the company by two directors of the company and in case of a firm by not less than one-half of the partners in the firm, as the case may be.

**In Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd.** 1963-(033)-Com Cases-0862-SC, the Supreme Court held that the exchange was not liable to file any return of the forfeited shares under Section 75(1) of the Companies Act, 1956 [Corresponds to section 39 of the Companies Act, 2013] when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital and approved the observations of Harries C.J. in S.M. Nandy's case that: "On such forfeiture all that happened was that the right of the particular shareholder disappeared but the shares considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it";

**Alote Estate v. R.B. Seth Hiralal Kalyanmal Kasliwal** [1970] 40 Com Cases 1116 (SC). In case of inadequacy of consideration, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full, unless the contract is fraudulent;

**Harmony and Montage Tin and Copper Mining Company**; Spargo's case (1873) 8 Ch. App. 407. Any payment which is presently enforceable against the company such as consideration payable for property purchased, will constitute payment in cash; (D) **Chokkalingam v. Official Liquidator** AIR 1944 Mad. 87. Allotment of shares against promissory notes shall not be valid.

**<u>Debentures</u>**

BORROWING In order to run a business effectively/successfully, adequate amount of capital is necessary. In some cases capital arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. External Commercial borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits etc. Thus, borrowing is a mechanism used whereby the money is arranged through external resources with an implied or expressed intention of returning money.

Power of Company to Borrow The power of the company to borrow is exercised by its directors, who cannot borrow more than the sum authorized. The powers to borrow money and to issue debentures whether in or outside India can only be exercised by the Directors at a duly convened meeting. Pursuant to Section 179(3) (c) & (d) directors have to pass resolution at a duly convened

Board Meeting to borrow money. The power to issue debentures cannot be delegated by the Board of directors. However, the power to borrow monies can, be delegated by a resolution passed at a duly convened meeting of the directors to a committee of directors, managing director, manager or any other principal officer of the company. The resolution must specify the total amount up to which the moneys may be borrowed by the delegates. Often the power of the company to borrow is unrestricted, but the authority of the directors acting as its agents is limited to a certain extent. For example, Section 180(1)(c) of the Act prohibits the Board of directors of a company from borrowing a sum which together with the monies already borrowed exceeds the aggregate of the paid-up share capital of the company and its free reserves apart from temporary loans obtained from the company's bankers in the ordinary course of business unless they have received the prior sanction of the company by a special resolution in general meeting. Explanation to section 180(1)(c) provides that the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature. It is further provided in proviso to Section 180(1)(c) that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be borrowing of monies by the banking company within the meaning of clause (c) of Sub-section (1) of Section 180. It is important at this stage to distinguish between, borrowing which is ultra vires the company and borrowing which is intra vires the company but outside the scope of the director's authority. The provisions of Sub-section (5) of Section 180 clearly lay down that debts incurred in excess of the limit fixed by clause (c) of Sub-section (1) shall not be valid unless the lender proves that he lent his money in good faith and without knowledge of the limit imposed by Sub-section (1) being exceeded. With recent exemption notification no 464(E) private companies have been exempted to comply the entire provisions of Section 180 of the Companies Act 2013, resultantly special resolution is not required to exercise powers under section 180 for private companies.

The behaviour of the directors, as the company's agents, can have no effect whatsoever on the validity of the loan for no agent can have more capacity than his principal. No agent can have a power which is not with the principal. If, therefore, the borrowing is ultra vires the company so that the company has no capacity to undertake it, the lender can have no rights at common law. No

debt is created and any security which may have been created in respect of the borrowing is also void. The lender cannot sue the company for the repayment of the loan. [**Sinclain v. Brouguham**(1914) 88 LJ Ch 465].

If the borrowing by the directors is ultra vires their powers, the directors may, in certain circumstances, be personally liable for damages to the lender, on the ground of the implied warranty given by them, that they had power to borrow [Firbank's Executors v. Humphreys, (1886) 18 QBD 54; Garrard v. James, 1925 Ch. 616]. (G) Sometimes it happens that a power to borrow exists but is restricted to a stated amount, in such a case if by a single transaction an amount in excess is borrowed, only the excess would be ultra vires and not the whole transaction [**Deonarayan Prasad Bhadani v. Bank of Baroda**, (1957) 27 Com Cases 223 (Bom)].

The acquiescence of all shareholders in excess loans contracted by directors beyond their powers but not ultra vires the powers of the company would be sufficient to validate such excess debts. [**Sri Balasar aswathi Ltd. v. Parameswara Aiyar**, (1956) 26 Com Cases 298, 308: AIR 1957 Mad 122].

If the borrowing is unauthorized, the company will be liable to repay, if it is shown that the money had gone into the company's coffers [**Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd**., (1957) 27 Com Cases 660: AIR 1957 All 311].

TYPES OF BORROWINGS A company uses various kinds of borrowing to finance its operations. The various types of borrowings can generally be categorized into:

1. Long term/short term borrowing,
2. Secured/unsecured borrowing,
3. Syndicated/ Bilateral borrowing,
4. Private/Public borrowing.

1A. Long Terms Borrowings - Funds borrowed for a period ranging for five years or more are termed as long-term borrowings. A long term borrowing is made for getting a new project financed or for making big capital investment etc. Generally Long term borrowing is made against charge on fixed Assets of the company.

1B. Short Term Borrowings - Funds needed to be borrowed for a short period say for a period up to one year or so are termed as short term borrowings. This is made to meet the working capital need of the company. Short term borrowing is generally made on hypothecation of stock and debtors.

1C. Medium Term Borrowings - Where the funds to be borrowed are for a period ranging from two to five years, such borrowings are termed as medium term borrowings. The commercial banks normally finance purchase of land, machinery, vehicles etc.

2A Secured/unsecured borrowing – A debt obligation is considered secured, if creditors have recourse to the assets of the company on a proprietary basis or otherwise ahead of general claims against the company.

2B Unsecured debts comprise financial obligations, where creditors do not have recourse to the assets of the company to satisfy their claims.

3A Syndicated borrowing – if a borrower requires a large or sophisticated borrowing facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. The borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate loans, each with different terms and conditions.

3B Bilateral borrowing refers to a borrowing made by a company from a particular bank/financial institution. In this type of borrowing, there is a single contract between the company and the borrower.

4A Private borrowing comprises bank-loan type obligations whereby the company takes loan from a bank/financial Institution.

4B Public borrowing is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter, with few if any restrictions i.e. Debentures, Bonds etc.

Debentures According to Section 2(30) of Companies Act, 2013, “debenture” includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. Further it is provided that— (a) the instruments referred to in

Chapter III-D of the Reserve Bank of India Act, 1934; and (b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

Nature of Debentures and transferability As per Section 44 of the Act, the debentures of the Company are movable property which will be transferable as per the provisions given in the Articles of Association of the company.' As per the provisions Section 56, securities will be transferable vide Form SH-4. Transferability is governed by the provisions of the Articles of Association. Pari Passu Clause in case of Debentures

Debentures are usually issued in a series with a pari passu clause and it follows that they would be on an equal footing as to security and should the security be enforced, the amount realised shall be divided prorata, i.e., they are be discharged rateably. In the event of deficiency of assets, they will abate proportionately. The expression 'pari passu' implies with equal step, equally treated, at the same rate, or at par with. When it is said that existing debentures shall be issued pari passu clause, it implies that no difference will be made between the old and new debentures. If the words pari passu are not used, the debentures will be payable according to the date of issue, and if they are all issued on the same day, they will be payable accordingly to their numerical order. However, a company cannot issue a new series of debentures so as to rank pari passu with prior series, unless the power to do so is expressly reserved and contained in the debentures of the previous series.

| **Sl. No** | **Debenture** | **Share** |
|---|---|---|
| 1. | Debentures constitute a loan. | Shares are part of the capital of a company. |
| 2. | Debenture holders are creditors. | Shareholders are members/owners of the company. |
| 3. | Debenture holder gets fixed interest which carries a priority over dividend | Shareholder gets dividends with a varying rate. |
| 4. | Debentures generally have a charge on the assets of the company. | Shares do not carry any such charge. |

| | | |
|---|---|---|
| 5. | Debentures can be issued at a discount without restrictions. | Shares cannot be issued at a discount |
| 6. | The rate of interest is fixed in the case of debentures. | Whereas on equity shares the dividend varies from year to year depending upon the profit of the company and the Board of directors decides to declare dividends or not. |
| 7. | Debenture holders do not have any voting rights | Shareholders enjoy voting rights. |
| 8. | Interest on debenture is payable even if there are no profits i.e. even out of capital. | Dividend can be paid to shareholders only out of the profits of the company and not otherwise. |
| 9. | Interest paid on debenture is a business expenditure and allowable deduction from profits | Dividend is not allowable deduction as business expenditure. |

Debenture Trust deed Debenture Trust deed is a written instrument legally conveying property to a trustee often for the purpose of securing a loan or mortgage. It is the document creating and setting out the terms of a trust. It will usually contain the names of the trustees, the identity of the beneficiaries and the nature of the trust property, as well as the powers and duties of the trustees. It constitutes trustees charged with the duty of looking after the rights and interests of the debenture holders. As per section 71(7), any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee there of from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion:

Provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

A trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company; and a copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee. As per section 71 and sub-rule (1) of Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 a trust deed in Form No. SH. 12 or as near there to as possible shall be executed by the company issuing debentures in favour of the debenture trustees within three months of closure of the issue or offer. [Rule18(5)]

Rule 18(8) states that a trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company. Further, a copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee.

**Acceptance of Deposit by Companies**

Companies aim to secure finance by different cost-effective methods to suit their financial requirements. Companies have always been attracted towards financing through deposits and, at times, problems have arisen in the context of such deposits. In order to control the malpractices, the Companies Act, 2013 has introduced strict provisions under the deposit regime. Sections 73 to 76 of the Companies Act 2013 read with the Companies (Acceptance of Deposits) Rules, 2014 regulate the invitation, acceptance and repayment of deposits by Companies.

Applicability The provisions under Sections 73 to 76 of the Companies Act 2013 and the Companies (Acceptance of Deposits) Rules, 2014 shall apply to all companies except –

- a banking company and
- a non- banking financial company as defined in the Reserve Bank of India Act, 1934 and

- a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 2013; and
- such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf. [Section 73(1) read with Rule 1(3)]

Deposits have been defined under the Companies Act, 2013 ("**2013 Act**") to include any receipt of money by way of deposit or loan or in any other form by a company. However deposits do not include such categories of amounts as may be prescribed in consultation with the Reserve Bank of India ("**RBI**"). Chapter V of the 2013 Act and the Companies (Acceptance of Deposits) Rules, 2014 as amended from time to time ("**Deposits Rules**") primarily cover regulations relating to deposits. The Deposits Rules provide an exhaustive definition of deposits which is exclusionary in nature and exclude certain amounts received by a company, from the ambit of deposits. It may also be noted that the Companies Act, 1956 ("**1956 Act**") and the Companies (Acceptance of Deposits) Rules, 1975 also defined deposits in a similar manner and excluded certain amounts which were not to be considered deposits.

The dilemma is that some of the exclusions introduced under the Deposits Rules lack clarity. At times these exclusions are contradictory to related provisions under the Deposits Rules. In this article, we have attempted to analyse some of these contradictions and examine the broad practical difficulties attached with the definition of deposits along with the framework devised for their repayment under the 2013 Act.

II. Exclusions under the 2013 Act and Deposits Rules

The amounts which do not fall within the ambit of the definition of deposits under the 2013 Act and Deposits Rules are *inter alia*:

a. Loans taken by a company from another company;

b. Loans from directors or a relative of a director subject to the directors/relative furnishing a declaration that such amounts are not being funded by borrowing or accepting loans or deposits from others and the company disclosing the same in the Board's' report;

c. Any non-interest bearing amount received and held in trust;

d. Any amount received from an employee of the company not exceeding his annual salary in the nature of non-interest bearing security deposit; and

e. Such other items mentioned in Rule 2 (c) of the Deposits Rules.

One of the exclusions that necessitate discussion is set out in Rule 2(c) (ii) of the Deposits Rules which excludes from the ambit of deposits any amount received from foreign institutions, foreign governments or foreign banks, foreign corporate bodies, foreign citizens ("**Foreign Bodies**") subject to the provisions of Foreign Exchange Management Act, 1999 and the rules and regulations made there under ("**FEMA**").

FEMA prescribes that capital instruments should be issued by the company within a period of 180 (one hundred and eighty) days from receipt of inward remittance by the company, failing which the inward remittance should be refunded immediately. Failure to follow these timelines may attract penalties. In exceptional cases, refund of the amount of consideration outstanding beyond a period of 180 (one hundred and eighty) days from the date of receipt may be considered by the RBI, on the merits of the case. This is where the dichotomy lies. The Deposits Rules stipulate that an amount received towards share application money will not be considered a deposit as long as allotment against the amount is made within 60 (sixty) days of receipt of such money or the money is refunded within 15 (fifteen) days from the completion of 60 (sixty) days. The question that arises is whether the allotment should be made within the 60 (sixty) day's period prescribed under the Deposits Rules or within the 180 (one hundred and eighty) day's period prescribed under FEMA.

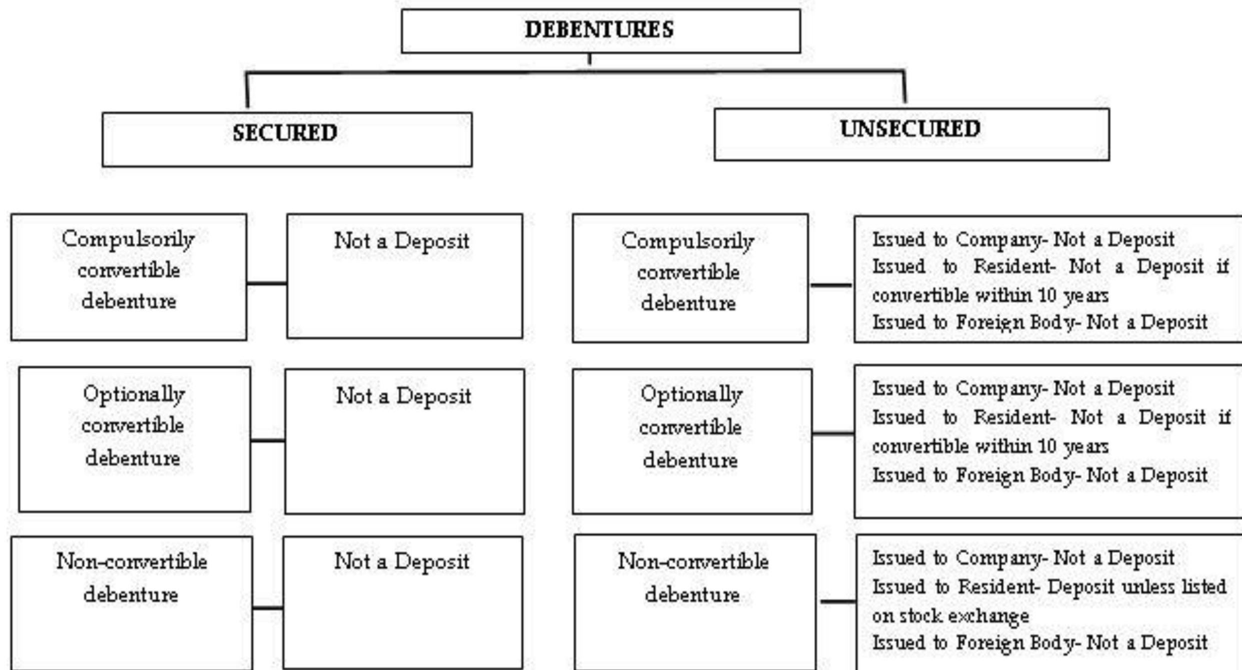
This anomaly has given rise to two interpretations. The 2013 Act has been enacted to govern and encompass within its domain companies incorporated in India and all matters relating thereto. FEMA provides a framework and lays down guidelines with respect to foreign investment. Hence it may be argued that the 2013 Act is a specific legislation which governs the subject of companies as opposed to FEMA which governs foreign investment and contains a general provision with respect to the issuance of securities to foreign investors. Therefore, following the principle of *generalia specialibus non derogant*, the provisions under FEMA which are general in nature, should yield to 2013 Act which is a specific legislation with respect to the issuance procedure. Therefore share application money will not be treated as a deposit for a period of 60 (sixty) days. Hence, securities should be issued within 60 (sixty) days from the receipt of money as opposed to

180 (one hundred and eighty) days prescribed under FEMA failing which the share application money will be treated as a deposit.

An alternative interpretation is that considering FEMA governs the framework with respect to foreign investment, foreign investors should be able to enjoy the leniency afforded under FEMA. However this interpretation seems to provide a foreign investor a superior position vis-a-vis a domestic investor. Considering the conundrum, in order to avoid having to comply with the procedure prescribed under Deposits Rules with respect to accepting deposits and therefore potentially having to comply with regulations on external commercial borrowings, allotment of shares should be made within 60 (sixty) days of receipt of the application money.

The other exclusion which prompts a discussion is set out in Rule 2(c) (ix) which excludes from the definition of Deposits the amounts raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III of the 2013 Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within 10 (ten) years[1]. This exclusion essentially signifies that a secured debenture, regardless of its tenure or convertibility, shall be exempt from the purview of deposits. However, an unsecured debenture shall only be exempt from the purview of deposits as long as it is compulsorily convertible within 10 (ten) years. This would mean that non-convertible unsecured debentures would be considered as deposits. However, any amount raised by issue of non-convertible and unsecured debentures listed on a stock exchange as per regulations framed by SEBI shall not be considered as deposits[2]. It needs to be noted here that FEMA does not prescribe any timeline for conversion of debentures. When the exclusions stated in Rule 2(c)(ii) and Rule 2(c)(ix) are read together, one needs to determine whether an unsecured debenture issued by a company to a Foreign Body which is convertible in more than 10 (ten) years, where such issuance is in conformity with FEMA, will amount to a deposit.

Further, it may be noted that Rule 2 (c) (vi) exempts from the definition of deposits any amount received by a company from another company.Based on a bare reading of the aforementioned provisions, one may argue that since amounts received from a Foreign Body are exempt from the purview of deposits debentures issued to such Foreign Body, regardless of its secured, unsecured, convertible or unconvertible nature and regardless of the tenure shall not attract the provisions pertaining to Deposits.




III. Exclusions under the 1956 Act

Another continuously discussed topic is whether the term 'deposits' as used and defined in the 2013 Act and the Deposits Rules meant to exclude from its scope the amounts which were not considered as deposits under the 1956 Act. Interestingly after more than a year of the provision being notified[3], the Ministry of Corporate Affairs decided to put this debate to rest and issued a circular on March 30, 2015[4] ("**Circular**"). The Circular clarified that amounts not treated as deposits under the 1956 Act i.e. amounts received by private companies from their members, directors or their relatives prior to April 01, 2014, will not be treated as deposits under the 2013 Act and Rules, subject to the condition that appropriate disclosures are made in the financial statements of the company of such amounts. The Circular further clarified that any renewal or acceptance of fresh deposits on or after April 01, 2014 shall be in accordance with the 2013 Act and the Rules.

IV. Repayment of Deposits

Section 74 of the 2013 Act stipulates that the deposits accepted by a company before the commencement of the Act should be repaid by a company within one year from the commencement of the Act or from the date on which payment of such deposit becomes due, whichever is earlier. It is interesting to note that though the debate around the usage of the term 'deposit' in Section 74 of the 2013 Act has been largely put to rest, the term 'repay' which has been

extensively used in the Section has not been given much air-time. The debate on the term 'repay' may seem redundant as more than 2 (two) years have elapsed since the commencement of the Section however, since a company may with the permission of the tribunal seek an extension and repay the amount in the time permitted by the tribunal, the discussion around the term may still be relevant. Further, the Companies Amendment Bill, 2016 proposes to revise Section 74 to state that deposits accepted by a company before the commencement of the Act should be repaid by a company within three years from the commencement of the Act or on or before expiry of the period for which the deposits were accepted, whichever is earlier whichever is earlier. In light of this, it may be imperative to explore what 'repay' would mean.

The confusion around the term 'repay' in Section 74(1) (b) of the Act is a question of interpretation of the term. A traditional interpretation would be that the sub-section stipulates the actual repayment of the amounts by a company to its lenders in cash or cash equivalents. Some may differ from such interpretation since sub-section (b) of Section 74 seems to be open ended and does not suggest that the deposits are necessarily required to be repaid only in cash or cash equivalents.

Hence one may ask whether the sub-section necessitates actual payment of deposits by a company to its lenders in cash or cash equivalents; or does it include a scenario where the repayment can be done in any other manner as well, which may even include issuance of securities to the lenders against the deposits accepted (the issuance being in accordance with the other provisions of the Act).

One may subscribe to a view that since Section 74(1) (b) does not precisely require a company to repay the 'amount' of deposit, it need not be read to mean the actual payment of the amount of deposit in cash or cash equivalent. It can be asserted that the term 'repay' in this context has been used to suggest extinguishment of liability and not actual payment of the amount of deposit. Using this interpretation if a company, upon receiving instructions from its lender, repays the deposit in the manner required by the lender, such repayment of the deposits will satisfy the requirement of Section 74(1) (b) of the Act. It would be appropriate if such instruction by a lender be accompanied with a statement or an acknowledgment that such application would amount to repayment of the deposit.

On the other hand it may be argued to the contrary that Section 74, when read in its entirety, contemplates the actual payment of the amounts of deposits by a company and does not merely

suggest extinguishment of liability in any manner. The basis to substantiate this view is that the other sub-sections of Section 74 use the phrase 'amount of deposits' rather than 'deposits', which seem to suggest that payment of such deposits should be done in cash or cash equivalent and not in any other manner.

**Charge on Assets**

Borrowing funds is an important source for a company to raise capital for financing large-scale projects and expanding its business. Corporate borrowings involve loans obtained by a company by way of creating a charge on its assets as security to the lender company. As defined in the Companies Act, 2013, ("*Act*") "charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage. The Act prescribes for registration of charges with the Registrar of Companies.

According to Section 77(1) of the Act, it is the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge, with the Registrar of Companies within thirty days of its creation. The provisions of Section 77 of the Act relating to registration of charges shall, so far as may be, apply to a company acquiring any property subject to a charge within the meaning of that section; or any modification in the terms or conditions or the extent or operation of any charge registered under that section. Where a charge is registered with the Registrar of Companies, he shall issue a certificate of registration of such charge to the company and/ or to the person in whose favor the charge is created.

Form and manner of Registration

The method of registration of a charge is the filing of particulars of charge along with the instrument creating charge, with the Registrar of Companies within the period prescribed in Section 77(1) of the Act. However, in the event of failure to file the particulars within the prescribed period, the company can get the charge registered by seeking condonation from the Central Government. This is also known as "rectification of the register of charges".[1]

The application for registration of charge is to be submitted to the Registrar of Companies in such form, on payment of such fees and in such manner as prescribed in the Companies (Registration of Charge) Rules, 2014.

For registration of charge as provided in Section 77(1), Section 78 and Section 79 of the Act, the particulars of the charge (together with a copy of the instrument, if any, creating or modifying the charge) shall be filed with the Registrar of Companies within a period of thirty days of the date of creation or modification of charge along with the fee, in Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification), as the case may be, duly signed by the company and the charge holder.

Extension of time for Registration

The proviso to Section 77(1) of the Act provides for extension of time for filing particulars for registration of charge. It is stated therein, that the Registrar of Companies may allow such registration to be made within a period of three hundred days of such creation on payment of additional fees. Rule 4 provides that the application for delay shall be made in Form No.CHG-1 and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

However, if registration is not made within a period of three hundred days of such creation, the company shall seek extension of time for filing of the particulars or for the registration of the charge from the Central Government (in eForm CHG-8) in accordance with Rule 12 and Section 87 of the Act. The eForm CHG-1 for registration of charge, will be processed by the Registrar of Companies office after the order of Central Government for approval for condonation of delay (in eForm INC 28) has been filed with the Registrar of Companies. The Central Government can provide for extension of time on the ground that the omission to file with the Registrar of Companies, the particulars of any charge or, the omission to register such charge, was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company, or any other grounds, it is just and equitable to grant relief.

In the case of *Tristar Container Service (Asia) P. Ltd. v. WW Shipping Agencies P. Ltd.*[2], an application for extension of time was filed by a creditor. The petitioners were under the impression

that respondents have filed the particulars of charges, but on a search conducted into records of the Registrar of Companies, it was found that the particulars of charges were not filed. However, in spite of the petitioners requesting the respondents to cause registration of the charges, the respondents did not effect the registration of the charges and therefore, the petitioners filed the said petition, which, if allowed would not cause prejudice to any stakeholder or the respondents, including the creditors. It was held that, in these circumstances the delay in filing of the particulars of the charges be condoned and time be extended for filing such particulars, with direction to the respondents to sign Form No. 8 as well for its registration. In the said case the petitioners showed that the delay was due to a sufficient cause and therefore, extension of time was granted for filing particulars of the charge.

**Effect of non-registration of charge**

Section 77(3) of the Act states that, in case no charge is created by a company, i.e. a charge is not registered, and a certificate of registration is not issued by the Registrar of Companies, then the charge shall not be taken into account by the liquidator or any other creditor. However, nothing provided in Section 77(3) of the Act shall prejudice any contract or obligation for the repayment of the money secured by a charge.

Section 86 of the Act, provides for punishment for contraventions of Section 77 of the Act. It is provided that, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

Therefore, an application must be made for registration of charges to the Registrar of Companies in the prescribed format so that the Registrar of Companies after being satisfied with the application, may issue a certificate of registration of charge and entitle the company and its creditors to rights at the time of liquidation.

# UNIT – 5

# RECONSTRUCTION, AMALGAMATION AND WINDING UP

**Synopsis**

- Reconstruction and Amalgamation
- Winding Up of a Company
- Winding up a registered and unregistered company
- Winding up a registered company
- Voluntary Winding up of a registered company
- Members' voluntary winding up
- Creditors Voluntary Winding Up
- Procedure
- Role of Company in Voluntary Liquidation:
- Winding Up Subject to Supervision of Court
- Winding up an Unregistered Company
- Locus Standi of a contributory to bring a petition for winding up
- Winding up under 2013 Act
- Winding up of a Company by Tribunal
- Steps for Voluntary Winding up of a Company

**Reconstruction and Amalgamation**

The company wished to avoid being wound up and negotiated a scheme in which the existing shareholdings in the company would be transferred to a new company which would take over the company's undertaking and assets as well as its debts. This was to be affected by a scheme for reconstruction which would result in the old company's shareholders holding four per cent of the shares in the new company.

Notwithstanding the heritage of schemes of arrangement which can be traced back to the United Kingdom in the 1860s, and the common origins of schemes in Australia and Singapore and an established body of legal principles, there is a notable degree of inconsistency in the line of judicial authorities on the nature of schemes of arrangements.

In particular, there is some controversy as to whether a scheme of arrangement derives its efficacy from an order of court or from the statute. Australian courts favour the former view. English courts, in contrast, take the position that a scheme of arrangement which has been approved by the requisite majority of the company's creditors derives its efficacy from statute and therefore operates as a statutory contract.

An arrangement embraces such diverse schemes as conversion of debt into equity, subordination of secured or unsecured debt, conversion of secured claims into unsecured claims and vice versa, increase or reduction of share capital and other forms of reconstruction and amalgamation.

According to Halsbury's Laws of England:

"Neither 'reconstruction nor amalgamation' has a precise legal meaning. Where an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is a reconstruction. It is none the less a reconstruction because all the assets do not pass to the new company, or all the shareholders of the transferor company are not shareholders in the transferee company, or the liabilities of the transferor company are not taken over by the transferee company. 'Amalgamation' is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to a new company or by the transfer of one or more undertakings to existing companies."

Mergers, Amalgamation and Demergers of Companies under the Companies Act 1956 are governed by sections 391 to 396 Companies Act 1956.

It requires companies to make application to the court under section 391, which empowers the court to sanction the compromise or arrangement proposed by the companies. Section 392 further empowers the High Court to enforce a compromise or arrangement ordered by the court under section 391 of the Companies Act. Section 393 provides supporting provisions for compliance with the provisions or directions given by the court. Sections 395, 396 and 396A are supplementary provisions relating to amalgamation. Section 395 deals with the power to amalgamate without going through the procedure of the court.

Amendment in the Companies Act, 1956 in year 2002 gave powers to National Company Law Tribunal to review and to allow any compromise or arrangement, which is proposed between a company and its creditors or any class of them or between a company and its members or any class of them. However, because of non-formation of National Company Law Tribunal, these powers still lie with High Courts and the parties concerned can make applications to high courts.

Reconstruction and amalgamation by Voluntary Winding Up

A compromise involves a settlement of a dispute. An arrangement, in contrast, is broader and has been held to be of wide import. It can cover any lawful arrangement that touches or concerns the rights and obligations of the company and its shareholders or creditors, Section 494 of the Companies Act 1956, which similar to section 287 of the Companies Act 1948 givers power a company to reconstruct or amalgamate by means of voluntary liquidation wherein the liquidator transfers the assets of the company in exchange for shares or other shares of the transferee company.

Effect on Shareholders

The effect on shareholders is that the resolution is valid, and the arrangement is binding upon them. Nevertheless, any shareholder may, in specific circumstances, dissent from the sale or arrangement.

The dissenting shareholder is required under sub section (3) of this section to give notice of his dissent to the liquidator in writing within seven days after passing of the special resolution. A legal representative of deceased shareholder is also entitled to dissent. However, it is open for the liquidator to waive such notice.

The shareholder who neither agrees to the scheme nor challenges it but refuses to accept shares in transferee company (especially if they are not fully paid) to avoid further liability , on these shares , shall be deemed to have permitted the liquidator to sell the new shares and pay him the net proceeds. The liquidator shall recover the expenses incurred on such sale from the proceeds of that sale. If there is more than one such shareholder, net proceeds shall be distributed proportionately.

Effect on creditors.

The scheme does not expressly state that any arrangement under this section is binding on the creditors yet it can be deducted from subsection (5) that the arrangement is binding on creditors as well unless they move the court / Tribunal within one year after passing of resolution of winding up and challenge the arrangement.

Nevertheless, an arrangement sanctioned by the special resolution does not relieve the liquidator of the old company is dissolved. To leave everything to the new company is a "gross dereliction" of duty by the liquidator.

Consent of the shareholders

The Companies Act, 1956, prescribes varying requirements for decisions to attain binding force on the company and with sound and profound reasons. As is evident from a reading of sections 189 and190 of the Act, some decisions are efficacious on receiving the assent of a simple majority whilst others require that there must be not less than three times the number of votes cast in favour of a Resolution than those opposed to it. Section 391 of the Act, which deals with compromises and arrangements, contemplates the consent of three-fourths in value of the affected persons for the decision to be binding on the remainder. Chapter VI, comprising sections 397 to 409 of the Act, protects the rights of persons constituting a minority, holding not less than ten per cent of the members. Section 395 of the Act is logically at the end of this spectrum, and envisages and permits, within a defined arena, the drastic dilution of the rights of a class consisting of members constituting less than ten per cent. Although this dilution has been seen and termed even as an 'expropriation', jural interference was nonetheless found to be unnecessary only on this ground. The question that arises is whether there is any rationale in the prescribed percentages, dependent upon the gravity of theme assures to be affected. In my opinion, it is not legally odious to expect a minuscule group to fall in line with the dictates of an overwhelming majority comprising ninety per cent of the group. Usually, there is wisdom in the strength of members. There is every possibility that where nine persons are willing to accept a particular offer, the remaining single person may be standing apart from the others for motives which are not mercantile or commercial. While considering provisions analogous to section 395 of the Act, Maugham, J. had expressed the following opinion which has stood the test of time, thus

“I think, however, the view of the Legislature is that where not less than nine-tenths of the shareholders in the transfer or company approve the scheme or accept the offer prima facie, at any rate, the offer must be taken to be a proper one, and in default of an application by the dissenting shareholders, which includes those who do not assent, the shares of the dissentients may be acquired on the original terms by the transferee company. Accordingly, I think it is manifest that the reasons for inducing the court to ‘order otherwise’ are reasons which must be supplied by the dissentients who take the step of making an application to the court, and that the onus is on them of giving a reason why their shares should not be acquired by the transferee company.

One conclusion which I draw from that fact is that the mere circumstance that the sale or exchange is compulsory is one which ought not to influence the court. It has been called an expropriation, but I do not regard that phrase as being very apt in the circumstances of the case. The other conclusion I draw is this, that again prima facie the court ought to regard the scheme as a fair one in as much as it seems to me impossible to suppose that the court, in the absence of very strong grounds, is to be entitled to set up its own view of the fairness of the scheme in opposition to so very large a majority of the shareholders who are concerned. Accordingly, without expressing a final opinion on the matter, because there may be special circumstances in special cases, I am unable to see that I have any right to order otherwise in such a case as I have before me, it is affirmatively established that, notwithstanding the views of a very large majority of shareholders the scheme is unfair.”

Tek Chand, J. has in Benarsi Das Sara/ v. Dalmia Dadri Cement Ltd. opined that the" principle underlying section 395 is that where a company obtains 90 per cent of the shares or class of shares under a scheme of arrangement, it can compel the dissentient minority to part with its shares. Conversely the dissenting shareholders are also entitled to compel the company to acquire their shares as well as and on the same terms. Section 395 of the Companies Act, 1956, corresponds to section 209 of the English Companies Act, 1948, which reproduces with amendments section 155 of the English Act of 1929.” final on account of pending appeals.

**Winding Up of a Company**

Winding up of a company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. In words of

Professor Gower, “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, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.”

According to Halsbury's Laws of England, “Winding up is a proceeding by means of which the dissolution of a company is brought about & in the course of which its assets are collected and realised; and applied in payment of its debts; and when these are satisfied, the remaining amount is applied for returning to its members the sums which they have contributed to the company in accordance with Articles of the Company.” Winding up is a legal process.

Under the process, the life of the company is ended & its property is administered for the benefits of the members & creditors. A liquidator is appointed to realise the assets & properties of the company. After payments of the debts, is any surplus of assets is left out they will be distributed among the members according to their rights. Winding up does not necessarily mean that the company is insolvent. A perfectly solvent company may be wound up by the approval of members in a general meeting.

There are differences between winding up and dissolution. At the end of winding up, the company will have no assets or liabilities. When the affairs of a company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of the companies and its legal personality as a corporation comes to an end.

Winding up a registered and unregistered company

The procedure for winding up differs depending upon whether the company is registered or unregistered. A company formed by registration under the Companies Act, 1956 is known as a registered company. It also includes an existing company, which had been formed and registered under any of the earlier Companies Acts.

In **Pierce Leslie & Co. Ltd v. Violet Ouchterlony**, 1969 SCR (3) 203 the Hon’ble supreme court held that winding up precedes the dissolution. There 'is no statutory provision vesting the properties of a dissolved company in a trustee or having the effect of abrogating, the law of escheat.

The shareholders or creditors of a dissolved company cannot be regarded as its heirs and successors. On dissolution of a company, its properties, if any, vest in the government.

Winding up a registered company

The Companies Act provides for two modes of winding up a registered company. Grounds for Compulsory Winding Up or Winding up by the Tribunal:

1. If the company has, by a Special Resolution, resolved that the company be wound up by the Tribunal.
2. If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting. A petition on this ground may be filed by the Registrar or a contributory before the expiry of 14 days after the last day on which the meeting ought to have been held. The Tribunal may instead of winding up, order the holding of statutory meeting or the delivery of statutory report.
3. If the company fails to commence its business within one year of its incorporation or suspends its business for a whole year. The winding up on this ground is ordered only if there is no intention to carry on the business and the Tribunal's power in this situation is discretionary.

   4. If the number of members is reduced below the statutory minimum i.e. below seven in case of a public company and two in the case of a private company.
4. If the company is unable to pay its debts.
5. If the tribunal is of the opinion that it is just and equitable that the company should be wound up.
6. Tribunal may inquire into the revival and rehabilitation of sick units. It its revival is unlikely; the tribunal can order its winding up.
7. If the company has made a default in filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years.
8. 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.

   IBA Health v. Info-Drive Systems (CA No. 8230/2010) - Kapadia C.J. begins his analysis

by noting that the Company Court is not required in a winding-up proceeding to examine complex issues of law and fact, or resolve serious disputes between parties. The Supreme Court held that a Company Court cannot proceed with a winding-up petition if the respondent raises a “substantial” or “bona fide” dispute as to the existence of the debt.

The following observations are pertinent:

A dispute would be substantial and genuine if it is bona fide and not spurious, speculative, illusory or misconceived. The Company Court, at that stage, is not expected to hold a full trial of the matter. It must decide whether the grounds appear to be substantial. The grounds of dispute, of course, must not consist of some ingenious mask invented to deprive a creditor of a just and honest entitlement and must not be a mere wrangle.

It is settled law that if the creditor's debt is bona fide disputed on substantial grounds, the court should dismiss the petition and leave the creditor first to establish his claim in an action, lest there is danger of abuse of winding up procedure. The Company Court always retains the discretion, but a party to a dispute should not be allowed to use the threat of winding up petition as a means of forcing the company to pay a bona fide disputed debt.

The solvency of a company cannot stand in the way of a winding-up petition if the company does indeed owe an unpaid debt to the creditor.

The Company Court cannot be “maliciously” used as a “debt collecting agency”, and that “an action may lie in appropriate Court in respect of the injury to reputation caused by maliciously and unreasonably commencing liquidation proceedings against a company and later dismissed when a proper defense is made out on substantial grounds.” This judgment may ensure that a winding-up petition is scrutinised more carefully before it is admitted.

The petition for winding up to the Tribunal may be made by: -

1. The company, in case of passing a special resolution for winding up.
2. A creditor, in case of a company's inability to pay debts.
3. A contributory or contributories, in case of a failure to hold a statutory meeting or to file a statutory report or in case of reduction of members below the statutory minimum.

4. The Registrar, on any ground provided prior approval of the Central Government has been obtained.
5. A person authorised by the Central Government, in case of investigation into the business of the company where it appears from the report of the inspector that the affairs of the company have been conducted with intent to defraud its creditors, members or any other person.
6. The Central or State Government, if the company has acted against the sovereignty, integrity or security of India or against public order, decency, morality, etc.

In Amalgamated Commercial Traders (P) Ltd. v. A.C.K. Krishnaswami, (1965) 35 Company Cases 456 (SC), this Court held that "It is well-settled that a winding up petition is not a legitimate means of seeking to enforce payment of the debt which is bona fide disputed by the company. A petition presented ostensibly for a winding up order but really to exercise pressure will be dismissed, and under circumstances may be stigmatized as a scandalous abuse of the process of the court."

The above-mentioned decision was later followed by this Court in Madhusudan Gordhandas and Co. v. Madhu Woollen Industries Pvt. Ltd. 1971) 3 SCC 632. it was further stated that if the court is satisfied, that sufficient reasons exist in the petition for winding up, then it will pass a winding up order. Once the winding up order is passed, following consequences follow:

1. Court will send notice to an official liquidator, to take change of the company. He shall carry out the process of winding up, (sec. 444)
2. The winding up order, shall be applicable on all the creditors and contributories, whether they have filed the winding up petition or not.
3. The official liquidator is appointed by central Government (sec. 448).
4. The company shall relevant particulars, relating to, assets, cash in hand, bank balance, liabilities, particulars of creditors etc., to the official liquidator. (sec. 454).
5. The official liquidator shall within six months, from the date of winding up order, submit a preliminary report to the court regarding:
    - Particulars of Capital
    - Cash and negotiable securities

- Liabilities
  Movable and immovable properties
- Unpaid calls, and

6. An opinion, whether further inquiry is required or not (455)

In Vijay Industries v. NATL Technologies Ltd, (2009) 3 SCC 527, it was laid down that if the debt is bona fide disputed, there cannot be "neglect to pay" within the meaning of Section 433(1)(a) of the Companies Act, 1956. If there is no neglect, the deeming provision does not come into play and the winding up on the ground that the company is unable to pay its debts is not substantiated and non-payment of the amount of such a bona fide disputed debt cannot be termed as "neglect to pay" so as to incur the liability under Section 433(e) read with Section 434(1)(a) of the Companies Act, 1956. The Central Govt. shall keep a cognizance over the functioning of official liquidator and may require him to answer any inquiry. The official liquidator, usually a public accountant, must, of course, be a person wholly independent and outside the influence neither of the company, nor in any way connected with its business. In the course of the winding-up operation a liquidator usually consults with the shareholders and the creditors of the company, with the purpose of facilitating his task or proposing a compromise of arrangement between the parties.

When the creditors are all paid, or the capital of the company (if limited) is exhausted, the liquidator is to lay before the Court a complete account, show in the manner in which the operations have been conducted and the property of the company disposed of. The Court, upon exhibition of the said account, pronounces the dissolution of the company.

Stay Order

Where, the court has passed a winding up order, it may stay the proceedings of winding up, on an application filed by official liquidator, or creditor or any contributory. The general scheme of the Companies Act is that the Court should have complete control of all proceedings in winding up.

Voluntary Winding up of a registered company

When a company is wound up by the members or the creditors without the intervention of Tribunal, it is called as voluntary winding up. It may take place by: -

1. By passing an ordinary resolution in the general meeting if: -

- the period fixed for the duration of the company by the articles has expired.
- some event on the happening of which company is to be dissolved, has happened.

2. By passing a special resolution to wind up voluntarily for any reason whatsoever.

Within 14 days of passing the resolution, whether ordinary or special, it must be advertised in the Official Gazette and also in some important newspaper circulating in the district of the registered office of the company. It was held in Neptune Assurance Co. Ltd. vs Union Of India, 1973 SCR (2) 940, that in the Companies Act the expression "voluntary winding up", means a winding up by a special resolution of a company to that effect. Similarly, the expression "winding up by the court" means winding up by an order of the Court in accordance with S. 433 of the Companies Act. The Companies Act (Section 484) provides for two methods for voluntary winding up: -

<u>Members' voluntary winding up</u>

It is possible in the case of solvent companies which are capable of paying their liabilities in full. There are two conditions for such winding up: -

a. A declaration of solvency must be made by a majority of directors, or all of them if they are two in number. It will state that the company will be able to pay its debts in full in a specified period not exceeding three years from commencement of winding up. It shall be made five weeks preceding the date of resolution for winding up and filed with the Registrar. It shall be accompanied by a copy of the report of auditors on Profit & Loss Account and Balance Sheet, and also a statement of assets and liabilities upto the latest practicable date; and
b. Shareholders must pass an ordinary or special resolution for winding up of the company.

The provisions applicable to members' voluntary winding up are as follows: -

1) Appointment of liquidator and fixation of his remuneration by the General Meeting.
2) Cessation of Board's power on appointment of liquidator except so far as may have been sanctioned by the General Meeting, or the liquidator.

3) Filling up of vacancy caused by death, resignation or otherwise in the office of liquidator by the general meeting subject to an arrangement with the creditors.
4) Sending the notice of appointment of liquidator to the Registrar.
5) Power of liquidator to accept shares or like interest as a consideration for the sale of business of the company provided special resolution has been passed to this effect.
6) Duty of liquidator to call creditors' meeting in case of insolvency of the company and place a statement of assets and liabilities before them.
7) Liquidator's duty to convene a General Meeting at the end of each year.
8) Liquidator's duty to make an account of winding up and lay the same before the final meeting.

The liquidator shall take the following steps, when affairs of the company are fully wound up: (497)

1. Call a general meeting of the members of the company, a lay before it, complete picture of accounts, winding up procedure and how the properties of company are disposed of. 2) The meeting shall be called by advertisement, specifying the time, place and object of the meeting.
2. The liquidator shall send to, the Registrar and official Liquidator copy of account, within one week of the meeting.
3. If from the report, official liquidator comes to the conclusion, that affairs of the company are not being carried in manner prejudicial to the interest of its members, or public, then the company shall be deemed to be dissolved from the date of report to the court.
4. However, if official liquidator comes to a finding, that affair have been carried in a manner prejudicial to interest of member or public, then court may direct the liquidator to investigate furthers.

<u>When can't a company commence a Members' Voluntary Winding Up?</u>

Not every company can be wound up in a members' voluntary winding up. The first exception is insolvent companies. The company must be solvent at the time and the directors must have executed a Declaration of Solvency stating so and setting out the assets and liabilities.

The Act sets out 3 more exceptions:

a. if an application has been filed for the winding up of the company on the basis that the company is insolvent (whether it is or not); and
b. the company has already been wound up by the Court. Once the Court has made that order, the directors and members lose the power to make any other appointment.
c. A third exception is where the company is the corporate trustee of a number of trusts, and one or more of these trusts are continuing.

The directors do not appoint the liquidators and the company is not wound up because of the meeting of directors. The directors will generally nominate liquidators to be appointed by the members, but the actual appointment of liquidators and the winding up occur by resolution of the members. The directors and members may also bypass the meeting process and pass resolutions without the need for the meeting, as long as all directors or members agree to the resolution being passed. They may do this by executing a certificate of resolutions which is passed when the last person executes the certificate.

The directors must have made proper inquiries and actually believe that the company is solvent (that it will be able to pay all of its creditors within 12 months after the commencement of the winding up). Only then can they resolve that the company is solvent, and the Declaration of Solvency can be executed. Once the directors have executed that Declaration of Solvency and have resolved to call a meeting of members to consider the appointment of liquidators, the declaration of solvency will be filed with ASIC and notices calling a meeting of the members will be issued to all members.

Creditors Voluntary Winding Up

In Palmer's Company Precedents, Part 11, 1960 Edn., at p. 25, the following passage appears

"A winding up petition is a perfectly proper remedy for enforcing payment of a just debt. It is the mode of execution which the Court gives to a creditor against a company unable to pay its debts." It is possible in the case of insolvent companies. It requires the holding of meetings of creditors besides those of the member's right from the beginning of the process of voluntary winding up. It is the creditors who get the right to appoint liquidator and hence, the winding up proceedings are

dominated by the creditors. In Pankaj Mehra v. State of Maharashtra, 2000 100 Comp Cas 417 SC it was laid down that once a petition for winding up is presented it is not a necessary concomitant that the winding up would follow. This position is made clear in Section 440(2) which says that "the court shall not make a winding up order on a petition presented to it under Sub-section (1), unless it is satisfied that the voluntary winding up or winding up subject to the supervision of the Court cannot be continued with due regard to the interests of the creditors or contributories or both." So, a judicial exercise is called for to reach the satisfaction of the court that winding up has to be continued with due regard to the interest of the creditors or the contributors. Section 443 of the Companies Act is important in this context.

<u>The provisions applicable to creditors' voluntary winding up are as follows: -</u>

1. The Board of Directors shall convene a meeting of creditors on the same day or the next day after the meeting at which winding up resolution is to be proposed. Notice of meeting shall be sent by post to the creditors simultaneously while sending notice to members. It shall also be advertised in the Official Gazette and also in two newspapers circulating in the place of registered office.
2. A statement of position of the company and a list of creditors along with list of their claims shall be placed before the meeting of creditors.
3. A copy of resolution passed at creditors' meeting shall be filed with Registrar within 30 days of its passing.
4. It shall be done at respective meetings of members and creditors. In case of difference, the nominee of creditors shall be the liquidator.
5. A five-member Committee of Inspection is appointed by creditors to supervise the work of liquidator.
   6) Fixation of remuneration of liquidator by creditors or committee of inspection.
6. Cessation of board's powers on appointment of liquidator.

<u>Debt</u>

The sub section above does not confer on any person a right to seek an order that a company shall be wound up. It confers power to the court to pass an order of winding up in appropriate cases, i.e. the remedy is discretionary and cannot be claimed as a matter of right. However, the right to

petition, being a statutory right cannot be excluded by a clause in the articles of association. A company will not be wound up merely because it is unable to pay its debts so long as it can be revived or resurrected by a scheme or arrangement or it still has prospects of coming back to life.

A debt for a company must be determined or definite sum of money payable immediately or at a future date. A conditional or contingent liability is not a debt, unless the contingency or condition has already happened. Where a company acts as a guarantor for repayment of a loan, and the principle debtor has committed default, the amount guaranteed is a 'debt' in respect of which a petition for winding up will lie under this section. When a dividend is declared by the company, it becomes a debt due by the company and entitles the shareholder to apply under this section in case the company is unable to pay the amount of the dividend. A winding up petition cannot be sustained on the basis of a debt which became due before prior to the company's incorporation even if one of the objects of the company was to pay off the debt.

The scope of the meaning to be given to the phrase "unable to pay its debts" appearing in section 218(1)(e) of the Companies Act 1965 is explained by McPherson in his book "The Law of Company Liquidation" (3rd Edition) at page 54 as follows:

The phrase "unable to pay its debts" is susceptible of two interpretations. One meaning which may properly be attached to it is that a company is unable to pay its debts if it is shown to be financially insolvent in the sense that its liabilities exceed its assets. But to require proof of this in every case would impose upon an applicant the often near-impossible task of establishing the true financial position of the company and the weight of authority undoubtedly supports the view that the primary meaning to the phrase is insolvency in the commercial sense - that is inability to meet current demands irrespective of whether the company is possessed of assets which, if realised, would enable it to discharge its liabilities in full.

The court should not go in a winding-up petition into disputed questions of fact which cannot be sorted out without leading evidence. A claim for damages for breach of contract is not in the category of a debt due. A petition filed by a secured creditor just to exert pressure on the company is liable to be dismissed. The machinery for winding up will not be allowed to be utilized merely as a means for realizing debts due from a company. A winding up petition is not a legitimate means of seeking to enforce payment of a debt which is bona fide disputed by a company. However, the

court can hardly exercise any discretion where the company is so hopelessly insolvent that there is absolutely no chance of resurrection. The company is not liable to be wound up if it is financially sound and refuses to pay the debts. Winding up is not an alternative to a civil suit

The views of Indian courts are also not rigid on the issue of winding up under sub section (e) of Section 433, different views have been adopted by courts.

In National Textile Workers' Union vs PR Ramakrishnan, the Supreme Court, in order to avoid undue hardship on the part of the company, had held that the trade union could not present a petition for winding up. It cannot represent workers for this purpose, as they have an alternative remedy under the Industrial Disputes Act, 1947. However, in the case of M Satyanarayana vs Stiles India Ltd, the high court of Andhra Pradesh has held that the unpaid salary is also a debt.

In brief, it can be inferred that a winding up order with reference to Section 433(e) is an extreme remedy and therefore, is to be sparingly invoked. In Re Long Thai Sawmill (Miri) and (1974) 2 MLJ 227, the Privy Council pointed out that for a case to be brought within section 181 (1((a) at all, the complainant must identify and prove "oppression" or "disregard". The mere fact that one or more of those managing the company possessed the majority of the voting power and, in reliance upon the power, made policy or executive decisions, with which the complainant did not agree, was not enough. There must be a visible departure from the standards of the fair dealing and a violation of the conditions of fair play which a shareholder is entitled to expect before a case of oppression can be made out.

**Procedure**

Company in the general meeting [ in which resolution for winding up is passed], and the creditors in their meeting, appoint liquidator. They may either agree on one liquidator, or if two names are suggested, then liquidator appointed by creditor shall act.

1. Any director, member or creditor may approach the court, for direction that; Liquidator appointed in general meeting shall act, or He shall act jointly with liquidator appointed by creditor, or Appointing official liquidator, or Some other person to be appointed as liquidator. [502 (2)]
2. The remuneration of liquidator shall be fixed by the creditors, or by the court. (504)

3. On appointment of liquidator, all the power of Board of Directors shall cease. (505)
4. In case, the winding up procedure, takes more than one year, then he will have to call a general meeting, and meeting of creditors, at the end of each year, and he shall present, a complete account of the procedure, and the status / position of liquidation (505).

As soon as the affairs of the company are wound up, the liquidator shall call a final meeting of the company as well as that of the creditors through an advertisement in local newspapers as well as in the Official Gazette at least one month before the meeting and place the accounts before it. Within one week of meeting, liquidator shall send to Registrar a copy of accounts and a return of resolutions.

A sick or potentially sick company can file a petition for voluntary winding up of company. The company must seek clearance for closure from the government. A company referred to the Board of Financial and Industrial Reconstruction can be wound-up after the order is passed by the board. Once the amount of settlement (assets minus liabilities) is determined, the permission of RBI is taken to make the final settlement to the owners of the company. Distribution of property of company on voluntarily winding up [ both members and creditors voluntarily winding up].

Once the company is fully wound up, and assets of the company sold or distributed, the proceedings collected are utilised to pay off the liabilities. The proceedings so collected shall be utilised to pay off the creditors in equal proportion. Thereafter any money or property left, may be distributed among members according to their rights and interests in the company.

**Role of Company in Voluntary Liquidation:**

A - Member's Voluntary Winding Up

1. To convene a Board Meeting: To make a declaration of solvency in Form 149 under Rule 313 of Company Court Rules 1959. If Directors are of the opinion that company has no debts or will pay its debts within 3 years.
2. Declaration should be accompanied by Audited Balance Sheet and Profit & Loss account as on the nearest practicable date before declaration & Auditor's Report thereon.
3. Approval of draft declaration & affidavit as well as Authority to director to sign and deliver the declaration to Roc.

4. To approve draft Resolution to be passed in the Meeting of Shareholders.
5. To appoint liquidator (s) and fix their remuneration - Body corporate cannot be appointed, however, body corporate of professionals as approved by Central Govt. can be appointed. CA firm can be appointed as liquidator. The remuneration fixed by the members in meeting cannot be increased.
6. To fix date, time and venue for holding General Meeting & approve the draft notice and to issue notice for General Meeting.
7. To hold General Meeting and pass Ordinary or Special Resolution as applicable.
8. To file the declaration duly verified by an affidavit before a Judicial Magistrate with concerned ROC before the date of General Meeting in e-form 62. (a) For winding up (b) For appointment of liquidator.
9. To forward copies of notices and proceedings of general meeting to Stock Exchange promptly (if applicable).
10. To file notice for the appointment of the liquidator within 10 days from the date of passing of Resolution of winding up to the Registrar of Companies (e-form 62) - The vacancy in the office of the liquidator will be filled by company in its general meeting and fresh notice will be given to ROC within 10 days of such appointment.
11. To submit a statement of affairs of the company in Form-57 duly verified by Affidavit in form-58 within 21 days of commencement of winding up to the liquidator. The Statement of Affairs primarily includes - Assets, liabilities and debts, Name, address and other particulars of creditors, secured and unsecured. In case of secured creditors, the nature of security be mentioned.

Distinguish between ‘Members’ Voluntary Winding-up’ and ‘Creditors’

Members’ voluntary winding-up can be resorted to by solvent companies and thus requires the filing of Declaration of Solvency by the Directors of the company with the Registrar. Creditors’ winding-up, on the other hand, is resorted to by insolvent companies. In Members’ voluntary winding-up there is no need to have creditors’ meeting. But, in the case of creditors’ voluntary winding-up, a meeting of the creditors must be called immediately after the meeting of the members.

Liquidator, in the case of members' winding-up, is appointed by the members. But in the case of creditors' voluntary winding-up, if the members and creditors nominate two different persons as liquidators, creditors' nominee shall become the liquidator. In the case of Creditor's voluntary winding-up, if the creditors so wish, a 'Committee of Inspection' may be appointed. In the case of Members' voluntary winding-up, there is no provision for any such Committee.

The remuneration of liquidator/(s) is fixed by the members in case of Members' voluntary winding-up (Section 490) whereas the same is to be fixed by the Committee of Inspection, if any, or by the creditors in case of Creditors' voluntary winding-up (Section 504). In Bowes v. Hope Life Insurance and Guarantee Co. and in Re General Company for Promotion of Land Credit it was stated that "a winding up order is not a normal alternative in the case of a company to the ordinary procedure for the realisation of the debts due to it"; but nonetheless it is a form of equitable execution. Propriety does not affect the power but only its exercise. If so, it follows that in terms of cl. (d) of r. 1 of O.XL of the Code of Civil Procedure, a Receiver can file a petition for winding up of a company for the realisation of the properties, movable and immovable, including debts, of which he was appointed the Receiver.

Winding Up Subject to Supervision of Court

1. Winding up subject to supervision of court, is different from "Winding up by court."
2. Here the court can only supervise the winding up procedure. Resolution for winding up, is passed by members in the general meeting. It is only for some specific reasons, that court may supervise the winding up proceedings. The court may put up some special terms and conditions also.
3. However, liberty is granted to creditors, contributories or other to apply to court for some relief. (522) Where a Company is being wound up voluntarily, any person who would have been entitled to petition for compulsory winding up may petition instead for the voluntary winding up to be continued subject to the supervision of court.
4. The Petitioner must prove that voluntary winding up cannot continue with fairness to all concerned parties.
5. Court may then appoint an additional Liquidator or continue with the existing Liquidator to give security.

6. The Liquidator must file with the Registrar every three months a report of the progress of the liquidation - The court may also appoint liquidators, in addition to already appointed, or remove any such liquidator. The court may also appoint the official liquidator, as a liquidator to fill up the vacancy.
7. Liquidator is entitled to do all such things and acts, as he thinks best in the interest of company. He shall enjoy the same powers, as if the company is being wound-up voluntarily.
8. The court also may exercise powers to enforce calls made by the liquidators, and such other powers, as if an order has been made for winding up the company altogether by court.

Winding up an Unregistered Company

According to the Companies Act, an unregistered company includes any partnership, association, or company consisting of more than seven persons at the time when petition for winding up is presented. But it will not cover the following: -

a. A railway company incorporated by an Act of Parliament or other Indian law or any Act of the British Parliament.
b. A company registered under the Companies Act, 1956.
c. A company registered under any previous company laws.
d. An illegal association formed against the provisions of the Act.

However, a foreign company carrying on business in India can be wound up as an unregistered company even if it has been dissolved or has ceased to exist under the laws of the country of its incorporation. The provisions relating to winding up of an unregistered company: -

a. Such a company can be wound up by the Tribunal but never voluntarily.
b. Circumstances in which unregistered company may be wound up are as follows: -
    - If the company has been dissolved or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs.
    - If the company is unable to pay its debts.
    - If the Tribunal regards it as just and equitable to wind up the company.

- Contributory means a person who is liable to contribute to the assets of a company in the event of its being wound up. Every person shall be considered a contributory if he is liable to pay any of the following amounts - Any debt or liability of the company; Any sum for adjustment of rights of members among themselves; Any cost, charges and expenses of winding up; on the making of winding up order, any legal proceeding can be filed only with the leave of the Tribunal.

Locus Standi of a contributory to bring a petition for winding up

Recently, the Supreme Court of India in **Severn Trent Inc. v. Chloro Controls (India) Pvt. Ltd**. [(2008) 4 SCC 130] dealt with an interesting point of law related to the locus standi of a contributory to file a petition for winding up. The issue before the Supreme Court called for an interpretation of Section 439(4)(b) of the Companies Act, 1956. Under this Section, a contributory is not entitled to present a petition for winding up unless the shares in respect of which he is a contributory, or some of them, (a) were originally allotted to him; or (b) were held by him and registered in his name for a certain period; or (c) devolved on him through the death of a former holder. Severn Trent did not dispute that category (a) was inapplicable in the case; but argued that it should be held to have conformed to categories (b) and (c).

Essentially, the contention was that the requirement of the shares having to be "registered in his name" was not a mandatory requirement and could be waived in certain circumstances. Otherwise, a company (particularly in cases where two groups of shareholders are severely hostile to each other) could prevent a contributory from bringing a petition for winding up by simply refusing to register the shares in the name of the contributory. Alternatively, Severn Trent argued that the shares could be deemed to have devolved upon it through the "death" of the former holder. After the merger between Capital Control (Delaware) and Severn Trent, the former had effectively met its "civil death", and its shares had then devolved upon the latter.

The Court held that the plain language of Section 439 could not be modified or read down; and to come under category (b), it was essential that the shares should be held by the contributory and registered in his name. Section 439(4) was held to be a complete code in this respect, leaving no room for equitable considerations to be used to allow a petition in cases where a strict reading of the provisions would not allow one. Court stated, "… if there is omission, default or illegal action

on the part of the Company in not registering the name of the contributory even though he/it can be said to be a contributory by holding the shares… the law provides a remedy."

This case is significant because it is perhaps the only clear Supreme Court decision on the issue of locus standi of a contributory to bring a petition for winding up. The case now conclusively settles that Section 439(4) is an exhaustive code on the subject of winding up by contributories; and in order to present a petition for winding up, a contributory must be able to bring itself within the wordings of the categories mentioned in Section 439(4)(b); with all the categories being construed according to a strict literal meaning.

Winding up under 2013 Act

A private limited company is an artificial judicial person and requires various compliances like appointment of Auditor, regular filing of income tax return, annual return filing and more. Failing to maintain compliance for a Company could result in fines and/or disqualification of the Directors from incorporating another Company. Therefore, if a private limited company has become inactive and there are no transactions in the company, then it is best to wind up the Company.

Voluntary winding up of a company can be initiated at any time by the shareholders of the company. In case there are any secured or unsecured creditors or employees on-roll, the outstanding dues must be settled. Once all the dues are settled, the bank accounts of the company must be closed. Finally, the company must regularise any overdue compliance like income tax return or annual filing and surrender the GST registration. Once, all activities are stopped and the registrations are surrendered, the winding up application petition can be filed with the Ministry of Corporate Affairs.

Winding up of a Company by Tribunal

Winding up of a company may be required due to a number of reasons including closure of business, loss, bankruptcy, passing away of promoters, etc., The procedure for winding up of a company can be initiated voluntarily by the shareholders or creditors or by a Tribunal.

As per Companies Act 2013, a company can be wound up by a Tribunal, if:

- The company is unable to pay its debts.
- The company has by special resolution resolved that the company be wound up by the Tribunal.
- The company has acted against the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign states, public order, decency or morality.
- The Tribunal has ordered the winding up of the company under Chapter XIX.
- If the company has not filed financial statements or annual returns for the preceding five consecutive financial years.
- If the Tribunal is of the opinion that it is just and equitable that be company should be wound up.
- If the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purposes or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and it is proper that the company be wound up.

Voluntary Winding up of a Company

The winding up of a company can also be done voluntarily by the members of the Company, if:

- If the company passes a special resolution for winding up of the Company.
- The company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period of its duration, if any, fixed by its articles of association or on the occurrence of any event in respect of which the articles of association provide that the company should be dissolved.

Steps for Voluntary Winding up of a Company

The following are the steps for initiating a voluntary winding up of a Company:

**Step 1:** Convene a Board Meeting with two Directors or by a majority of Directors. Pass a resolution with a declaration by the Directors that they have made an enquiry into the affairs of the Company and that, having done so, they have formed the opinion that the company has no

debts or that it will be able to pay its debts in full from the proceeds of the assets sold in voluntary winding up of the company. Also, fix a date, place, time agenda for a General Meeting of the Company after five weeks of this Board Meeting.

**Step 2:** Issue notices in writing calling for the General Meeting of the Company proposing the resolutions, with suitable explanatory statement.

**Step 3:** In the General Meeting, pass the ordinary resolution for winding up of the company by ordinary majority or special resolution by 3/4 majority. The winding up of the company shall commence from the date of passing of this resolution.

**Step 4:** On the same day or the next day of passing of resolution of winding up of the Company, conduct a meeting of the Creditors. If two thirds in value of creditors of the company are of the opinion that it is in the interest of all parties to wind up the company, then the company can be wound up voluntarily. If the company cannot meet all its liabilities on winding up, then the Company must be wound up by a Tribunal.

**Step 5:** Within 10 days of passing of resolution for winding up of company, file a notice with the Registrar for appointment of liquidator.

**Step 6:** Within 14 days of passing of resolution for winding up of company, give a notice of the resolution in the Official Gazette and also advertise in a newspaper with circulation in the district where the registered office is present.

**Step 7:** Within 30 days of General Meeting for winding up of company, file certified copies of the ordinary or special resolution passed in the General Meeting for winding up of the company.

**Step 8:** Wind up affairs of the company and prepare the liquidators account of the winding up of the company and get the same audited.

**Step 9:** Call for final General Meeting of the Company.

**Step 10:** Pass a special resolution for disposal of the books and papers of the company when the affairs of the company are completely wound up and it is about to be dissolved.

**Step 11:** Within two weeks of final General Meeting of the Company, file a copy of the accounts and file and application to the Tribunal for passing an order for dissolution of the company.

**Step 12:** If the Tribunal is satisfied, the Tribunal shall pass an order dissolving the company within 60 days of receiving the application.

**Step 13:** The company liquidator would then file a copy of the order with the Registrar.

**Step 14:** The Registrar, on receiving the copy of the order passed by the Tribunal then publish a notice in the Official Gazette that the company is dissolved.

Objectives or Reasons to Winding Up of a Company

Avoid Compliance

A company is a legal entity and a juristic person established created under the Companies Act. Therefore, a company is required to maintain regular compliance throughout its lifecycle. Winding up process can be to close a company that is not active and avoid compliance responsibilities.

Fast to Close

A company can also be closed by filing an application with the MCA in about 3 to 6 months. The entire process can be completed online. Hence, the process for closing a company is fast and easy in India through IndiaFilings.

Avoid Fines

A company that doesn't file its compliance on time incurs fines and penalty including debarment of the Directors from starting another Company. Hence, it is better to officially wind up a company that is inactive and avoid potential fines or liabilities in the future.

Low Cost

When compared to maintaining compliance for a dormant company, it might actually be cheaper to wind up a company and incorporate again when the time is right. IndiaFilings can help you wind up a company starting from just Rs.29899 all-inclusive fee.

Easy to Close

A company with minimal or no activities that has maintained proper compliance can be closed very easily in India. If any compliance is overdue, the compliance must first be regularised and registrations surrendered to close the company.

**Modes of Winding Up**

As per section 270 of the Companies Act 2013, the procedure for winding up of a company can be initiated either –

a. By the tribunal or,
b. Voluntary.

I. WINDING UP OF A COMPANY BY A TRIBUNAL: -

As per Companies Act 1956, a company can be wound up by a tribunal on the basis of the following reasons:

1. Suspension of the business for one year from the date of incorporation or suspension of business for whole year.
2. Reduction in number of minimum members as specified in the act (2 in case of private company and 7 in case of public company)

But with the introduction of new Companies Act 2013, these above stated grounds for winding up have been deleted and some new situations for winding up have been inserted.

As per new Companies Act 2013, a company can be wound up by a tribunal in the below mentioned circumstances:

1. When the company is unable to pay its debts
2. If the company has by special resolution resolved that the company be wound up by the tribunal.

3. If the company has acted against the interest of the integrity or morality of India, security of the state, or has spoiled any kind of friendly relations with foreign or neighboring countries.
4. If the company has not filled its financial statements or annual returns for preceding 5 consecutive financial years.
5. If the tribunal by any means finds that it is just & equitable that the company should be wound up.
6. If the company in any way is indulged in fraudulent activities or any other unlawful business, or any person or management connected with the formation of company is found guilty of fraud, or any kind of misconduct.

II. Who can apply: -

Section 272 provides that a winding up petition is to be filed in the prescribed form no 1, 2 or 3 whichever is applicable, and it is to be submitted in 3 sets. The petition for compulsory winding up can be presented by the following persons:

- The company
- The creditors; or
- Any contributory or contributories
- By the central or state govt.
- By the registrar of any person authorized by central govt. for that purpose

At the time of filing petition, it shall be accompanied with the statement of Affairs in form no 4. That petition shall state the facts up to a specific date which shall not more than 15 days prior to the date of making the statement. After preparing the statement it shall be certified by a Practicing Chartered Accountant. This petition shall be advertised in not less than 14 days before the date fixed for hearing in both newspapers English and any other regional language.

III. FINAL ORDER AND ITS CONTENT: -

The tribunal after hearing the petition has the power to dismiss it or to make an interim order as it think appropriate or it can appoint the provisional liquidator of the company till the passing of winding up order. An order for winding up is given in form 11.

IV. VOLUNTARY WINDING UP OF A COMPANY: -

The company can be wound up voluntarily by the mutual decision of members of the company, if:

- The company passes a Special Resolution stating about the winding up of the company.
- The company in its general meeting passes a resolution for winding up as a result of expiry of the period of its duration as fixed by its Articles of Association or at the occurrence of any such event where the articles provide for dissolution of company.

V. PROCEDURE FOR VOLUNTARY WINDING UP: -

1. Conduct a board meeting with 2 Directors and thereby pass a resolution with a declaration given by directors that they are of the opinion that company has no debt or it will be able to pay its debt after utilizing all the proceeds from sale of its assets.
2. Issues notices in writing for calling of a General Meeting proposing the resolution along with the explanatory statement.
3. In General Meeting pass the ordinary resolution for the purpose of winding up by ordinary majority or special resolution by 3/4th majority. The winding up shall be started from the date of passing the resolution.
4. Conduct a meeting of creditors after passing the resolution, if majority creditors are of the opinion that winding up of the company is beneficial for all parties then company can be wound up voluntarily.
5. Within 10 days of passing the resolution, file a notice with the registrar for appointment of liquidator.
6. Within 14 days of passing such resolution, give a notice of the resolution in the official gazette and also advertise in a newspaper.

7. Within 30 days of General meeting, file certified copies of ordinary or special resolution passed in general meeting.
8. Wind up the affairs of the company and prepare the liquidators account and get the same audited.
9. Conduct a General Meeting of the company.
10. In that General Meeting pass a special resolution for disposal of books and all necessary documents of the company, when the affairs of the company are totally wound up and it is about to dissolve.
11. Within 15 days of final General Meeting of the company, submit a copy of accounts and file an application to the tribunal for passing an order for dissolution.
12. If the tribunal is of the opinion that the accounts are in order and all the necessary compliances have been fulfilled, the tribunal shall pass an order for dissolving the company within 60 days of receiving such application.
13. The appointed liquidator would then file a copy of order with the registrar.
14. After receiving the order passed by tribunal, the registrar then publish a notice in the official Gazette declaring that the company is dissolved.

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