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SYLLABUS

OBJECTIVE AND EXPECTED OUTCOME OF THE COURSE:

The objective of this course is to provide basic knowledge of the provisions of the CompanyLaw. To guide the students about different terminologies in company law.

Block I (**Nature of a company**)

Unit I: Definition of a company, Characteristics of a company,

Unit II: Lifting the corporate veil, Company distinguished from partnership.

Unit III: Classification on the basis of Incorporation; Classification on the basis of Liability; Classification on the basis of number of members; Classification on the basis of Control; Classification on the basis of Ownership.

Unit IV: Steps involved in the formation and incorporation of a company.

Block II (**Memorandum of association**):

Unit V: Meaning and Importance, Form and Contents, Alteration of Memorandum.

Unit VI: Meaning, Relationship of and distinction between MOA and AOA.

Unit VII: Meaning, Definition and contents, statutory requirements in relation to prospectus.

Unit VIII: Kinds of share capital, Alteration of share capital, Ways for raising share capital,

Block III: (Allotment, issue, forfeiture and surrender of shares and debentures)

Unit IX: Allotment of shares, share certificate and share warrant, calls on shares,

Unit X: Forfeiture and surrender of shares, transfer of shares.

Unit XI: Borrowing powers, Debentures and charges.

Block IV (Company Management)

Unit XII: Definition of Director, appointment of director, position of a director,

Unit XIII: Restrictions on the appointment of director, Disqualifications of director,

Unit XIV: Meetings of directors, powersof directors, duties and liabilities of directors.

Unit XV: General meetings of shareholders, requisites of a valid meeting, proxies, voting and poll.

Block V: (Auditors and winding up)

Unit XVI: Audit committee; appointment of auditors; rights, powers and duties of auditors.

Unit XVII: Meaning of winding up; modes of winding up, consequences of winding up, procedure of winding up by the court; voluntary winding up.

Chapter 1

Nature of a company

Learning Objectives

Introduction

Definition of Company

Characteristics of a company

Lifting the corporate veil

Company distinguished from partnership

Summary

Keywords

Answer to check your progress

Terminal questions

Suggested readings

Learning Objectives

After reading this lesson, you should be able to:

(a) Define a company and explain its features.

(b) Describe the process of lifting the corporate veil.

(c) Explain the difference between company and partnership.

Introduction

In this era of industrial revolution many big business organization exists and many more emerges. All these required big investment and involvement of risk. The Multinational companies like Coca-Cola, General Motors and Reliance have their investors and customers all over the world. We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions like (a) which business they should start or begin with, (b) whether they should form a new company or take over some existing company, (c) if new company is to be started, whether they should start a private company or pubic company, (d) what should be the capital of the company etc. After deciding about the formation of the company, interested persons take necessary steps, and the company is actually formed. Thereafter, they start their business.

Definition of Company

Company is a voluntary association which is formed and organized to carry out business activity.

- A company is a "corporation" - an artificial person created by law.
- A human being is a "natural" person.
- A company is a "legal" person.

- A company thus has legal rights and obligations in the same way that a natural person does.

Section 3 (1) (i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1) (ii) Of the act states that "an existing company means a company formed and registered under any of the previous companies laws".

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

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

Example: Suppose, two persons want to do business at large scale but they have limited money. They are also not interested to make partnership due to its unlimited liability. They go to the office of registrar of companies and fill the form of creation of company and attaching required documents. They also pay the required fees. After this, registrar will register their company. This registered company will be independent Identity.

Characteristics of a company

Following are the characteristics of the company:

- **Incorporated association**: "A company is created after registration under the Companies Act. It comes into existence from the date mentioned in the certificate of incorporation. Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not registered in such way. For forming a public company at least seven persons and for a private company at least two persons are persons are required. These persons will subscribe their names to the

Memorandum of association and also conform to other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability" [Sec 12 (1)].

- **Artificial legal person**. A company is not natural person as we discussed already in the beginning of this chapter it is an artificial person. It exists in the eyes of the law but cannot act on its own. It has to act through a board of directors chosen by shareholders. It was rightly pointed out in Bates V Standard Land Co. "The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them".
- **A company has a legal distinct entity** and is independent of its members: The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members.
- **Perpetual succession**

  The life of company is very stable that human being's life. There is no effect of changing, death, insolvency of respected member on company. Its existence is not affected by members' existence at any time. Shares can easily transfer from one member to another member, so liquidation of company is only possible by law. Thus, a company has a perpetual existence, irrespective of changes in its membership.
- **Common seal**

  Company cannot sign on any contract being an artificial person so it works with common seal. Every document of contract with company is only valid, if there is common seal of company on it.
- **Limited liability**

  Limited liability is also another important feature of company. It is the reason that large number of investors invest in limited liability companies. It is the liability of company to repay not the liability of its members. Members' liability is only limited up to the purchased value of shares. They have to pay balance amount of their shares.
- **Separate property**

  It is also feature of company that property of company is different from its member's property. It can purchase or sell property without the permission of shareholders. In other words, assets of company are not the assets of members.
- **Right to sue**

Company can sue other parties like natural person for protecting its assets and properties. Other persons can also charge on the company.

Check your progress

1. In the case of unincorporated associations like partnership firms, the liability of the partners for the debts of the business is_____.
2. An incorporated company never_____except when it is_____as per law.
3. A member does not even have an_____in the property of the company.
4. A company cannot go beyond the power stated in the_____.
5. A member may sell his shares in the_____and_____the money invested by him.
6. A company, as a person separate from its members, may even sue one of its members for _____.
7. A company is a_____for_____.
8. An unincorporated company, association or partnership consisting of large number of persons has been declared_____.
9. An illegal association is liable to be_____.
10. Company law in India has been modelled on the_____.

Lifting the corporate veil

Before dealing with the lifting of corporate veil it is pertinent to define what the meaning of a company is. Strictly, a company has no particular definition but section 3(1) (i) of the Companies Act attempts to provide the meaning of the word in context of the provisions and for the use of this act. It states: 'a company means a company formed and registered under this Act or an existing company as defined in section 3 (1) (ii).' The company must be registered under the Companies Act for it to become an incorporated association. If it is not registered it becomes an illegal association.

Let us first discuss the exact meaning of corporate veil and lifting of corporate veil with limited liability concept.

Corporate veil: A legal concept that separates the personality of a corporation from the personalities of its shareholders and protects them from being personally liable for the company's debt and other obligations.

Lifting the corporate refers to the possibility of looking behind the company's framework (or behind the company's separate personality) to make the members liable, as an exception to the rule that they are normally shielded by the corporate shell (i.e. they are normally not liable to outsiders at all either as principles or as agents or in any other guise, and are already normally liable to pay the company what they agreed to pay by way of share purchase price or guarantee, nothing more).

When the true legal position of a company and the circumstances under which its entity as a corporate body will be ignored and the corporate veil is lifted, the individual shareholder may be treated as liable for its acts.

The corporate veil may be lifted where the statute itself contemplates lifting the veil or fraud or improper conduct is intended to be prevented.

"It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of public interest, the effect on parties who may be affected, etc.". This was iterated by the Supreme Court in *Life Insurance Corporation of India v. Escorts ltd* [vi].

The circumstances under which corporate veil may be lifted can be categorized broadly into two following heads:

1. Statutory Provisions
2. Judicial interpretation

STATUTORY PROVISIONS

Section 5 of the Companies Act defines the individual person committing a wrong or an illegal act to be held liable in respect of offences as 'officer who is in default'. This section gives a list of officers who shall be liable to punishment or penalty under the expression 'officer who is in default' which includes a managing director or a whole-time director.

Section 45- Reduction of membership below statutory minimum: This section provides that if the members of a company is reduced below seven in the case of a public company and below two in the case of a private company (given in Section 12) and the company continues to carry on the business for more than six months, while the number is so reduced, every person who knows this fact and is a member of the company is severally liable for the debts of the company contracted during that time.In the case of *Madan lal v. Himatlal & Co.****[vii]***the respondent filed suit against a private limited company and its directors for recovery of dues. The directors resisted the suit on the ground that at no point of time the company did carry on business with members below the legal minimum and therefore, the directors could not be made severally liable for the debt in question. It was held that it was for the respondent being *dominus litus,* to choose persons of his choice to be sued.

Section 147- Misdescription of name: Under sub-section (4) of this section, an officer of a company who signs any bill of exchange, hundi, promissory note, cheque wherein the name of the company is not mentioned is the prescribed manner, such officer can be held personally liable to the holder of the bill of exchange, hundi etc. unless it is duly paid by the company. Such instance was observed in the case of Hendon v. Adelman.[viii]

Section 239- Power of inspector to investigate affairs of another company in same group or management: It provides that if it is necessary for the satisfactory completion of the task of an inspector appointed to investigate the affairs of the company for the alleged mismanagement, or oppressive policy towards its members, he may investigate into the affairs of another related company in the same management or group.

Section 275- Subject to the provisions of Section 278, this section provides that no person can be a director of more than 15 companies at a time. Section 279 provides for a punishment with fine which may extend to Rs. 50,000 in respect of each of those companies after the first twenty.

Section 299- This Section gives effect to the following recommendation of the Company Law Committee: “It is necessary to provide that the general notice which a director is entitled to give to the company of his interest in a particular company or firm under the proviso to sub-section (1) of section 91-A should be given at a meeting of the directors or take reasonable steps to secure that it is brought up and read at the next meeting of the Board after it is given.[ix] The section applies to all public as well as private companies. Failure to

comply with requirements of this Section will cause vacation of the office of the Director and will also subject him to penalty under sub-section (4).

Sections 307 and 308- Section 307 applies to every director and every deemed director. Not only the name, description and amount of shareholding of each of the persons mentioned but also the nature and extent of interest or right in or over any shares or debentures of such person must be shown in the register of shareholders.

Section 314- The object of this section is to prohibit a director and anyone connected with him, holding any employment carrying remuneration of as such sum as prescribed or more under the company unless the company approves of it by a special resolution.

Section 542- Fraudulent conduct: If in the course of the winding up of the company, it appears that any business of the company has been carried on with intent to defraud the creditors of the company or any other person or for any fraudulent purpose, the persons who were knowingly parties to the carrying on of the business, in the manner aforesaid, shall be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company, as the court may direct. In *Popular Bank Ltd., In re*[x] it was held that section 542 appears to make the directors liable in disregard of principles of limited liability. It leaves the Court with discretion to make a declaration of liability, in relation to 'all or any of the debts or other liabilities of the company'. This [xi]section postulates a nexus between fraudulent reading or purpose and liability of persons concerned.

JUDICIAL INTERPRETATIONS

By contrast with the limited and careful statutory directions to 'lift the veil' judicial inroads into the principle of separate personality are more numerous. Besides statutory provisions for lifting the corporate veil, courts also do lift the corporate veil to see the real state of affairs. Some cases where the courts did lift the veil are as follows:

1. *United States v. Milwaukee Refrigerator Transit Company* ***[xii]***- In this case the U.S. Supreme Court held that "where the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will disregard the corporate entity and treat it as an association of persons."

Some of the earliest instances where the English and Indian Courts disregarded the principle established in Salomon's case are:

2. *Daimler Co. Ltd. v. Continental Tyre and Rubber Co. (Great Britain) Ltd****[xiii]***- This is an instance of determination of enemy character of a company. In this case, there was a German company. It set up a subsidiary company in Britain and entered into a contract with Continental Tyre and Rubber Co. (Great Britain) Ltd. for supply of tyres. During the time of war the British company refused to pay as trading with an alien company is prohibited during that time. To find out whether the company was a German or a British company, the Court lifted the veil and found out that since the decision making bodies, the board of directors and the general body of shareholders were controlled by Germans, the company was a German company and not a British company and hence it was an enemy company.

3. *Gilford Motor Co. v. Horne****[xiv]***- This is an instance for prevention of façade or sham. In this case an employee entered into an agreement that after his employment is terminated he shall not enter into a competing business or he should not solicit their customers by setting up his own business. After the defendant's service was terminated, he set up a company of the same business. His wife and another employee were the main shareholders and the directors of the company. Although it was in their name, he was the main controller of the business and the business solicited customers of the previous company. The Court held that the formation of the new company was a mere cloak or sham to enable him to enable him to breach the agreement with the plaintiff.

4. *Re, FG (Films) Ltd****[xv]***- In this case the court refused to compel the board of film censors to register a film as an English film, which was in fact produced by a powerful American film company in the name of a company registered in England in order to avoid certain technical difficulties. The English company was created with a nominal capital of 100 pounds only, consisting of 100 shares of which 90 were held by the American president of the company. The Court held that the real producer was the American company and that it would be a sham to hold that the American company and American president were merely agents of the English company for producing the film.

5. *Jones v. Lipman****[xvi]***- In this case, seller of a piece of land sought to evade specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose and thus he attempted to avoid completing the sale of his house to the plaintiff. Russel J. describing the company as a "devise and a sham, a mask which he

holds before his face and attempt to avoid recognition by the eye of equity" and ordered both the defendant and his company specifically to perform the contract with the plaintiff.

6. *Tata Engineering and Locomotive Co. Ltd. State of Bihar**[xvii]*** – In this case it was stated that a company is also not allowed to lay claim on fundamental rights on the basis of its being an aggregation of citizens. Once a company is formed, its business is the business of an incorporated body thus formed and not of the citizens and the rights of such body must be judged on that footing and cannot be judged on the assumption that they are the rights attributable to the business of the individual citizens.

7. *N.B. Finance Ltd. v. Shital Prasad Jain**[xviii]***- In this case the Delhi High Court granted to the plaintiff company an order of interim injunction restraining defendant companies from alienating the properties of their ownership on the ground that the defendant companies were merely nominees of the defendant who had fraudulently used the money borrowed from the plaintiff company and bought properties in the name of defendant companies. The court did not in this case grant protection under the doctrine of corporate veil.

8. *Shri Ambica Mills Ltd. v. State of Gujarat**[xix]***- It was held that the petitioners were as good as parties to the proceedings, though their names were not expressly mentioned as persons filing the petitions on behalf of the company. The managing directors in their individual capacities may not be parties to such proceedings but in the official capacity as managing directors and as officers of the company, they could certainly be said to represent the company in such proceedings. Also as they were required to so act as seen from the various provisions of the Act and the Rules they could not be said to be total strangers to the company petition.

Company distinguished from partnership

When two or more person are carrying out any business altogether and agreed to share the profits then this relationship is known as partnership. Person entered in to partnership is called as individual partner and collectively as a firm.

The main difference between the company and partnership are as follows:

1. Regulating Act:

A partnership firm is governed by the Indian Partnership Act, 1932 while company is regulated by Companies Act, 1956.

2. Mode of creation:

In case of partnership firm registration is not compulsory whereas a company cannot come into existence unless it is registered.

3. Number:

In the partnership firm minimum number of partner is two and maximum number is twenty but in case of banking it is ten. The minimum number in a public company is seven and in case of a private companies two. The maximum limit of members in case of a private company is fifty but in case of public company there is no maximum limit.

4. Liability:

In case of partnership the liability of partners is unlimited whereas in case of a company the liability of shareholders is limited (except in case of unlimited companies) to the extent of face value of shares or to the extent of guarantee.

5. Management:

In case of partnership firm every partner of a firm has a right to participate in the management of the business unless the partnership deed provides otherwise and the affairs of a company are managed by its directors. Its members have no right to take part in the day to day management.

6. Capital:

The share capital of a company can be increased or decreased only in accordance with the provisions of the Companies Act, whereas partners can alter the amount of their capital by mutual agreement.

7. Legal Status:

A company has a separate legal status distinct from its shareholders, while a partnership firm has no legal existence distinct from its partners.

8. Transfer of Interest:

Shares in a public company are freely transferable from one person to another person. In private company the right to transfer shares is restricted, while a partner cannot transfer his interest to others without the consent of other partners.

9. Insolvency/Death:

Insolvency or death of a shareholder does not affect the existence of a company. On the other hand a partnership ceases to exist if any partner retires, dies or is declared insolvent.

10. Winding up:

A company comes to an end only when it is wound up according to the provisions of the Companies Act. A firm is dissolved by an agreement or by the order of court. It is also automatically dissolved on the insolvency of a partner.

11. Books:

The provisions of Companies Act, 1956 have their bearing on the preparation of accounts books of a company but in case of firm there is no specific legal direction to this effect.

12. Audit:

Audit of accounts is discretionary in case of a partnership firm compulsory whereas it is generally compulsory in case of a company.

13. Authority of Members:

A partner is an agent of a firm. He can enter into contracts with outsiders and incur liabilities so long as he acts in the ordinary course of firm's business. A shareholder is not an agent of a company and has no power to bind the company by his acts.

14. Commencement of Business:

The commencement of business in a firm is not required to fulfil legal formalities while a company has to comply with various legal formalities and has to file various documents with the Registrar of Companies before the commencement of business.

Summary

Company can be defined as group of persons associated together to achieve some common business objective. A company formed and registered under the Companies Act has certain special features, which disclose the nature of a company. Companies can be classified into

five categories according to the mode of incorporation, on the basis of liability of the member, on the basis of investment. The entire process of formation of a company can be divided into four distinct stages namely promotion incorporation, capital subscription and commencement of business. However, a private company can start business as soon as it obtains the certificate of incorporation.

Keywords

Company: A company means a body of individuals associated together for a common objective, which may be business for profit or for some charitable purposes.

Registered Company: A registered company is one which is formed and registered under the Indian Companies Act, 1956 or under any earlier Companies Act in force in India.

Public Company: A public company means a company which is not a private company. Any seven or more persons can join hands to form a public company.

Holding Company: A company shall be deemed to be the holding company to another if that other is its subsidiary.

Corporate veil: A legal concept that separates the personality of a corporation from the personalities of its shareholders, and protects them from being personally liable for the company's debts and other obligations.

Answer to check your progress

1. Unlimited

2. Dies, wound up

3. Insurable interest

4. M.O.A

5. Open market, realize

6. Libel

7. Voluntary association, profit

8. Illegal

9. Taxed

10. English acts

Terminal questions

1. Explain the characteristics of a company under the Companies Act, 1956.

2. Define corporate veil?

3. Bring out the difference between partnership and company form of organization.

4. Define 'Company'. What are its essential characteristics?.

5. When can Corporate Veil of a Company be lifted?

Suggested readings

1. S.S. Gulshan & G.K. Kapoor, Business Law, New Age International Publishers, New Delhi.
2. S.C. Kuchhal, Mercantile Law, Vikas Publishing House, New Delhi.
3. P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.
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7. N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.
8. S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.
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11. R.S.N. Pillai and Bagavathi, Business Law, S. Chand & Co., New Delhi.

Chapter 2

Kinds of companies

Learning Objectives

After reading this lesson, you should be able to develop understanding regarding different types of companies.

Introduction

Industrial has revolution led to the emergence of large scale business organizations. These organizations require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of partnerships of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to overcome the limitations of partnership business. The Multinational companies like Coca-Cola and, General Motors have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Tubro etc. We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions like (a) which business they should start or begin with, (b) whether they should form a new company or take over some existing company, (c) if new company is to be started, whether they should start a private company or pubic company, (d) what should be the capital of the company etc. In this regards there are different types of companies based on formation, liability and investment.

Kinds of company

Joint stock company can be of various types. The following are the important types of company:

Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies.

A. Chartered companies. These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the

charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charted, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

B. Statutory Companies. These companies are incorporated by a special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading Corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alternations in the powers of such companies can be brought about by legislative amendments. The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts [Sec

616 (d)] These companies are generally formed to meet social needs and not for the purpose of earning profits.

C. **Registered or incorporated companies**. These are formed under the Companies act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following.

i) Companies limited by Shares: These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining unpaid on the shares subscribed by him. Such a company is called company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.

ii) Companies Limited by Guarantee: These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company [Sec 13(3)] This amount promised by him is called ‘Guarantee’. The Articles of

Association of the company state the number of member with which the company is to be registered [Sec 27 (2)]. Such a company is called a company limited by guarantee. Such companies depend for their existence on entrance and subscription fees. They may or may not have a share capital. The liability of the member is limited to the extent of the guarantee and the face value of the shares subscribed by them, if the company has a share capital. If it has a share capital, it may be a public company or a private company. The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company. Non trading or non-profit companies formed to promote culture, art, science, religion, commerce, charity, sports etc. are generally formed as companies limited by guarantee.

iii) Unlimited Companies: Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an 'unlimited company' [Sec 12(c)]. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered [Sec 27 (1)].The articles of an unlimited company shall state the number of member with which the company is to be registered.

On the Basis of Number of Members

On the basis of number of members, a company may be:

A. Private Company.

B. Public Company.

A. Private Company

According to Sec. 3(1) (iii) of the Indian Companies Act, 1956, a private company is that company which by its articles of association:

i) limits the number of its members to fifty, excluding employees who are members or ex-employees who were and continue to be members;

ii) restricts the right of transfer of shares, if any;

iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company.Where two or more persons hold share jointly, they are treated as a single member.

According to Sec 12 of the Companies Act, the minimum number of members to form a private company is two. A private company must use the word "Pvt" after its name.

- Characteristics or Features of a Private Company. The main features of a private of a private company are as follows :

i) A private company restricts the right of transfer of its shares. The shares of a private company are not as freely transferable as those of public companies. The articles generally state that whenever a shareholder of a private Company wants to transfer his shares, he must first offer them to the existing members of the existing members of the company. The price of the shares is determined by the directors. It is done so as to preserve the family nature of the company's shareholders.

ii) It limits the number of its members to fifty excluding members who are employees or ex-employees who were and continue to be the member. Where two or more persons hold share jointly they are treated as a single member. The minimum number of members to form a private company is two.

iii) A private company cannot invite the public to subscribe for its capital or shares of debentures. It has to make its own private arrangement.

B. Public company

According to Section 3 (1) (iv) of Indian Companies Act.1956 "A public company which is not a Private Company", If we explain the definition of Indian Companies Act. 1956 in regard to the public company, we note the following:

i) The articles do not restrict the transfer of shares of the company

ii) It imposes no restriction no restriction on the maximum number of the members on the company.

iii) It invites the general public to purchase the shares and debentures of the companies.

- Differences between a Public Company and a Private company

1. Minimum number : The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.

2. Maximum number: There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.

3. Number of directors. A public company must have at least 3 directors whereas a private company must have at least 2 directors (Sec. 252)

4. Restriction on appointment of directors. In the case of a public company, the directors must file with the register a consent to act as directors or sign an undertaking for their qualification shares. The directors or a private company need not do so (Sec 266).

5. Restriction on invitation to subscribe for shares. A public company invites the general public to subscribe for shares. A public company invites the general public to subscribe for the shares or the debentures of the company. A private company by its Articles prohibits invitation to public to subscribe for its shares.

6. Name of the Company: In a private company, the words "Private Limited" shall be added at the end of its name.

7. Public subscription: A private company cannot invite the public to purchase its shares or debentures. A public company may do so.

8. Issue of prospectus: Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the registrar before allotting shares.

9. Transferability of Shares. In a public company, the shares are freely transferable (Sec. 82). In a private company the right to transfer shares is restricted by Articles.

10. Special Privileges. A private company enjoys some special privileges. A public company enjoys no such privileges.

11. Quorum. If the Articles of a company do not provide for a larger quorum, members personally present in the case of a public company are quorum for a meeting of the company.

12. Managerial remuneration. Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.

13. Commencement of business. A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a "Certificate of Commencement of business".

- **Special privileges of a Private Company**

Unlike a private a public company is subject to a number of regulations and restrictions as per the requirements of Companies Act, 1956. It is done to safeguard the interests of investors/shareholders of the public company. These privileges can be studied as follows:

a) Special privileges of all companies. The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company :

1. A private company may be formed with only two persons as member. [Sec.12(1)]

2. It may commence allotment of shares even before the minimum subscription is subscribed for or paid (Sec. 69).

3. It is not required to either issue a prospectus to the public of file statement in lieu of a prospectus. (Sec 70 (3)]

4. Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. [Sec 81 (3)]

5. Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 14)

6. It need not keep an index of members. (Sec. 115)

7. It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required. [Sec. 149 (7)]

8. It need not hold statutory meeting or file a statutory report [Sec. 165 (10)]

9. Unless the articles provide for a larger number, only two persons personally present shall form the quorum in case of a private company, while at least five member personally present form the quorum in case of a public company (Sec. 174).

10. A director is not required to file consent to act as such with the Registrar.

Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private companies [Sec. 266 (5) (b)]

11. Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company on or before 1st April 1952 [Sec. 284 (1)]

12. In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two members if not more than seven members are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up (Sec. 179).

13. It need not have more than two directors, while a public company must have at least three directors (Sec. 252)

b) Privileges available to an independent private company (i.e. one which is not a subsidiary of a public company)

An independent private company is one which is not a subsidiary of a public company. The following special privileges and exemptions are available to an independent private company.

1. It may give financial assistance for purchase of or subscription for shares in the company itself.

2. It need not, like a public company, offer rights shares to the equity shareholders of the company.

3. The provisions of Sec. 85 to 90 as to kinds of share capital, new issues of share capital, voting, issue of shares with disproportionate rights, and termination of disproportionately excessive rights, do not apply to an independent private company.

4. A transfer or transferee of shares in an independent private company has no right of appeal to the Central Government against refusal by the company to register a transfer of its shares.

5. Sections 171 to 186 relating to general meeting are not applicable to an independent private company if it makes its own provisions by the Articles. Some provisions of these Sections are, however made expressly applicable.

6. Many provisions relating to directors of a public company are not applicable to an independent private company, e.g.

a) it need not have more than 2 directors.

b) The provisions relating to the appointment, retirement, reappointment, etc. of directors who are to retire by rotation and the procedure relating, there to are not applicable to it.

c) The provisions requiring the giving of 14 days' notice by new candidates seeking election as directors, as also provisions requiring the Central Government's sanction for increasing the number of directors by amending the Articles or otherwise beyond the maximum fixed in the Articles, are not applicable to it.

d) The provisions relating to the manner of filing up casual vacancies among directors and the duration of the period of office of directors and the requirements that the appointment of directors should be voted on individually and that the consent of each candidate for directorship should be filed with the Registrar, do not apply to it.

e) The provisions requiring the holding of a share qualification by directors and fixing the time within which such qualification is to be acquired and filing with the Registrar of a declaration of share qualification by each director are also not applicable to it.

f) It may, by its Articles, Provide special disqualifications for appointment of directors.

g) It may provide special grounds for vacation of office of a director.

h) Sec. 295 prohibiting loans to directors does not apply to it.

i) An interested director may participate or vote in Board's proceedings relating to his concern of interest in any contract of arrangement.

7. The restrictions as to the number of companies of which a person may be appointed managing director and the prohibition of such appointment for more than 5 years at a time, do not apply to it

8. The provisions prohibiting the subscribing for, or purchasing of, shares or debentures of other companies in the same group do not apply to it.

9. The provisions of Section 409 conferring power on the Central Government to present change in the Board of directors of a company where in the opinion of the Central Government such change will be prejudicial to the interest of the company, do not apply to it.

- **When a Private company becomes a Public company**

A private company shall become a public company in following cases:

i) By default: When it fails to comply with the essential requirements of a private company provided under Section 3 (1) (iii) Default in complying with the said three provisions shall disentitle a private company to enjoy certain privileges (Sec. 43).

ii) A private company which is a subsidiary of another public company shall be deemed to be a public company.

iii) By provisions of law - Section 43-A.

a) Where not less than 25% of the paid-up share capital of a private company is held by one or more bodies" corporate such a private company shall become a public company from the data in which such 25% is held by body corporate [Sec. 43-A (1)]

b) Where the average annual turnover of a private company is not less than Rs. 10 crores during the relevant period, such a private company shall become a public company after the expiry of the period of three months from the last day of the relevant period when the accounts show the said average annual turnover [Sec. 43 A (1 A)].

c) When a private company holds not less than 25% of the paid up share capital of a public company the private company shall become a public company from the date on which the private company holds such 25%[Sec. 43A (IB)].

d) Where a private company accepts, after an invitation is made by an advertisement of receiving deposits from the public other than its members, directors or their relatives, such private company shall become a public company [Sec. 43A (IC)].

iv) By Conversion: When the private company converts itself into a public company by altering its Articles in such a manner that they no longer include essential requirements of a private company under Section 3 (1) (iii). On the data of such alternations, it shall cease to be private company. It shall comply with the procedure of converting itself into a public company [Sec. 44].The Articles of Association of such a public company may continue to have the three restrictions and may continue to have two directors and less than seven members . Within 3 months of such a conversion. Registrar of Companies shall be intimated. The Registrar shall delete the word 'Private' before the words 'Limited' in the name of the company and shall also make necessary alternations in the certificate of incorporation.

On the basis of Control

On the basis of control, a company may be classified into :

1. Holding companies, and

2. Subsidiary Company

1. Holding Company [Sec. 4(4)]. A company is known as the holding company of another company if it has control over the other company. According to Sec 4(4) a company is deemed to be the holding company of another if, but only if that other is its subsidiary. A company may become a holding company of another company in either of the following three ways:a) by holding more than fifty per cent of the normal value of issued equity capital of the company; or b) By holding more than fifty per cent of its voting rights; or c) by securing to itself the right to appoint, the majority of the directors of the other company , directly or indirectly. The other company in such a case is known as a "Subsidiary company". Though the two companies remain separate legal entities, yet the affairs of both the companies are managed and controlled by the holding company. A holding company may have any number of subsidiaries. The annual accounts of the holding company are required to disclose full information about the subsidiaries.

2. Subsidiary Company.[Sec. 4 (I)]. A company is known as a subsidiary of another company when its control is exercised by the latter (called holding company) over the former called a subsidiary company. Where a company (company S) is subsidiary of another company (say Company H), the former (Company S) becomes the subsidiary of the controlling company (company H).

On the basis of Ownership of companies

a) Government Companies. A Company of which not less than 51% of the paid up capital is held by the Central Government of by State Government or Government singly or jointly is known as a Government Company. It includes a company subsidiary to a government company. The share capital of a government company may be wholly or partly owned by the government, but it would not make it the agent of the government. The auditors of the government company are appointed by the government on the advice of the Comptroller and Auditor General of India. The Annual Report along with the auditor's report are placed before both the House of the parliament. Some of the examples of government companies are - Mahanagar Telephone Corporation Ltd., National Thermal Power Corporation Ltd., State

Trading Corporation Ltd. Hydroelectric Power Corporation Ltd. Bharat Heavy Electricals Ltd. Hindustan Machine Tools Ltd. etc.

b) Non-Government Companies. All other companies, except the Government Companies, are called non-government companies. They do not satisfy the characteristics of a government company as given above.

Check your progress

1. A_____is a company limited by shares or by guarantee.An _____ company is a company not having any limit on the liability of its members.

2. _____with limited liability are permitted to be registered under a licence granted by the C.G. without using the words "limited" or "private limited".

3. Section_____defines Government company.

4. Auditor of a government company shall be appointed or reappointed by _____.

5. An_____company is a company, the principal business of which consist in acquiring, holding and dealing in shares and securities.

6. A company formed under the act of the parliament or state legislature is called a _____.

7. Not less than_____of the paid-up share capital of Public Financial Institutions (PFI) is held by or controlled by the C. G.

8. The membership of_____is open to such people who themselves are the primary producers, which is an activity by which same agricultural produce is produced by such primary producers.

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

10. If the_____holds more than half in nominal value of subsidiary's equity share capital, the relationship of holding company and subsidiary subsists between them**.**

Summary:

Company may be defined as group of persons associated together to achieve some common objective. A company formed and registered under the Companies Act has certain special features, which reveal the nature of a company. These characteristics are also called the advantages of a company because as compared with other business organizations, these are in fact, beneficial for a company. Companies can be classified into five categories according to the mode of incorporation on the basis of number of members, on the basis of control, on the basis of ownership and on the basis of nationality of the company.

Keywords:

Company: A company means a body of individuals associated together for a common objective, which may be business for profit or for some charitable purposes.

Registered Company: A registered company is one which is formed and registered under the Indian Companies Act, 1956 or under any earlier Companies Act in force in India.

Public Company: A public company means a company which is not a private company. Any seven or more persons can join hands to form a public company.

Holding Company: A company shall be deemed to be the holding company to another if that other is its subsidiary.

Unlimited Company: A company not having any limit on the liability of its member is called an unlimited company.

Answer to check your progress

1. A limited company, unlimited

2. Associations not for profit

3. Section 617

4. Comptroller and Auditor General of India (C & AG)

5. Investment

6. Statutory company / corporation

7. 51%

8. Producer companies

9.Investment company

10. Holding company

Terminal questions

1. Explain the special privileges of a private company as compared to a public company.

2. Bring out the difference between public and private company form of organization.

3. Write notes on: a) Chartered Companies b) Government Companies

4. Classify company form of organization on the basis of number of members.

5. Give classification of a company on the basis of ownership.

Suggested readings

1. P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.
2. N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.
3. S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.
4. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.
5. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

Chapter 3

Formation of a company

Learning objectives

After reading this lesson, you should be able to describe the process of formation of a company.

Introduction

We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions such as (a) which business they should start, (b) whether they should form a new company or take over the business of some existing company, (c) if new company is to be started, whether they should start a private company or pubic company, (d) what should be the capital of the company etc. After deciding about the formation of the company, by interested persons take necessary steps, and the company is actually formed. Thereafter, they start their business. Thus, there are various stages in the formation of a company from thinking of starting a business to the actual starting of the business.

Formation of a Company:

Company is an artificial person created by following a legal procedure. Before a company is formed, a lot of preliminary work is to be performed. The lengthy process of formation of a company can be divided into four distinct stages: (i) Promotion; (ii) Incorporation or Registration; (iii) Capital subscription; and (iv) Commencement of business. However, a private company can start business as soon as it obtains the certificate of incorporation. It needs to go through first two stages only. The reason is that a private company cannot invite public to subscribe to its share capital. But a public company having a share capital, has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers (Section 149). These four stages are discussed as follows :

Promotion :

The term ‘promotion’ is a term of business and not of law. It is frequently used in business. Haney defines promotion as “the process of organizing and planning the finances of a business enterprise under the corporate form”.Gerstenberg has defined promotion as “the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.” First of all the idea of carrying on a business is conceived by promoters. Promoters are persons engaged in, one or the other way; in the formation of a company. Next, the promoters make detailed study to assess the feasibility of the business idea and the amount of financial and other resources required. When the promoters are satisfied about practicability of the business idea, they take necessary steps for assembling the business elements and making provision of the funds required to launch the business enterprise. Law does not require any qualification for the promoters. The promoters stand in a fiduciary position towards the company about to be formed.

From the fiduciary position of promoters, the following important results follow:

- A promoter cannot be allowed to make any secret profits. If any secret profit is made in violation of this rule, the company may, on discovering it, compel the promoter to account for and surrender such profit.
- The promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If he contracts to sell his own property to the company without making a full disclosure, the company may either rescind the sale or affirm the contract and recover the profit made out of it by the promoter.
- The promoter must not make an unfair or unreasonable use of his position and must take care to avoid anything which has the appearance of undue influence or fraud. Promoter's Remuneration A promoter has no right to get compensation from the company for his services in promoting it unless the company, after its incorporation, enters into a contract with him for this purpose. If allowed, remuneration may be paid in cash or partly in cash partly in shares and debentures of the company. Promoter's Liability If a promoter does not disclose any profit made out of a transaction to which the company is a party, then the company may sue the promoter and recover the undisclosed profit with interest Otherwise, the company may set aside the transaction i.e., it may restore the property to promoter and recover its money. Besides, Section 62 (1) holds the promoter liable to pay compensation to every person who subscribes for any share or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. Section 62 also provides certain grounds on which a promoter can avoid his liability. Similarly Section 63 provides for criminal liability for misstatement in the prospectus and a promoter may also become liable under this section.

Promoter's Contracts Preliminary contracts are contracts made on behalf of a company yet to be incorporated. Following are some of the effects of such contracts;

- The company, when it comes into existence, is not bound by any contract made on its behalf before its incorporation. A company has no status prior to its incorporation.
- The company cannot ratify a pre-incorporation contract and hold the other party liable. Like the company, the other party to the contract is also not bound by such a contract.
- The agents of a proposed company may sometimes incur personal liability under a contract made on behalf of the company yet to be formed.

Incorporation:

This is the second stage of the company formation. It is the registration that brings a company into existence. A company is legally constituted on being duly registered under the Act and after the issue of Certificate of Incorporation by the Registrar of Companies.

For the incorporation of a company the promoters take the following preparatory steps:

i) To find out form the Registrar of companies whether the name by which the new company is to be started is available or not. To take approval of the name, an application has to be made in the prescribed form along with requisite fee;

ii) To get a letter of Intent under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act.

iii) To get necessary documents i.e. Memorandum and Articles of Association prepared and printed.

iv) To prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

Registration of a company is obtained by filing an application with the Registrar of Companies of the State in which the registered office of the company is to be situated.

The application should be accompanied by the following documents:

1. Memorandum of association properly stamped, duly signed by the signatories of the memorandum and witnessed.

2. Articles of Association, if necessary.

3. A copy of the agreement, if any, which the company proposes to enter into with any individual for his appointment as managing or whole-time director or manager.

4. A written consent of the directors to act in that capacity, if necessary.

5. A statutory declaration stating that all the legal requirements of the Act prior to incorporation have been complied with. The Registrar will scrutinize these documents. If the Registrar finds the document to be satisfactory, he registers them and enters the name of the company in the Register of Companies and issues a certificate called the certificate of incorporation (Section 34). The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing in it is conclusive, even if wrong. Further, the certificate is 'conclusive evidence that all the requirements of this Act in respect of registration and matters precedent and related thereto have been fulfilled and that the association is a company authorized to be registered and duly registered under this Act. Once the company is created it cannot be got rid of except by resorting to provisions of the Act which provide for the winding up of company. The certificate of incorporation, even if it contains irregularities, cannot be cancelled.

Capital Subscription:

A private company can start business immediately after the grant of certificate of incorporation but public limited company has to further go through 'capital subscription stage' and 'commencement of business stage'. In the capital subscription stage, the company makes necessary arrangements for raising the capital of the company. With a view to ensure protection on investors, Securities and Exchange Board of India (SEBI) has issued 'guidelines for the disclosure and investor protection'. The company making a public issue of share capital must comply with these guidelines before making a public offer for sale of shares and debentures. If the capital has to be said through a public offer of shares, the directors of the public company will first file a copy of the prospectus with the Registrar of

Companies. On the scheduled date the prospectus will be issued to the public. Investors are required to forward their applications for shares along with application money to the company's bankers mentioned in the prospectus. The bankers will then forward all applications to the company and the directors will consider the allotment of shares. If the subscribed capital is at least equal to 90 percent of the capital issue, and other requirements of a valid allotment are fulfilled the directors pass a formal resolution of allotment. However, if the company does not receive applications which can cover the minimum subscription within 120 days of the issue of prospectus, no allotment can be made and all money received will be refunded. If a public company having share capital decides to make private placement of shares, then, instead of a 'prospectus' it has to file with the Registrar of Companies a ' statement in lieu of prospectus' at least three days before the directors proceed to pass the first share allotment resolution. The contents of a prospectus and a statement in lieu of a prospectus are almost alike.

Commencement of Business A private company can commence business immediately after the grant of certificate of incorporation, but a public limited company will have to undergo some more formalities before it can start business.

The certificate for commencement of business is issued by Registrar of Companies, subject to the following conditions.

1. Shares payable in cash must have been allotted up to the amount of minimum subscription
2. Every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others.

3. No money should have become refundable for failure to obtain permission for shares or debentures to be dealt in any recognized stock exchange.

4. A declaration duly verified by one of directors or the secretary that the above requirements have been complied with which is filed with the Registrar. The certificate to commence business granted by the Registrar is a conclusive evidence of the fact that the company has complied with all legal formalities and it is legally entitled to commence business. It may also be noted that the court has the power to wind up a company, if it fails to commence business within a year of its incorporation [Sec. 433 (3)]

Check your progress

1. _____are generally the persons who assume the primary responsibility of matters relating to promotion of company.
2. A_____is not forbidden from making profit, but from making secret profit.
3. Disclosure by promoters to the company should be through the medium of the _____.
4. A_____is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed.
5. In addition to disclosing secret profits, a_____has the duty to disclose to the company any interest he has in transaction entered into by him.
6. _____may be suspended by the court for taking part in the management of the

company for a period of_____in circumstances specified U/S 203.

7. A_____is criminally liable U/S 63. He may be made liable to public examination if the court so orders.
8. A_____has no legal right to claim promotional expenses for his services unless there is a valid contract.
9. Whatever be the nature of remuneration or benefit, it must be disclosed in the prospectus, if paid, within_____preceding the date of the prospectus.
10. The persons who assume the primary responsibility of matters relating to promotion of a company are called_____. A promoter may be a natural person as a company. A person who may have so acted in the formation of a company may well be termed as a _____.

Summary:

The whole process of formation of a company can be divided into four distinct stages namely promotion incorporation, capital subscription and commencement of business. However, a private company can start business as soon as it obtains the certificate of information. The memorandum of Association of a company tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. The memorandum of association of every clause, objects clause, liability clause, Memorandum of association cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure prescribed in the Companies Act. Articles of association contain the rules and regulations which are granted for the internal management of the company. The company may alter its articles of association any time by following the procedure as prescribed in the Companies Act. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their time perspective. This is known as doctrine of constructive notice.

Keywords

Promotion: Promotion means the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.

Promoter: A promoter is a person who undertakes to form a company with reference to a given object and brings it into actual existence.

Preliminary Contract: Preliminary contract refers to those agreements or contracts entered into between different parties on behalf and for the benefit of the company prior to its incorporation.

Certificate of Commencement of Business: A public company, having a share capital and issuing a prospectus inviting the public to subscribe for shares, will have to file a few documents with the registrar who shall scrutinize them and if satisfied will issue a certificate to commence business.

Memorandum of Association: It is the document which defines the objects and lays down the fundamental conditions upon which along the company is allowed to be incorporated. Articles of Association: Articles of association are the rules, regulation and byelaws for governing the internal affairs of the company.

Answer to check your progress

1. Promoters
2. Promoter
3. B.O.D
4. Promoter
5. Promoter
6. Promoter, 5 yrs.
7. Promoter
8. Promoter
9. 2 year
10. Promoters, promoter.

Terminal questions:

1. Explain the process of formation of a company under the Companies Act, 1956.

2. "A certificate of incorporation is conclusive evidence that all the requirements of the Companies Act have been complied with". Comment.

3. What are the requirements of commencement of business .

Suggested readings:

1. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

2. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

3. R.H. Pandia, Principle of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

4. S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

5. K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

Chapter 4

Memorandum of association

Learning objectives

Introduction

Meaning of Memorandum of association

Importance of Memorandum of association

Form and Contents of Memorandum of association

Alteration of Memorandum

Summary

Keywords

Answer to check your progress

Terminal questions

Suggested readings

Learning objectives

After reading this lesson, you should be able to

(a) Describe in detail the memorandum of association.

(b) Explain the different clauses of memorandum of association and the alterations thereof.

(c) Highlight the importance of constructive notice of memorandum of association.

Introduction

We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions such as (a) which business they should start, (b) whether they should form a new company or take over the business of some existing company, (c) if new company is to be started, whether they should start a private company or pubic company, (d) what should be the capital of the company etc. After deciding about the formation of the company, the interested persons take necessary steps, and the company is actually formed. Thereafter, they start their business. Thus, there are various stages in the formation of a company from thinking of starting a business to the actual starting of the business. One of the essentials for the registration of a company is memorandum of association (sec 33). It is the first step in the formation of a company. Its importance lies in the fact that it contains the fundamental clauses which have often been described as the conditions of the company's incorporation. Memorandum of association is divided into 5 clauses. We will discuss in detail in this chapter.

Meaning of Memorandum of association

A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders. The MOA is accessible to the public and describes the company's name, physical address of registered office, names of shareholders and the distribution of shares. The MOA and the Articles of Association serve as the constitution of the company. The MOA is not applied in the U.S. but is a legal requirement for limited liability companies in European countries including the United Kingdom, France and Netherlands, as well as some Commonwealth nations.

Importance of Memorandum of Association

The preparation of Memorandum of Association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. It governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly the ranges of activities are. It enables these parties to know the purpose, for which their money is going to be used by the company and

the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

Forms of Memorandum (Sec. 14)

Companies Act has given four forms of Memorandum of Association in Schedule I.

These are as follows:

Table B:Memorandum of a company limited by shares.

Table C: Memorandum of a company limited by guarantee and not having a share capital.

Table D : Memorandum of company limited by guarantee and having share capital.

Table E Memorandum of an unlimited company

Every company is required to adopt one of these forms or any other form as near there to as circumstances admit.

The memorandum of Association of a company shall be (a) printed, (b) divided into paragraphs numbered consecutively, and (c) signed by prescribed number of subscribers (7 or more in the case of public company, two or more in the case of private company respectively). Each subscriber must sign for his/her name, address, description and occupation in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

Contents of Memorandum of Association

1. Name clause

Promoters of the company have to make an application to the registrar of Companies for the availability of name. The company can adopt any name if :

i) There is no other company registered under the same or under an identical name;

ii) The name should not be considered undesirable and prohibited by the Central Government (Sec. 20). A name which misrepresents the public is prohibited by the Government under the Emblems & Names (Prevention of Improper use) Act, 1950 for example, Indian National Flag, name pictorial representation of Mahatma Gandhi and the Prime Minister of India, name and emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments. Where the name of the company closely resembles the name of the company already registered, the Court may direct the change of the name of the company.

iii) Once the name has been approved and the company has been registered, then
a) the name of the company with registered office shall be affixed on outside of the business premises;

b) if the liability of the members is limited the words "Limited" or "Private Limited" as the case may be, shall be added to the name; [Sec 13(1) (1)].

Omission of the word 'Limited' makes the name incorrect. Where the word' Limited" forms part of a company's name, omission of this word shall make the name incorrect. If the company makes a contract without the use of the word "Limited", the officers of the company who make the contract would be deemed to be personally liable [Atkins & Co v Wardle, (1889) 61 LT 23].

The omission to use the word 'Limited' as part of the name of a company must have been deliberate and not merely accidental. Note the following case in this regard:

Dermatine Co. Ltd. v Ashworth, (1905) 21 T.L.R. 510. A bill of exchange drawn upon a limited company in its proper name was duly accepted by 2 directors of the company. The rubber stamp by which the word of acceptance were impressed on the bill was longer that the paper of the bill and hence the word 'Limited' was missed. Held, the company was liable to pay and the directors were not personally liable.

(c) the name and address of the registered office shall be mentioned in all letterheads, business letters, notices and Common Seal of the Company, etc. (Sec. 147).

In Osborn v The Bank of U. A. E., [9 Wheat (22 US), 738]; it was held that the name of a company is the symbol of its personal existence. The name should be properly and correctly mentioned. The Central Government may allow a company to drop the word "Limited" from its name**.**

2. **Registered Office Clause:**

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company. Further, every company must have a registered office either from the day it begins to carry on business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed. Registered Office of a company is the place of its residence for the purpose of delivering or addressing any communication, service of any notice or process of court of law and for determining question of jurisdiction of courts in any action against the company. It is also the place for keeping statutory books of the company.

Notice of the situation of the registered office and every change shall be given to the Registrar within 30 days after the date of incorporation of the company or after the date of change. If default is made in complying with these requirements, the company and every officer of the company who is default shall be punishable with fine which may extend to Rs. 50 per during which the default continues.

3. **Object Clause**

This is the most important clause in the memorandum because it not only shows the object or objects for which the company is formed but also determines the extent of the powers which the company can exercise in order to achieve the object or objects. Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. It is essential that the public who purchase its shares should know clearly what are the objects for which they are paying.

In the case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act. 1965, the object clause has simply to state the objects of the company. But in the case of a company to be registered after be amendment, the objects clause must state separately.

i) Main Objects: This sub-clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects.
ii) Other objects: This sub-clause shall state other objects which are not included in the above clause.

Further, in case of a non-trading company, whose objects are not confined to one state, the objects clause must mention specifically the States to whose territories the objects extend. (Sec. 13)

A company, which has a main object together with a number of subsidiary objects, cannot continue to pursue the subsidiary objects after the main object has come to an end.

Crown Bank Re (1890) 44 Ch D. 634. A company's objects clause enabled it to act as a bank and further to invest in securities land to underwrite issue of securities. The company abandoned its banking business and confined itself to investment and financial speculation. Held, the company was not entitled to do so.

Incidental acts. The powers specified in the Memorandum must not be construed strictly. The company may do anything which is fairly incidental to these powers. Anything reasonable incidental to the attainment or pursuit of any of the express objects of the company will, unless expressly prohibited, be within the implied powers of the company.

While drafting the objects clause of a company the following points should be kept in mind.

i) The objects of the company must not be illegal, e.g. to carry on lottery business.
ii) The objects of the company must not be against the provisions of the Companies Act such as buying its own shares (Sec. 77), declaring dividend out of capital etc.
iii) The objects must not be against public, e.g. to carry on trade with an enemy country.

iv) The objects must be stated clearly and definitely. An ambiguous statement like "Company may take up any work which it deems profitable" is meaningless.

v) The objects must be quite elaborate also. Note only the main objects but the subsidiary or incidental objects too should be stated.

The narrower the objects expressed in the memorandum, the less is the subscriber's risk, but the wider such objects the greater is the security of those who transact business with the company.

4. Capital Clause

In case of a company having a share capital unless the company is an unlimited company, Memorandum shall also state the amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount [Sec. 13 (4)]. The capital with which the company is registered called the authorized or nominal share capital. The nominal capital is divided into classes of shares and their values are mentioned in the clause. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects of the company. IN case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less than one share. Each subscriber of the Memorandum shall write against his name the number of shares he takes.

5. Liability Clause

In the case of company limited by shares or by guarantee, Memorandum of Association must have a clause to the effect that the liability of the members is limited. It implies that a shareholder cannot be called upon to pay any time amount more then the unpaid portion on the shares held by him. He will no more be liable if once he has paid the full nominal value of the share.

The Memorandum of Association of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up, while he is a member or within one year after he ceased to be so, towards the debts and liabilities of the company as well as the costs and expenses of winding up and for the adjustment of the rights of the contributories among themselves not exceeding a specified amount.

Any alteration in the memorandum of association compelling a member to take up more shares, or which increases his liability, would be null and void.(Sec 38).

If a company carries on business for more than 6 months while the number of members is less than seven in the case of public company, and less than two in case of a private company each member aware of this fact, is liable for all the debts contracted by the company after the period of 6 months has elapsed (Sec. 45).

5. Association or Subscription Clause

In this clause, the subscribers declare that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one

share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any. This clause generally runs in this form : "we, the several person whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the number of shares in the capital of the company, set opposite of our respective name".

After registration, no subscriber to the memorandum can withdraw his subscription on any ground.

Alteration of Memorandum of Association

Alteration of Memorandum of association involves compliance with detailed formalities and prescribed procedure. Alternations to the extent necessary for simple and fair working of the company would be permitted. Alterations should not be prejudicial to the members or creditors of the company and should not have the effect of increasing the liability of the members and the creditors.

Contents of the Memorandum of association can be altered as under :

1. Change of name

   A company may change its name by special resolution and with the approval of the Central Government signified in writing. However, no such approval shall be required where the only change in the name of the company is the addition there to or the deletion there from, of the word "Private", consequent on the conversion of a public company into a private company or of a private company into a public company. (Sec. 21)

   By ordinary resolution: If through inadvertence or otherwise, a company is registered by a name which, in the opinion of the Central Government, is identical with or too nearly resembles the name of an existing company, it may change its name by an ordinary resolution and with the previous approval of the Central Government signified in writing [Sec. 22(1) (a)].

   Registration of change of name: Within 30 days passing of the resolution, a copy of the order of the Central Government's approval shall also be field with the Registrar within 3 months of the order. The Registrar shall enter the new name in the Register of Companies in place of the former name and shall issue a fresh certificate of incorporation with the necessary alterations. The change of name shall be complete and effective only on the issue of such certificate. The Registrar shall also make the necessary alteration in the company's memorandum of association (Sec. 23).

   The change of name shall not affect any right or obligations of the company or render defective any legal proceeding by or against it. (Sec. 23)

2. **Change of Registered Office**

This may involve:

a) Change of registered office from one place to another place in the same city, town or village. In this case, a notice is to be give within 30 days after the date of change to the Registrar who shall record the same.

b) Change of registered office from one town to another town in the same State. In this case, a special resolution is required to be passed at a general meeting of the shareholders and a copy of it is to be filed with the Registrar within 30 days.The within 30 days of the removal of the office. A notice has to be given to the Registrar of the new location of the office.

c) Change of Registered Office from one State to another State to another State.

Section 17 of the Act deals with the change of place of registered office form one State to another State. According to it, a company may alter the provision of its memorandum so as to change the place of its registered office from one State to another State for certain purposes referred to in Sec 17(1) of the Act. In addition the following steps will be taken.

Special Resolution

For effecting this change a special resolution must be passed and a copy there of must be filed with the Registrar within thirty days. Special resolution must be passed in a duly convened meeting.

Confirmation by Central Government

The alteration shall not take effect unless the resolution is confirmed by the Central Government.The Central Government before confirming or refusing to confirm the change will consider primarily the interests of the company and its shareholders and also whether the change is bonafide and not against the public interest. The Central Government may then issue the confirmation order on such terms and conditions as it may think fit.

3. Alteration of the Object Clause

The Company may alter its objects on any of the grounds (I) to (vii) mentioned in Section 17 of the Act. The alteration shall be effective only after it is approved by special resolution of the members in general meeting with the Companies Amendment Act, 1996, for alteration of the objects clause in Memorandum of Associations sanction of Central Government is dispensed with.

Limits of alteration of the Object Clause

The limits imposed upon the power of alteration are substantive and procedural. Substantive limits are provided by Section 17 which provides that a company may

change its objects only in so far as the alteration is necessary for any of the following purposes:

i) to enable the company to carry on its business more economically or more effectively;
ii) to enable the company to attain its main purpose by new or improved means;
iii) to enlarge or change the local area of the company's operation;
iv) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company;
v) to restrict or abandon any of the objects specified in the memorandum
vi) to sell or dispose of the whole, or any part of the undertaking of the company;
vii) to amalgamate with any other company or body of persons.

Alterations in the objects is to be confined within the above limits for otherwise alteration in excess of the above limitations shall be void. A company shall file with the registrar a special resolution within one month from the date of such resolution together with a printed copy of the memorandum as altered. Registrar shall register the same and certify the registration [Sec. 18].

Effect of non -registration with Registrar

Any alteration, if not registered shall have no effect. If the documents required to be filed with the Registrar are not filed within one month, such alteration and the order of the Central Government and all proceedings connected therewith shall at the expiry of such period become void and inoperative. The Central Government may, on sufficient cause show, revive the order on application made within a further period of one month [Sec. 19]

4. Alteration of Capital Clause

The procedure for the alteration of share capital and the power to make such alteration are generally provided in the Articles of Association If the procedure and power are not given in the Articles of Associational, the company must change the articles of association by passing a special resolution. If the alteration is authorized by the Articles, the following changes in share capital may take place:

1. Alteration of share capital [Section 94-95]
2. Reduction of capital [Section 100-105]
3. Reserve share capital or reserve liability [Section 99]
4. Variation of the rights of shareholders [Section 106-107]
5. Reorganization of capital [Section 390-391]

5. Alteration of Liability Clause

Ordinarily the liability clause cannot be altered so as to make the liability of members unlimited. Section 38 states that the liability of the members cannot be increased

without their consent. It lays down that a member cannot by changing the memorandum or articles, be made to take more shares or to pay more the shares already taken unless he agrees to do so in writing either before or after the change.

A company, if authorized by its Articles, may alter its memorandum to make the liability of its directors or manager unlimited by passing a special resolution. This rule applies to future appointees only. Such alteration will not affect the existing directors and manager unless they have accorded their consent in writings[Section 323].

Section 32 provides that a company registered as unlimited may register under this Act as a limited company. The registration of an unlimited company as a limited company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into by the company before such registration.

Check your progress

1. The first step in the formation of a company is to prepare a document called the_____.

2. The_____of a company contains the fundamental provisions of the company's constitution.

3. The purpose of the_____clause in the memorandum is_____.

4. Where a company is a subscriber to the M.O.A, it must be signed by a duly_____.

5. _____witness can attest all the signatures provided be is not himself a subscriber (of) to the memorandum.

6. Pursuant to MCA-21 project, the soft copies of the MOA & AOA should be filed along with _____.

7. The_____must make_____to ensure that the name allowed by him is not misleading or intended to deceive with reference to its objects clause.

8. The MCA has also clarified that a_____is not an official publication of a company within the meaning of section 147 of the act.

9. The_____clause is of great importance because it determines the purpose and the capacity of the company.

10. It is_____ for a company to act beyond the limits of its_____.

SUMMARY

The whole process of formation of a company can be divided into four distinct stages namely promotion incorporation, capital subscription and commencement of business. However, a

private company can start business as soon as it obtains the certificate of information. The memorandum of Association of a company tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. The memorandum of association of every clause, objects clause, liability clause, Memorandum of association cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure prescribed in the Companies Act.

Keywords

Promotion: Promotion means the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.

Promoter: A promoter is a person who undertakes to form a company with reference to a given object and brings it into actual existence.

Preliminary Contract: Preliminary contract refers to those agreements or contracts entered into between different parties on behalf and for the benefit of the company prior to its incorporation.

Certificate of Commencement of Business: A public company, having a share capital and issuing a prospectus inviting the public to subscribe for shares, will have to file a few documents with the registrar who shall scrutinize them and if satisfied will issue a certificate to commence business.

Memorandum of Association: It is the document which defines the objects and lays down the fundamental conditions upon which along the company is allowed to be incorporated.

Answer to check your progress

1. MOA

2. MOA

3. The objects, two fold

4. Authorized agent

5. One

6. E-form No. 1

7. Registrar, preliminary enquiries

8. Share certificate

9. Objects

10. Ultra vires, memorandum

Terminal questions

1. "A certificate of incorporation is conclusive evidence that all the requirements of the Companies Act have been complied with". Comment.
2. What is a Memorandum of Association? Discuss its clauses.
3. How the alteration in the different clauses of Memorandum of Association can be made?
4. What are the contents of MOA? What are its contents?
5. Elaborate the importance of MOA.

Suggested readings

1. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.
2. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.
3. R.H. Pandia, Principles of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.
4. S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.
5. K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

Chapter 5

Articles of association

Learning objectives

Introduction

Meaning of Articles of association

Contents of Articles of association

Distinction between MOA and AOA.

Summary

Keywords

Answer to check your progress

Terminal Questions

Suggested readings

Learning objectives

After reading this lesson, you should be able to

a) Describe articles of association

b) Discuss the contents of articles of association.

c) Highlight the importance of constructive notice of articles of association.

Introduction

Every company is required to file Articles of Association along with the Memorandum of Association with the Registrar at the time of its registration. Companies Act defines 'Articles as Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies Acts. They also include, so far as they apply to the company, those in the Table A in Schedule I annexed to the Act or corresponding provisions in earlier Acts. Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

Meaning of Articles of Association

A company is an incorporated body so there should be some rules and regulations formed for the management of its internal affairs and conduct of its business as well as the relation between the members and the company. Moreover, the rights and duties of its members and the company are to be recorded. This is why Articles of Association are necessary. The Articles of Association is a document that contains the purpose of the company as well as the duties and responsibilities of its members defined and recorded clearly. It is an important document which needs to be filed with the Registrar of Companies.

Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

In framing Articles of Association care must be taken to see that regulations framed do not go beyond the powers of the company itself as contemplated by the Memorandum of Association nor should they be such as would violate any of the requirements of the companies Act, itself. All clauses in the Articles ultra vires the Memorandum or the Act shall be null and void.

Article of Association are to be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation.

Each subscriber shall sign in the presence of at least one witness who shall attest the signatures and also mention his own address and occupation.

Contents of AOA

Articles generally contain provision relating to the following matters;

(i)the exclusion, whole or in part of Table A;

(ii) share capital different classes of shares of shareholders and variations of these rights
(iii) execution or adoption of preliminary agreements, if any;
(iv) allotment of shares;
(v) lien on shares
(vi) calls on shares;
(vii)forfeiture of shares;
(viii) issue of share certificates;
(ix) issue of share warrants;
(x) transfer of shares;
(xi) transmission of shares;
(xii) alteration of share capital;
(xiii) borrowing power of the company;
(xiv) rules regarding meetings;
(xv) voting rights of members;
(xvi) notice to members;
(xvii) dividends and reserves;
(xviii) accounts and audit;
(xix) arbitration provision, if any;
(xx) directors, their appointment and remuneration;
(xxi) the appointment and reappointment of the managing director, manager and secretary;
(xxii) fixing limits of the number of directors
(xxiii) payment of interest out of capital;
(xxiv) common seal; and
(xxv) winding up.

Model form of Articles

Different model forms of memorandum of association and Articles of Association of various types of companies are specified in Schedule I to the Act. The schedule is divided into following tables.

Table A deals with regulations for management of a company limited by shares.

Table B contains a model form of Memorandum of Association of a company limited by shares.

Table C gives model forms of Memorandum and Articles of Association of a company limited by guarantee and not having a share capital.

Table D gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital. The Articles of such a company contain in addition to the information about the number of members with which the company proposes to be registered, all other provisions of Table A.

Table E contains the model forms of memorandum and Articles of Association of an unlimited company.

A Public Company may have its own Article of Association. If it does not have its own Articles, it may adopt Table A given in Schedule I to the Act. have its own Articles, it may adopt Table A given in Schedule I to the Act.

Adoption and application of Table A (Section 28). There are 3 alternative forms in which a public company may adopt articles :

1. It may adopt Table A in full

2. It may wholly exclude Table A, and set out its own Articles in full

3. It may frame its own Articles and adopt part of Table A.

In other words, unless the Articles of a public company expressly exclude any or all provisions of Table A shall automatically apply to it.

Alteration of Articles

Section 31 grants power to every company to alter its articles whenever it desires by passing a special resolution and filing a copy of altered articles with the Registrar. An alteration is not invalid simply because it changes the company's constitution. Thus in Andrews v Gas Meter Co., A company was allowed by changing articles to issue preference shares when its memorandum was silent on the point.

Alteration of articles is much easier than memorandum as it can be altered by special resolution. However, there are various limitations under the Companies Act to the powers of the shareholders to alter the articles.

In case of conversion of a public company into a private company, alteration in the articles would only be effective after approval of the Central Government [Section 31]. The power are now vested with the Registrar of Companies.

Alteration of the articles shall not violate provisions of the Memorandum. It must be made bonafide the benefit of the company. All clauses in the articles ultra vires the Memorandum shall be null and void, and the articles shall be held inoperative. Alteration must not contain anything illegal and shall not constitute fraud on the minority.

Alteration in the articles increasing the liability of the members can be done only with the consent of the members.

The Court may even restrain an alteration where is likely to cause a damage which cannot be adequately compensated in terms of money. Similarly, a company cannot by altering articles, justify a breach of contract. Any alteration so made shall be valid as if originally contained in the articles.

Where a special resolution has been passed altering the articles or an alteration has been approved by the Central Government where required, a printed copy of the articles so altered shall be filed by the company with the Registrar of Companies within one month of the date of the passing of special resolution.

DISTINCTION BETWEEN ARTICLES OF ASSOCIATION AND MEMORANDUM OF ASSOCIATION

1) The memorandum contains the fundamental condition upon which alone the company is allowed to be incorporated. The articles are for the internal regulation and management of the company.

2) Memorandum defines the scope of the activities of the company, or the area beyond which the actions of the company cannot go. Articles are the rules for carrying out the objects of the company as set out in the memorandum.

3) Memorandum being the character of the company, is the supreme document. Art are subordinate to the memorandum. If any conflict between them, the memorandum prevails.

4) Every company must have its own memorandum. A company limited by shares need not have articles of its own. In such a case, Table A applies.

5) An action of the company outside the scope of its memorandum is void and incapable of ratification. An act of the company outside the scope of its articles can be confirmed by the shareholders.

6) There are strict restrictions on its alteration. The change of name requires the prior permission of central government and change of registered office to another state requires the prior approval of the Company Law Board. Articles can be altered by a special resolution, to any extent, provided they do not conflict with the memorandum and the Companies Act.

Check your progress

1. The_____of a company are its by-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business.

2. A company has a statutory right to alter its_____.

3. Utmost caution must be exercised in the preparation of the_____.

4. The alteration of_____must not constitute a fraud on the minority by the majority.

5_____binds the members in the same way as original articles.

Summary

Articles of association contain the rules and regulations which are granted for the internal management of the company. The company may alter its articles of association any time by following the procedure as prescribed in the Companies Act. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their time perspective. This is known as doctrine of constructive notice.

Keywords

Promotion: Promotion means the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.

Promoter: A promoter is a person who undertakes to form a company with reference to a given object and brings it into actual existence.

Preliminary Contract: Preliminary contract refers to those agreements or contracts entered into between different parties on behalf and for the benefit of the company prior to its incorporation.

Certificate of Commencement of Business: A public company, having a share capital and issuing a prospectus inviting the public to subscribe for shares, will have to file a few documents with the registrar who shall scrutinize them and if satisfied will issue a certificate to commence business.

Memorandum of Association: It is the document which defines the objects and lays down the fundamental conditions upon which along the company is allowed to be incorporated.

Articles of Association: Articles of association are the rules, regulation and byelaws for governing the internal affairs of the company.

Answer to check your progress

1. AOA

2. Alteration in Articles

3. AOA

4. AOA

5. AOA

Terminal questions

1 .How the alteration in the different clauses of articles can be made?

2. What is Articles of Association? What are its contents?

3. Distinguish between Memorandum of Association and Articles of Association.

Suggested readings

1. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

2. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

3. R.H. Pandia, Priciples of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

4. S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

5. K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi

Chapter 6

Prospectus

Learning objectives

Introduction

Meaning of Prospectus

Contents of Prospectus

Statutory requirements in relation to prospectus

Summary

Keywords

Answer to check your progress

Terminal Questions

Suggested readings

Learning objectives

After reading this lesson, you should be able to:

(a) Define a prospectus and explain the requirement regarding issue of prospectus.

(b) Describe the contents of the prospectus.

Introduction

The promoters of a public company will have to take steps to raise the necessary capital for the company, after having obtained the Certificate of Incorporation. A public company may invite the public to subscribe to its shares or debentures. Prospectuses are to be issued for this purpose. To issue a prospectus is very essential for a public company. If the promoters of the company are confident of raising the required capital privately from their friend or relatives, they need not issue a prospectus. In such a case, a statement in lieu of prospectus must be filed with the Registrar. A private company is not allowed to issue a prospectus since it cannot invite the general public to subscribe to its shares and debentures. It is not required to file a statement in lieu of prospectus.

Meaning of Prospectus

Section 2(36) defines a prospectus an "any document described as issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting orders from the public for the subscription or purchase of any share in, or debentures of, a body corporate". In simple words, a prospectus may be defined as an invitation to the public to subscribe to a company's shares or debentures. By virtue of the Amendment Act of 1974, any document inviting deposits from the public shall also come within the definition of prospectus. The word "Prospectus" means a document which invites deposits from the public or invites offers from the public to buy shares or debentures of the company.

A document will be treated as a prospectus only when it invites offers from a public. According to Section 67 the term "public" is defined as, "It includes any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner". It further provides that no offer of invitation shall be treated as mode to the public if, (i) the same is not calculated to result in the shares or debentures becoming available other than those receiving the offer or invitation; (ii) it appears to be a domestic concern of the person making and receiving the offer or invitation. The 'public' is a general word. No particular numbers are prescribed. The point is that the offer makes the shares and debentures available for subscription to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication does not satisfy the above point.

Where directors make an offer to a few of their friends, relatives or customers by sending them a copy of the prospectus marked "not for publication" it is not considered an offer to the public.

The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued to the public. Issued means issued to the public. Whether the prospectus has been issued to the public or not is a matter of fact. The leading case of this point is Nash v Lynde (1929) A.C. 158. In this case the managing director of a company prepared a document that was marked "strictly private and confidential" and did not contain the particulars required to be disclosed in a prospectus. A copy of the document along with application forms was sent to a solicitor who in turn sent it to the plaintiff. The document was held not be prospectus and as such the claim of the plaintiff for compensation was dismissed.

In the case Re South of England Natural Gas and Petroleum Co. Ltd.(1911) 1 Ch. 573, the distribution of 3,000 copies of a prospectus among the members of certain gas companies was held to be an offer to the public because person other than those receiving the offer could also accept it. One may note that under Section 67 an offer or invitation to any section of the public, whether selected as members or debenture holders of the company or as clients of the person making the invitation, will be deemed to be an invitation to the public.

The term "subscription of purchase of shares" means taking or agreeing to take shares for cash. Any document to be called a prospectus must have the following ingredients:

I. There must be an invitation offering to the public;

II. The invitation must be or on behalf of the company or in relation to an intended company;

III. The invitation must be to subscribe or purchase.

IV. The invitation must relate to shares or debentures.

Objects of Prospectus

The main objects of a prospectus are as follows:

1. To bring to the notice of public that a new company has been formed.

2. To preserve an authentic record of the terms of allotment on which the public have been invited to but its shares or debentures.

3. The secure that the directors of the company accept responsibility of the statement in the prospectus.

Statutory requirements in relation to prospectus

The relevant requirements regarding issue of prospectus are given below:

1. Issue after Incorporation

Section 55 of the Act permits the issue of prospectus in relation to an intended company. A prospectus may be issued by or on behalf of the company.

a) by a person interested or engaged in the formation company or

b) through an offer for sale by a person to whom the company has allotted shares.

2. Dating of Prospectus

A prospectus issued by a company shall be dated and that date shall be taken as the date of publication of the prospectus (Section 55). Date of issue of the prospectus may be different from the date of publication.

3. Registration of Prospectus

A copy of every prospectus must be delivered to the Registrar for registration before it is issued to the public. Registration must be made on or before the date of its publication. The copy sent for registration must be signed by every person who is named in the prospectus as a director or proposed director of the company or by his agent authorized in writing. Where the prospectus is issued in more than one language, a copy of its as issued in each language should be delivered to the registrar. This copy must be accompanied with the following documents:

If the report of an expert is to be published, his written consent to such publication;

b) a copy of every contract relating to the appointment and remuneration of managerial personnel;

c) a copy of every material contract unless it is entered in the ordinary course of business or two years before the date of the issue of prospectus;

d) a written statement relating to adjustments; if any, made by the auditors or accountants in their reports relating to profits and losses, assets and liabilities or the rates of dividends, etc.; and

e) written consent of auditors, legal advisers, attorney, solicitor, banker or broker of the company to act in that capacity.

A copy of the prospectus along with specific documents must been field with the Registrar. The prospectus must be issued within ninety days of its registration. A prospectus issued after the said period shall be deemed to be a prospectus, a copy of which has not been delivered to the Registrar for registration. The company and every person who is knowingly a party to the issue of prospectus without registration shall be punishable with fine which may extend to five thousand rupees (Section 60).

4. Expert to be unconnected with the Formation of the Company

A prospectus must not include a statement purporting to be made by an expert such as an engineer, valour, accountant etc. unless the expert is a person who has never been engaged or interested in the formation or promotion as in the management of the company (Section 57).

A statement of an expert cannot be include in the prospectus without his written consent and this fact should be mentioned in the prospectus. Further, this consent should not be withdrawn before delivery of the prospectus for registration Section (58).

5. Terms of the contract not to be varied

The terms of any contract stated in the prospectus or statement in lieu of prospectus cannot be varied after registration of the prospectus except with the approval of the members in the general meeting (Section 61).

6. Application Forms to be Accompanied with the Copy of Prospectus

Every from of application for subscribing the shares or debentures of a company shall not be issued unless it is accompanied by a copy of prospectus except when it is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures or in relation to shares or debentures which were not offered to the public [(Section 56(3)].

Section 56(5) provides that the prospectus need not contain all the details required by the Act where the offer is made to exiting members or debenture holders of the company or if such shares or debentures are in all respect uniform with shares or debentures already issued and quoted on a recognize stock exchange.

7. Personation for Acquisition etc. of Shares

The provision, consequences of applying for shares in fictitious names to be prominently displayed must be reproduced in every prospectus and every application form issued by the company to any person.

A person who makes in a fictitious name to a company for acquiring shares or subscribing any shares or subscribing any shares shall be liable to imprisonment which may extend to five years similarly, a person who induces a company to allot any shares or to register any transfer of shares in a fictitious name is also liable to the same punishment. [Section 68(a)].

8. Contents as per Schedule II

Every prospectus must disclose the matters as required in Schedule II of the Act. It is to be noted that if any condition binding on the applicant for shares or debentures in a company to waive compliance with any requirements of the Act as to disclosure in the prospectus or purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus shall be void [Section 56(2)].

If a prospectus is issued without a copy thereof, the necessary documents or the consent of the experts the company and every person, who is knowingly a part to the issue of the prospectus, shall be punishable with fine which may extend to Rs. 5,000/-.

CONTENTS OF PROSPECTUS

We know that a prospectus is issued to the public to purchase the shares or debentures of the company. Every person wants to invest his money in some sound undertaking. The soundness of a company can be known from the prospectus of a company. Thus, the prospectus must disclose the true nature of company's activities which enable the public to decide whether or not to invest money in the company. In fact, the public invest money in the company on the faith of the representation contained in the prospectus. Therefore, everything should be stated with strict accuracy, and the complete and true position of the company should be disclosed to the public.

Section 56 lays down that every prospectus issued (a) by or on behalf of a company, or (b) by on behalf of any person engaged or interested in the formation of a company, shall :

1. State the matters specified in Part I of Schedule II, and.

2. Set out the reports specified in Part II or Schedule II both Part I and II shall have effect subject to the provisions contained in Part III of that Schedule II.

Part I of Schedule II

1. The main objects of the company with names, descriptions, occupations and addresses of the signatories to the Memorandum of association, and number of shares subscriber by them.

2. The number and classes of shares, and the nature and extent of the interests of the shareholders in the property and profits of the company.

3. The number of redeemable preference shares intended to be issued with particulars as regards their redemption.

4. The number of shares fixed by the articles of company as the qualification of a director.

5. The names, addresses, description and occupation of directors, managing director or manager or any of those proposed person.

6. Any provisions in the articles or any contract relating to appointment, remuneration and compensation for loss of office of directors, managing director or manager.

7. The amount of minimum subscription.

8. The time of the opening of the subscription list cannot be earlier than the beginning of the fifth day after the publication of prospectus.

9. Amount payable on application and allotment on each share shall be stated. If any allotment was previously made within two preceding years, the details of the shares allotted and the amount; if any, paid thereon.

10. Particulars about any option or preferential right to be given to any person to subscribe for shares or debentures of the company.

11. The number, description and amount of shares and debentures which, within the last two years, have been issued or agreed to be issued as fully or partly paid up than in cash.

12. The amount paid or payable as a premium, if any, on such share issued within two years preceding the date of the prospectus or is to be issued

(11)

stating the necessary particulars.

13. The names of the underwriters of shares or debentures, if any, and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations.

14. The names or addresses description and occupations of the vendors from whom the property has been purchased or is to be purchased, and the amount paid or payable in cash, shares or debentures respectively.

15. The amount of underwriting commission paid within two preceding years or payable to any person for subscribing or procuring subscription for any shares or debentures of the company.

16. Any benefit given to any promoter or officer in preceding two years and the consideration for giving of the benefit.

17. Particulars as to the date, parties and general nature of every contract appointing or fixing the remuneration of managing director or manager, whenever entered into.

18. Particulars of every material contract not entered into in the ordinary course of business carried on or intended to be carried on by the company or a contract entered into more than two years before the date of the prospectus.

19. Names and addresses of the auditors of the company.

20. Full particulars of the nature and extent of interested of the directors or promoter in the promotion of the company or in the property acquired by

(12)

the company within two years of the issue of the prospectus.

21. If the share capital of the company is divided into different classes of shares, the rights of voting at meeting of the company and the rights in respect of capital and the dividends attached to several classes of shares respectively.

22. Where the articles of the company impose any restriction upon the members of the company in respect of the rights to attend, speak or vote at meetings of the company or the rights to transfer shares or on the directors of the company in respect of their powers of management, the nature and extent of these restrictions.

23. Where the company carries on business, the length of time during which it has been carried on. If the company proposes to acquire a business which has been carried on for less than three years, the length of time during which the business had been conducted.

24. If any reserves or profits of the company or any of its subsidiaries have been capitalized, particulars of the capitalization and particulars of the surplus arising from any revaluation on the assets of the company.

25. A reasonable time and place at which copies of all balance sheets and profits and loss accounts, if any, on which the report of the auditors under part II below is based, may be inspected.

Part II of Schedule II

I General Information

1. Names and address of the Company Secretary, Legal Adviser, Lead Managers, Co-managers, Auditors, Bankers to the company. Bankers to the issue and Brokers to the issue.

2. Consent of Directors, Auditors, Solicitors/Advocates, Managers to issue, Registrar of Issue, Bankers to the company, Bankers to the issue and Experts.

3. Expert's opinion obtained, if any.

4. Change, if any, in directors and auditors during the last 3 years, and reasons thereof.

5. Authority for the issue and details of resolution passed for the issue.

6. Procedure and time schedule for allotment and issue of certificates.

II. Financial Information

1. Report by the Auditors

A report by the auditors of the company as regards (a) its profits and losses and assets and liabilities of the company and (b) the rates of dividend, if paid by the company during the preceding 5 financial years.

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

2. Reports by the Accountants

(a) A report by the accountants on the profits or losses of the business for the preceding 5 financial years, and on the assets and liabilities of the business on a date which shall not be more than 120 days before the date of the issue of the prospectus. This report is required to be given, if the proceeds of the issue of the shares or debentures are to be applied directly on the purchase of any business.

(b) A similar report on the account of a body corporate by an accountant if the proceeds of the issue are to be applied in the purchase of shares of a body corporate so that body corporate becomes a subsidiary of the acquiring company.

(c) Principal terms of loans and assets charged as security.

3. Statutory and other Information

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

Part III of Schedule II

Part III of the schedule consists of provisions applying to Part I and II of the said schedule.

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

B. In the case of a company which has been carrying on business for less than 5 financial years, reference to 5 financial years means reference to that number of financial years for which business has been carried on.

C. Reasonable time and place at which copies of all balance sheets and profit and loss accounts on which the report of the auditors is based, and material contracts and other documents may be respected.

"Term year" wherever used herein earlier means financial year.

Declaration

That all the relevant provision of the Companies Act, 1956 and the guide lines issued by the Government have been complied with and no statement made in the prospectus is contrary to the provisions of the Companies Act, 1956 and rules thereunder. The prospectus shall be dated and signed by the directors.

Statement by Experts

1. Experts to be unconnected with formation or management of company (Section 57). Where a prospectus includes a statement made by an expert, he shall not be engaged or interested in the formation, promotion or management of the company. The expression 'expert' includes an engineer, accountant, a valor and, any other person whose profession gives authority to a statement made by him.

2. Expert’s consent to issue of prospectus containing statement by him (Section 58). A prospectus including a statement made by an expert shall not be issued, unless (a) he has given his written consent to be issued of the prospectus with the statement included in the form and context in which it is included and; (b) statement that he has given and has not withdrawn his consent as aforesaid appears in a prospectus.

A wholesome rule intended to protect intending investors by making the expert a party to the issue of the prospectus and making him liable for untrue statements (Section 58). Penalty [Section 59 (1)], if any, prospectus is issued in contravention of Section 57 or 58, the company, and every person who is knowingly a party to the issue thereof, shall be punishable with fine which may extent to Rs. 5,000/

SUMMARY

A prospectus means any invitation issued to the public inviting it to deposit money with the company or to take share or debentures of the company such invitation may be in the form of a document or a notice, circular, advertisement etc. Section 55 states that every prospectus must be dated, and that date is deemed to be the date of publications of the prospectus, prospectus should neither contain any mis-statement i.e. untrue or misleading nor omit to disclose any material fact. It there is any mis-statement or omission of material facts, then the directions promoters, the persons responsible for the issue of prospectus, and the company incur a liability for the same. The company can also allot shares or debentures without issuing the prospectus. However, in such a case, a statement known as 'Statement in lieu of Prospectus' is required to be prepared and field with the Registrar of Companies.

Keywords:

Prospectus: A document inviting offers from the public for the subscription of shares in on debentures of a company is known as a prospectus.

Minimum Subscription: Minimum subscription is the amount which, in the opinion of the board of directors, must be raised by the issue of share capital.

Statement in lieu of Prospectus: If a public company makes a private arrangement for raising capital then it must file a statement in lieu of prospectus with the Registrar three days before any allotment of shares or debentures can be made.

Terminal questions

1. What is a prospectus? Explain the requirements regarding issue of prospectus.

2. Is it compulsory for a company to issue prospectus?

3. Write short notes on the following:

A) Minimum subscription

B) Statement in lieu of prospectus

Suggested readings

1. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

2. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

3. R.H. Pandia, Principles of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

4. S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

5. K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi

Lesson-7

Share Capital

Structure

Objectives

After reading this lesson, you should be able:

- To understand meaning of share capital.
- To understand the types of share capital.

Introduction

In order to finance its activities the company needs capital. The word 'Capital' and 'share capital are synonymous in the case of company. Share capital means the capital raised by a company by issue of shares. Share capital can be raised either at the time of formation of the company for starting business operations or later on, for further expansion or diversification of business. But once raised share capital becomes a permanent liability of the company and, except in the case of redeemable preference shares, can be returned or repaid only at the time of winding up or according to buy back provisions.

Kinds of share capital

According to sections 43 of Company Act 2013 the share capital of a company shall be of two kinds, namely:—

A. equity share capital

i. with voting rights; or

ii. with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

B. preference share capital

i. ''equity share capital'', with reference to any company limited by shares, means all share capital which is not preference share capital;

ii. ''preference share capital'', with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

a. payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

b. repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

iii. Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely-

a. that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (*a*) of clause (*ii*), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

b. that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (*b*) of clause (*ii*), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Alteration of share capital

1) **Power of limited company to alter its share capital:** According to section 61 of company act 2013

a) A limited company having a share capital may, if so authorized by its articles, alter its memorandum in its general meeting to-

I. increase its authorized share capital by such amount as it thinks expedient;
II. consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares: Provided that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;
III. convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
IV. sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
V. Cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

b) The cancellation of shares under sub-section (*1*) shall not be deemed to be a reduction of share capital.

Ways of raising capital

There are two types of capital that a company can use to fund operations:

1) Debt
2) equity

Prudent corporate finance practice involves determining the mix of debt and equity that is most cost-effective.

1) Debt- When looking to expand, a company can raise additional capital by applying for a new loan or opening a line of credit. This type of funding is referred to as debt capital because it involves borrowing money under a contractual agreement to repay the funds at a later date. With the possible exception of personal loans from very generous friends or family members, debt capital carries with it the additional burden of interest. The most common types of debt capital are
2) bank loans,
3) personal loans,
4) bonds and
5) Credit card debt.

3) Equity capital- it is generated by the sale of shares of stock. If taking on more debt is not financially viable, a company can raise capital by selling additional shares. These can be either common shares or preferred shares. Preferred shares are unique in that payment of a specified dividend is guaranteed before any such payments are made on common shares. In exchange, preferred shareholders have limited ownership rights.

Activity-1

Explain different sources of raising funds----------

Allotment of share

A prospect issued by a company inviting the public to subscribe to the shares of a company is a mere invitation. An application for shares is an offer by a prospective shareholder to take shares. When an application is accepted it is an allotment. It is generally neither more nor less than the acceptance by the company of the offer to take shares. Allotment creates a binding contract between the parties.

Allotment as such has not been defined in the companies act. It is an appropriation by the directors out of the previously unappropriated capital of accompanies of a certain number of shares to a person. Till such allotment is made, shares as such do not exist. It is only by an allotment in this sense person. It is only by an allotment in this sense that shares come into existence. Where forfeited shares are reissued, it is not an allotment but a sale.

General principle regarding allotment:

The allotment to be valid must be made in accordance with the principles of the law of contract relating to offer and acceptance. An offer to take share must be made in writing which may be accepted by the company by allotting the shares to the applicants.

1) Proper authority
2) It must be absolute and unconditional
3) It must be in reasonable time

Certificate of shares

According to section 46 of company act 2013

1. A certificate, issued under the common seal of the company, specifying the shares held by any person, shall be *prima facie* evidence of the title of the person to such shares.

2. A duplicate certificate of shares may be issued, if such certificate —

   a) Is proved to have been lost or destroyed; or
   b) Has been defaced, mutilated or torn and is surrendered to the company.

3. Not with standing anything contained in the articles of a company, the manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

4. Where a share is held in depository form, the record of the depository is the *prima facie* evidence of the interest of the beneficial owner.

5. If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

Voting rights.

According to section 47

1. Subject to the provisions of section 43 and sub-section (*2*) of section 50
   a) Every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and
   b) His voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.
2. Every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

Share warrant

A share warrant is a document issued under the common seal of the company stating that the bearer is entitled to the shares specified therein. A share warrant is a bearer document and is transferable by mere delivery. Such share warrant is negotiable instruments. A public company limited by share may issue warrants.

Conditions for issue of share warrants

a) The shares shall be fully paid up.
b) The article shall authorize the issue of shares warrants.
c) Prior approval of the central government shall be obtained.
d) The share warrant shall be issued under the common seal of the company.

Check Your Progress A

1) Which of the following are the conditions for issue of share warrants
   a) The shares shall be fully paid up.
   b) The article shall authorize the issue of shares warrants.
   c) Prior approval of the central government shall be obtained.
   d) All of these

2) Which of the following is a source of debt fund
    a) Bank loans,
    b) Personal loans,
    c) Bonds and
    d) Equity capital

Calls on shares

When shares are issued the full amount of each share is not generally payable at once. A part is payable on application a part on allotment and the remainder by instalments when called for. A call may be defined as a demand by the company on its shareholders to pay whole or part of the balance remaining unpaid on each share; it is, thus, intimation to the shareholder to discharge his obligation by paying the whole or part of the amount which remains unpaid on the shares. Call may be made at any during the life time of company or liquidator may make a call on the shareholder during the course of winding up. All moneys payable by any member to the company under the memorandum or article is a debt due from him to the company. But he is not bound to pay unless a call has been made:

Requites of a valid call- a call to be valid must be in accordance with the provisions of the company act and the article of association of the company. Further, the following conditions must be satisfied:

1) The Board may, from time to time, make calls upon the members in respect of any monies unpaid on their shares (whether on account of the nominal value of the shares or by way of premium) and not by the conditions of allotment thereof made payable at fixed times.
2) A call shall be deemed to have been made at the time when the resolution of the Board authorizing the call was passed, and may be required to be paid by instalments.
3) Each member shall, subject to receiving at least fourteen days' notice specifying the time or times and place of payment, pay to the company, at the time or times and place so specified, the amount called on his shares.
4) A call may be revoked or postponed at the discretion of the Board. Calls on shares and Calls-in advance 20 (1) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sums is due shall pay interest thereon from the day appointed for payment thereof to the time of actual payment at such rate, as the Board may determine. (2) The Board shall be at liberty to waive payment of any such interest wholly or in part. Interest on calls not paid

Forfeiture of Shares

If a shareholder, having been called upon to pay any call on his shares, fails to pay the company may sue him to recover the amount of the call. But the article often provides that

the company may forfeit the shares of a shareholder, who has made a default. However, the shares may be forfeited if the following conditions are satisfied:

3) If a member fails to pay any call, or instalment of a call, on the day appointed for payment thereof, the Board may, at any time thereafter during such time as any part of the call or instalment remains unpaid, serve a notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest, which may have accrued.
4) The notice aforesaid shall name a further day (not being earlier than the expiry of fourteen days from the date of service of the notice) on or before which the payment required by the notice is to be made; and state that, in the event of non-payment on or before the day so named, the shares in respect of which the call was made shall be liable to be forfeited.
5) If the requirements of any such notice as aforesaid are not complied with, any share in respect of which the notice has been given may, at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the Board to that effect.

Forfeiture for non-payment of calls

(1) A forfeited share may be sold or otherwise disposed of on such terms and in such manner as the Board thinks fit.

(2) At any time before a sale or disposal as aforesaid, the Board may cancel the forfeiture on such terms as it thinks fit.

(3) A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares, but shall, notwithstanding the forfeiture, remain liable to pay to the company all monies which, at the date of forfeiture, were presently payable by him to the company in respect of the shares.

(4) The liability of such person shall however cease if and when the company has received payment in full of all such monies in respect of the share.

Surrender of shares

The company act does not provide for surrender of shares. Shares are said to be surrender when they are voluntarily given up. The articles of a company may authorize the directors to accept surrender of shares. Surrender of shares is valid where it is done to relieve the company from going through the formality of forfeiture of shares and the shareholder is willing to surrender the shares. A surrender and forfeiture have practically the same effect, the only difference being that the former is done with the assent of the shareholder while the latter is done at the instance of the company.

A surrender of partly paid shares, not liable to forfeiture, is unlawful, as it:

a) Releases the shareholder from further liability in respect of the shares.
b) Amounts to a purchase by the company of its own shares, and
c) Is a reduction of capital without the sanction of the court.

Check your progress B
Ture or False

1) The company act provide for surrender of shares.
2) The company act does not provide for surrender of shares.
3) A forfeited share may be sold or otherwise disposed of on such terms and in such manner as the Board thinks fit.

Activity-2

What do you mean by Surrender of shares

Transfer and transmission of securities

According to section 56 of company act 2013

1) A company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, other than the

transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee within a period of sixty days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities:

Provided that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

2) Nothing in sub-section (1) shall prejudice the power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.
3) Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.
4) Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted-

    a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
    b) within a period of two months from the date of allotment, in the case of any allotment of any of its share
    c) within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of transmission under sub-section (*2*), in the case of a transfer or transmission of securities;
    d) within a period of six months from the date of allotment in the case of any allotment of debenture:

Provided that where the securities are dealt with in a depository, the company shall Intimate the details of allotment of securities to depository immediately on allotment of such securities.

5) The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.
6) Where any default is made in complying with the provisions of sub-sections (*1*) to (*5*), the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.
7) Without prejudice to any liability under the Depositories Act, 1996, where and depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447.

Summary

In order to finance its activities the company needs capital. The word 'Capital' and 'share capital are synonymous in the case of company. Share capital means the capital raised by a company by issue of shares. Share capital can be raised either at the time of formation of the company for starting business operations or later on, for further expansion or diversification of business. But once raised share capital becomes a permanent liability of the company and, except in the case of redeemable preference shares, can be returned or repaid only at the time of winding up or according to buy back provisions.

Glossary

1. **Surrender of shares-** Shares are said to be surrender when they are voluntarily given up.

2. **Share warrant-** A share warrant is a document issued under the common seal of the company stating that the bearer is entitled to the shares specified therein.

Answer to check your progress

Check your progress A

1) (d)
2) (d)

Check your progress B

1) False
2) True

3) Ture

Model questions

1. Discuss the various kinds of share capital. How is the preference share capital distinguished from equity share capital?

2. Explain different methods by which a company can alter its share capital?

3. Explain the kinds of share capital?

Suggested readings

Garg, Sareen, Sharma, Chawla. *Mercantile Law*. Kalyani Publishers, 2010.

Kapoor, N.d. *Elements of Mercantile Law*. Sultan Chand & Sons, 2013.

Lesson-8

Bowering Power

Structure

Objectives

Introduction

8. 3 Bowering powers

The section 180(1) (c) states as follows:

180 (1) The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:

1) To borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business: Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

Explanation.—For the purposes of this clause, the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of othershort-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature;

2) Every special resolution passed by the company in general meeting in relation to the exercise of the powers referred to in clause (c) of sub-section (1) shall specify the total amount up to which monies may be borrowed by the Board of Directors.

3) No debt incurred by the company in excess of the limit imposed by clause (c) of sub-section (1) shall be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

Meaning of Debenture

Debentures are creditor ship securities representing long-term indebtedness of a company. A debenture is an instrument executed by the company under its common seal acknowledging

indebtedness to some person or persons to secure the sum advanced. It is, thus, a security issued by a company against the debt. A public limited company is allowed to raise debt or loan through debentures after getting certificate of commencement of business if permitted by its Memorandum of Association. Companies Act has not defined the term debenture.

Debentures, like shares, are equal parts of loan raised by a company. Debentures are usually secured by the company by fixed or floating debentures at periodical intervals, generally six months and the company agrees to pay the principal amount at the expiry of the stipulated period according to their terms of issue. Like shares, they are issued to the public at part, at a premium or at a discount. Debenture-holders are creditors of the company. They have no voting rights but their claims rank prior to preference shareholders and equity shareholders. Their exact rights depend upon the nature of debentures they hold.

Salient Features of Debentures

The most salient features of Debentures are as follows:

- A debenture acknowledges a debt
- It is in the form of certificate issued under the seal of the company.
- It usually shows the amount & date of repayment of the loan.
- It has a rate of interest & date of interest payment.
- Debentures can be secured against the assets of the company or may be unsecured. Debentures are generally freely transferable by the debenture holder.

Debenture holders have no rights to vote in the company's general meetings of shareholders, but they may have separate meetings or votes e.g. on changes to the rights attached to the debentures. The interest paid to them is a charge against profit in the company's financial statements

Types of Debentures

Debentures can be of following types:

1) **Redeemable and Irredeemable Debentures**

   Redeemable debentures are those which can be redeemed or paid back at the end of a

specified period mentioned on the debentures or within a specified period at the option of the company by giving notice to the debenture holders or by installments as per terms of issue. Irredeemable debentures are those which are repayable at any time by the company during its existence. No date of redemption is specified. the debenture holders cannot claim their redemption. However, they are due for redemption if the company fails to pay interest on such debentures or on winding up of the company. They are also called perpetual debentures.

2) **Secured and Unsecured Debentures**

Secured or mortgaged debentures carry either a fixed charge on the particular asset of the company or floating charge on all the assets of the company. Unsecured debentures, on the other hand, have no such charge on the assets of the company. They are also known as simple or naked debentures.

3) **Registered and Bearer Debentures**

Registered debentures are registered with the company. Name, address and particulars of holdings of every debenture holders are recorded on the debenture certificate and in the books of the company. At the time of transfer, a regular transfer deed duly stamped and properly executed is required. Interest is paid only to the registered debenture holders. Bearers debentures on the other hand, are transferred by more delivery without any notice to the company. Company keeps no record for such debentures. Debentures-coupons are attached with the debentures-certificate and interest can be claimed by the coupon-holder.

4) **Convertible and Non-convertible Debentures**

Convertible debentures are those which can be converted by the holders of such debentures into equity shares or preference shares, cannot be converted into shares. Now, a company can also issue partially convertible debentures under which only a part of the debenture amount can be converted into equity shares.

Procedure for issue of debentures

According to section 71 of company act 2013

1. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption:

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

2. No company shall issue any debentures carrying any voting rights.
3. Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.
4. Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.
5. No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.
6. A debenture trustee shall take steps to protect the interests of the debentureholders and redress their grievances in accordance with such rules as may be prescribed.
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 thereof 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.

8. A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
9. Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.
10. Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

11. If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.
12. A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.
13. The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

Activity-1

Explain debenture with example .....

Summary

Debenture holders have no rights to vote in the company's general meetings of shareholders, but they may have separate meetings or votes e.g. on changes to the rights attached to the debentures. The interest paid to them is a charge against profit in the company's financial statement

Glossary

Debenture- Debentures are creditor ship securities representing long-term indebtedness of a company. A debenture is an instrument executed by the company under its common seal acknowledging indebtedness to some person or persons to secure the sum advanced.

Model question

1. What is the meaning of debenture and explain the types of debentures?

2. Explain the bowering power of company?

Suggested reading

Garg, Sareen, Sharma, Chawla. *Mercantile Law*. Kalyani Publishers, 2010.

Kapoor, N.d. *Elements of Mercantile Law*. Sultan Chand & Sons, 2013.

Lesson – 9

Company management

Structure

Objective

Meaning of director

Appointment and Qualifications of Directors

Disqualifications for appointment of director

Duties of directors

Summary

Glossary

Suggested Readings

9.9. Model Questions

Objective

- To understand the meaning of director
- To understand the appointment and qualification of director

Meaning of director

An appointed or elected member of the board of directors of a company who, with other directors, has the responsibility for determining and implementing the company's policy.
A company director does not have to be a stockholder (shareholder) or an employee of the firm, and may only hold the office of director. Directors act on the basis of resolutions made at directors' meetings, and derive their powers from the corporate legislation and from the company's articles of association.
As the company's agents, they can bind the company with valid contracts entered into with third-parties such as buyers, lenders, and suppliers

Appointment and Qualifications of Directors

According to section 149 Company to have Board of Directors

1. Every company shall have a Board of Directors consisting of individuals as directors and shall have—
   a. a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and
   b. a maximum of fifteen directors:

Provided that a company may appoint more than fifteen directors after passing a special resolution:

Provided further that such class or classes of companies as may be prescribed, shall have at least one woman director.

2. (*2*) Every company existing on or before the date of commencement of this Act shall within one year from such commencement comply with the requirements of the provisions of sub-section (*1*).
3. (*3*) 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.
4. (*4*) Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Explanation.—For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

5. Every company existing on or before the date of commencement of this Act shall, within one year from such commencement or from the date of notification of the rules in this regard as may be applicable, comply with the requirements of the provisions of sub-section (*4*).

6. An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

a. who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

b.

i. who is or was not a promoter of the company or its holding, subsidiary or associate company;

ii. who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

c. who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

d. none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

e. who, neither himself nor any of his relatives—

i. holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

ii. is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

a. a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

b. any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

iii. holds together with his relatives two per cent. or more of the total voting power of the company; or

iv. is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. Or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

f. who possesses such other qualifications as may be prescribed.

7. Every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence as provided in sub-section (*6*).

Explanation.—For the purposes of this section, "nominee director" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

8. The company and independent directors shall abide by the provisions specified in Schedule IV.

9. Notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (*5*) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

10. Subject to the provisions of section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

11. Notwithstanding anything contained in sub-section (*10*), no independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director:

Provided that an independent director shall not, during the said period of three years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Explanation.—For the purposes of sub-sections (*10*) and (*11*), any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under those sub-sections.

12. Notwithstanding anything contained in this Act,—

i. an independent director;

ii. a non-executive director not being promoter or key managerial personnel, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

13. The provisions of sub-sections (*6*) and (*7*) of section 152 in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

According to section 152 Appointment of directors

1. Where no provision is made in the articles of a company for the appointment of the first director, 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 and in case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.
2. Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting.
3. No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154.
4. Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under this Act.
5. A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director and such consent has been filed with the Registrar within thirty days of his appointment in such manner as may be prescribed:

Provided that in the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice for the general meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment.

6.

a. Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall—

i. be persons whose period of office is liable to determination by retirement of directors by rotation; and

ii. save as otherwise expressly provided in this Act, be appointed by the company in general meeting.

b. The remaining directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

c. At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed in accordance with clauses (*a*) and (*b*) and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

d. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

e. At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

Explanation.—For the purposes of this sub-section, "total number of directors" shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

7.

a. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

b. If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless—

i. at that meeting or at the previous meeting a resolution for the re-appointment of such director has been put to the meeting and lost;

ii. the retiring director has, by a notice in writing addressed to the company or its Board of directors, expressed his unwillingness to be so re-appointed;

iii. he is not qualified or is disqualified for appointment;

iv. a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or

v. section 162 is applicable to the case.

Explanation.—For the purposes of this section and section 160, the expression "retiring director" means a director retiring by rotation.

Activity-1

Explain the procedure of appointment of director ----------

Disqualifications for appointment of director or Restrictions on the appointment of director

According to section 164 Disqualifications for appointment of director

1. 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.

2. No person who is or has been a director of a company which—

a. has not filed financial statements or annual returns for any continuous period of three financial years; or

b. has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

3. 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*):

Provided that the disqualifications referred to in clauses (*d*), (*e*) and (*g*) of sub-section (*1*) shall not take effect—

i. for thirty days from the date of conviction or order of disqualification;

ii. where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed off; or

iii. where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed off.

Duties of directors

According to section 166 Duties of directors

1. Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.
2. 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. A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
4. 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. 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. A director of a company shall not assign his office and any assignment so made shall be void.

7. If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Activity-2

Explain the duties of director .....

SUMMARY

An appointed or elected member of the board of directors of a company who, with other directors, has the responsibility for determining and implementing the company's policy.
A company director does not have to be a stockholder (shareholder) or an employee of the firm, and may only hold the office of director. Directors act on the basis of resolutions made at directors' meetings, and derive their powers from the corporate legislation and from the company's articles of association.
As the company's agents, they can bind the company with valid contracts entered into with third-parties such as buyers, lenders, and suppliers

GLOSSARY

Director- A person who is in charge of an activity, department, or organization.

SUGGESTED READINGS

Garg, Sareen, Sharma, Chawla. *Mercantile Law*. Kalyani Publishers, 2010.

Kapoor, N.d. *Elements of Mercantile Law*. Sultan Chand & Sons, 2013.

9.9. MODEL QUESTIONS

1. Explain the procedure of appointment of director?
2. Explain the duties of director?

Lesson 10

Meetings

STRUCTURE

Objectives

Introduction

Meaning of Meetings

Kinds of meetings

Shareholder meetings\ statutory (legal) meetings

Annual General Meeting (AGM)

Extra ordinary General Meetings

Requisites of meetings

Role of chairmen of a meeting

Secretarial work relating to statutory meeting

Functions before the meeting

Functions at the meeting

Functions after the meeting

proxy

voting and poll

Summary

Keywords

Answer to check your progress

Terminal questions

Suggested readings

OBJECTIVE

After reading this lesson, you should be able to

(a) Define a meeting and explain different types of meeting.

(b) Describe the provisions regarding voting and poll, proxies and resolutions

(c)Discuss the statutory provision regarding the various types of meeting of shareholders.

(d) Explain the prerequisites of a valid meeting.

INTRODUCTION

The company is a legal creation, a separate entity distinct from its members and is an artificial person. Being an artificial person, it cannot take any decisions on its own. It has to conduct meetings to make any decisions relating to its wellbeing by passing resolutions at properly constituted meetings of its shareholders or directors. Routine management of a company is in the hands of the directors, not in the hand of shareholders but the shareholders are important and retain some important powers. Many decisions require a resolution of the shareholders and cannot be decided by the directors alone. When two or more than two persons come together to have discussion on the matters of common interest, it is said to be a meeting.

Meaning of Meetings

When two or more than two persons come together to make decision after having discussion on the matters of common interest of its member, it is said to be a meeting. In simple language get together of persons with some objective and plan is known as meetings.

Who is a ‘Member’

(i) Anyone who subscribes the memorandum.

(ii)Any other person who agrees to become a member and whose name is entered on the register of members.

(b) Register of Members

CA 1985, s.352 requires" that every company must keep a register of its members. The register must show name and address of each member, date person became a member and, where applicable, the date he ceased to be a member ,the number of shares held by each member and the amount paid on them".

Kinds of meetings

Shareholder meetings\ statutory (legal) meetings

Sec-165 states, "Such a meetings may be called within a period of less than 1 month and not more than 6 months from the date of issue of Certificate of Commencement of Business".

Companies exempt from conducting a Statutory meeting:

•Private Company
•A public Company not having Share Capital
•A Public company limited by Guarantee and not having share capital
•An Unlimited Company
•A Government Company

Objectives of the Statutory Meeting:

1. To discuss the success of the formation of the company.

2. To approve/modify the contracts specified in the prospectus

3. Providing information to the members regarding Shares.

Note: Sec-433(b) provides, "the statutory report be delivered to the ROC otherwise company will be wound up".

Requirements to conduct a Statutory Meeting:

- Time, date and place of statutory meeting.
- Notice: A clear 21 day notice must be given to all.
- Agenda: Since all items are of Special Business category therefore each must be accompanied with an explanatory note for each item.

Statutory Report: Directors must send a report to every member 21 days before the date of the meeting.

Contents of the Statutory Report

- Shares
- Cash Received
- Abstract of Receipts and Payments
- Directors, Auditors and other Managerial personnel
- Contracts
- Underwriting Contracts
- Arrears of Calls
- Commission and Brokerage

Certification of the Statutory Report: At least 2 directors and the auditors must certify the Correctness. The Statutory report must be filed with the ROC in e-form 22.

Annual General Meeting (AGM)

This meetings must be held by every kind of company whether it is public or private once in a year. This meeting is to be call and held by the directors of company. The interval between two meetings cannot exceed than 15 months. The first AGM must be held within 18 months from date of its corporation.

A notice of the meetings to the directors should send at least 21 day before the meetings. The AGM must hold on a working day during business hours at the place of registered office of the company.

Objectives of the Meetings:

1) To check annual accounts.

2) Declaration of dividend.

3) Election of directors.

4) Appointment of auditors.

Extra ordinary General Meetings:

This meeting is different than statutory and AGM as it is held in the emergency situations like at the time of venture etc.

Objective of the business:

1) Special business e.g. a case of 20 billion rupees of export is at the door.

2) In some innovative cases: e.g. an idea of launching a new product.

Requisites of meetings

The necessities of a valid meeting are as following:

1. **Right convening authority**: A meeting is valid when it is convened by the proper authority otherwise it is invalid. For example Company's secretary is the proper authority to call a formal meeting.
2. **Proper notice**: Duly signed notice must be submitted to members before meeting. The place of meeting, time and date must be stated on that notice.
3. **Proper publicity of agenda**: Every member of the meeting should be properly informed of the agenda and must be aware of it.
4. **Legal purposes**: Every meeting must have a legal purpose.

5. **Requisite quorum**: For valid meeting requisite quorum is necessary. The meeting should not be stared until the requisite members of member s are resent.
6. **Presence of right persons**: Only members which are legally exists can present in the meeting. If there is an unauthorized person in the meeting, the meeting will be invalid.
7. **Proper presiding officer**: The chairman of a valid meeting must be a proper person.
8. **Conducting meeting according to the agenda**: A valid meeting must be conducted according to the agenda.

Role or function or duties of chairmen of a meeting: In all types of meetings, you have the following responsibilities as a presiding officer.

- Arranging the time and place
- Preparing and serving an agenda.
- Calling the meeting to order on time
- Making clear the purpose of the meeting
- Keeping the discussion on course
- Controlling over enthusiastic members
- Electing contributions from each member
- Creating a good atmosphere
- Summarizing the discussion form time to time
- Working to end the meeting on schedule
- Thanking to the members

Secretarial work relating to statutory meeting

Check your progress A

1) Which of the following is not the type of meeting
    a. Shareholder meetings\ statutory (legal) meetings
    b. Annual general meeting
    c. Extra ordinary meeting
    d. General meeting
2) Which of the following is the duty of chairmen of a meeting
    a. Arranging the time and place
    b. Preparing and serving an agenda.

c. Calling the meeting to order on time

d. All of these

Activity-1

Explain different requisites of meetings? .....

Functions before the meeting:

- Serving the notice to the concerned members.
- Maintaining time for statutory meeting,
- Drafting a notice for the meeting,
- Preparing statutory statement or report,
- Collecting the auditor's certificate,
- Preparing agenda of the meeting,
- Selection the place of the meeting,
- Calling on board of directors meeting,

- Listing the name of members who will attend the meeting,
- Calling on board of directors meeting,
- Preparing final notice of the meeting.

Functions at the meeting:

- Determining the quorum of the meeting,
- Stating the agenda,
- Supply necessary explanations,
- Giving the explanations,
- Writing the rough minutes.

Functions after the meeting:

- Preparing final minutes and resolutions,
- Submitting the statutory report

Proxy

Meaning of proxy: a member entitled to attend and vote at a meeting may vote either in person or by proxy. Proxy is a personal representation of the shareholder who may be described as his agent to carry out a course which the shareholder himself has decided upon. It also refers to the instrument by which a person is appointed to act for another at a meeting of the company. According to L.C.B. Grower, "the word proxy is used indiscriminately to describe both the agent and the instrument appointing him."

Thus the term proxy means two things:

I. The instrument or letter of authority whereby a member of the company appoints another person to represent him at its meeting and vote on his behalf and
II. The agent or the person appointed to represent and vote on behalf of a member of the company at its meeting.

Appointment of proxy

Every member of a company shall be entitled to appoint another person as his proxy to attend and vote instead of himself. A proxy need not be a member of a company.

Requirement as to instrument of proxy

1) Proxy must be deposited within 48 hours
2) Canvassing by directors for proxies prohibited

3) Disabilities and duties of proxy: the proxy has no right to speak at a meeting. But proxy can vote at a meeting.
4) Revocation of proxy: a proxy is always revocable. A proxy can be revoked at any time before the proxy has voted.
5) Inspection of proxy: every member entitled to vote at the meeting is authorized to inspect the proxy during the 24 hours preceding the meeting till the conclusion of the meeting.

voting and poll

The object of a meeting is to take prompt and wise decisions by common consent or by the majority where common consent is not possible. After a motion has been discussed in the meeting, it is put to vote for ascertaining the sense of the house.

Persons entitled to vote

1. Equity shareholders
2. Preference shareholders
3. Holders of share warrants
4. Joint holders
5. Insolvent
6. Representation of the corporation in meeting
7. Representation of the president and governor
8. Public trustee
9. Proxy
10. Person of unsound mind

Activity-2

At a meeting of a company, only 15 shareholders were present.9 voted for special resolution and 2 against and 4 did not vote at all. No poll was demanded and the chairman declared the resolution to be carried. Is this a valid resolution? ----------
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Check your progress B

1. The minimum number of members that must be present at the meeting is termed as ----------.

2. A person who is conducting Audit or person appointed by the company to execute the audit is called .....

3is the resolution which is passed, at a valid meeting by simple majority of the members.

4is the first meeting of the members of the company after its incorporations.

5. A notice of the meetings to the directors should send at-least---------- day before the meetings.

Summary

A meeting is a gathering or assembly of a number of persons for transacting any lawful business. But every gathering of persons does not constitute a meeting. A meeting would be valid if it is held by following the prescribed rules and regulations. The meetings of a company are of three kinds namely meetings of shareholders directors and creditors. Statutory meeting is the first meeting of the members of the company after its incorporations and must be held within six months from the date at which the company is entitled to start business. Annual general meeting is the regular meeting of the members of the company and the purpose of this meeting is to provide an opportunity to the members of the company express their views on the management of company's affairs. Any meeting other than the statutory and the annual general meeting of the company is known as extra-ordinary general

meeting, class meeting is the meeting of a particular class of shareholders. The business of the meeting is conducted in the form of resolutions passed at the meeting and the resolutions proposed in the meeting are decided on the votes of the members of the company. The remuneration payable to directors is determined by the articles of association of the company, or by a resolution of the company passed in its general meeting. The overall maximum limit of management remuneration in fixed by Section 198 of the Companies Act. The goal of an audit is to form and express an opinion on financial statements. The audit is performed to get reasonable assurance on whether the financial statements are free of material misstatement. An audit also includes assessing the accounting principles used and the significant estimates made by the management. Audit conclusions and reporting are one of the principles governing an audit. Reporting is the last procedure of the process of an audit. The scheme compromise or arrangements are mainly applicable to foreign companies formed outside India and doing business in India and Government Company i.e. those companies are liable to wound up under the act sec 390(a). When a company is suffering loss for several past years and suffering from financial difficulties, it may go for reconstruction .i.e. Formation of a new company to take-over the Assets of an existing company with the idea that the persons interested and the nature of business substantially remains the same. The term Amalgamation is taken to mean as the union of two or more companies, so as to form a third entity or one company is absorbed into another company.

Glossary

Meeting: A meeting may be defined as gathering or assembly of a number of persons for transacting any lawful business.

Statutory Meeting: Every public company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month but more than six months from the date on which the company is entitled to commence business hold a general meeting of the members of the company. This meeting is called the statutory meeting.

Annual General Meeting: Every company must in each year hold in addition to any other meeting, a general meeting as its annual general meeting.

Extra Ordinary General Meeting: Any meeting other than a statutory and an annual general meeting is called an Extra Ordinary General Meeting.

Class Meeting: Class meetings are separate meetings of holders of different classes of shares. They are held in cases where their rights are sought to be affected.

Quorum: It means the minimum number of members that must be present at the meeting.

Vote: A vote is the formal expression of the will of the members of the house either for or against a proposal.

Ordinary Resolution: It is the resolution which is passed, at a valid meeting by simple majority of the members, i.e., where the votes cast in favour of resolution exceeds the votes cast against it.

Managerial Remuneration: The total managerial remuneration payable by a public company or a private company which is a subsidiary of a public company to its directors, managing agent, secretaries and treasurer or manager in respect of any financial year shall not exceed 11% of the net profit of that company for that financial year.

Answer to check your progress

Check your progress A

6) (d)
7) (d)

Check your progress B

Ans.1 Quorum

Ans.2 Auditor

Ans.3 Ordinary Resolution

Ans.4 Statutory meeting

Ans.5 21

MODEL QUESTIONS

1. What do you mean by statutory meeting? What business is transacted at such meeting?

2. What are the statutory provisions regarding the holding of an annual general meeting?

3. What are the essentials of a valid meeting? Discuss in detail

4. What is a quorum? What happens if there is no quorum at a meeting at all?

5. Discuss the statutory provisions relating to payment of managerial remuneration of a public limited company.

6. What are different types of resolutions which must be passed in the meeting of shareholders?

7. What are different types of meetings?

8. What do you understand by quorum?

Suggested readings

1. S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai .

2. G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

3. S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

4. R.H. Pandia, Principles of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

5. N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi. S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.

Lesson-11

Auditors

Structure

Objectives

After reading this lesson, you should be able:

- To understand the meaning auditor.
- To understand the process of auditor appointment.

Introduction

To make directors to prepare accounts for showing the company's financial position to take decision at any particular point of time every company need to keep adequate accounting records in accordance with the Companies Act 2006," The records must show all sums of money received and spent by the company and a record of assets and liabilities and if the company fails to do so it will attract imprisonment or fine or both. Public company needs to keep records for 6 years from the date they were made while for private company this period is 3 years".

Auditor

"An auditor is an independent person of a current practicing certificate issued by one of the recognised supervisory bodies". As per the Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland, The Institute of Chartered Accountants in Ireland, and the Association of Chartered Certified Accountants .

Appointment of auditors

According to section 139

1. Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed: the company shall place the matter relating to such appointment for ratification by members at every annual general meeting that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.

2. No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

   a) an individual as auditor for more than one term of five consecutive years; and

   b) An audit firm as auditor for more than two terms of five consecutive years:

Provided that—

i. An individual auditor who has completed his term under clause (*a*) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

ii. An audit firm which has completed its term under clause (*b*), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:

Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act:

Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

3. Subject to the provisions of this Act, members of a company may resolve to provide that—

   a. in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or

   b. the audit shall be conducted by more than one auditor.

4. The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of sub-section (*2*).

5. Notwithstanding anything contained in sub-section (*1*), in the case of a Government company or any other company owned or controlled, directly or indirectly, 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, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

6. Notwithstanding anything contained in sub-section (*1*), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

7. Notwithstanding anything contained in sub-section (*1*) or sub-section (*5*), in the case of a Government company or any other company owned or controlled, directly or indirectly, 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, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next thirty days; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

8. Any casual vacancy in the office of an auditor shall—

   i. in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;

   ii. in the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days:

Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

9. Subject to the provisions of sub-section (*1*) and the rules made there under, a retiring auditor may be re-appointed at an annual general meeting, if—

   a. he is not disqualified for re-appointment;

   b. he has not given the company a notice in writing of his unwillingness to be re-appointed; and

   c. a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

10. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

11. Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

Activity-1

Explain the process of auditor appointment .....

Powers and duties of auditors

According to sections 143 the auditor has the following duties and powers

1. Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:—

   a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

   b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

   c. where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

   d. whether loans and advances made by the company have been shown as deposits;

   e. whether personal expenses have been charged to revenue account;

   f. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

2. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under sub-section (*11*) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

3. The auditor's report shall also state—

   a. whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

   b. whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

   c. whether the report on the accounts of any branch office of the company audited under sub-section (*8*) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

   d. whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

   e. whether, in his opinion, the financial statements comply with the accounting standards;

   f. the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

   g. whether any director is disqualified from being appointed as a director under sub-section (*2*) of section 164;

   h. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

   i. whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

   j. such other matters as may be prescribed.

4. Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

5. In the case of a Government company, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (*5*) or sub-section (*7*) of section 139 and direct

such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

6. The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report under sub-section (*5*) have a right to,—

   a. conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

   b. comment upon or supplement such audit report:

Provided that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub section (*1*) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

7. Without prejudice to the provisions of this Chapter, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (*5*) or sub-section (*7*) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

8. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

9. Every auditor shall comply with the auditing standards.

10. The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after

examination of the recommendations made by the National Financial Reporting Authority:

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

11. The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

12. Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

13. No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (*12*) if it is done in good faith.

14. The provisions of this section shall *mutatis mutandis* apply to—

    a. the cost accountant in practice conducting cost audit under section 148; or

    b. the company secretary in practice conducting secretarial audit under section 204.

15. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (*12*), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

Activity-2

Explain the duties of auditors .....

Summary

To make directors to prepare accounts for showing the company's financial position to take decision at any particular point of time every company need to keep adequate accounting records in accordance with the Companies Act 2006," The records must show all sums of money received and spent by the company and a record of assets and liabilities and if the company fails to do so it will attract imprisonment or fine or both. Public company needs to keep records for 6 years from the date they were made while for private company this period is 3 years".

Glossary

A**uditor**- "An auditor is an independent person of a current practicing certificate issued by one of the recognised supervisory bodies". As per the Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland, The Institute of Chartered Accountants in Ireland, and the Association of Chartered Certified Accountants .

Model questions

1. Write down the procedure of auditor's appointment?
2. What is the meaning of auditor? Explain the duties of auditor?

Suggested Readings

Garg, Sareen, Sharma, Chawla. *Mercantile Law*. Kalyani Publishers, 2010.

Kapoor, N.d. *Elements of Mercantile Law*. Sultan Chand & Sons, 2013.

Lesson -12

Winding up

Structure

- **Objectives**
- **Introduction**
- **Modes of winding up**
- **Tribunal winding up**
- **Voluntary winding up**
- **Summary**
- **Glossary**
- **Model question**
- **Suggested readings**

Objectives

After reading this lesson, you should be able:

- To understand the meaning of winding up
- To understand the procedure of winding up

Introduction

The process of selling all the assets of a business, paying off creditors, distributing any remaining assets to the principals or parent company, and then dissolving the business. Winding up can refer to such a process either for a specific business line of a corporation or to the dissolution of a corporation itself.

Modes of winding up.

According to section 270 winding up can be done by using two methods

1. The winding up of a company may be either—
   a) By the Tribunal; or
   b) Voluntary.
2. Notwithstanding anything contained in any other Act, the provisions of this Act with respect to winding up shall apply to the winding up of a company in any of the modes specified under sub-section (*1*).

a) Winding up by the Tribunal

According to section 271 Circumstances in which company may be wound up by Tribunal.

1. A company may, on a petition under section 272, be wound up by the Tribunal,—
   a) if the company is unable to pay its debts;
   b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
   c) 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;
   d) if the Tribunal has ordered the winding up of the company under Chapter XIX;
   e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned

in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

2. A company shall be deemed to be unable to pay its debts,—

a. if a creditor, by assignment or otherwise, to whom the company is indebted for an amount exceeding one lakh rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty-one days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor;

b. if any execution or other process issued on a decree or order of any court or tribunal in favor of a creditor of the company is returned unsatisfied in whole or in part; or

c. if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.

Procedure of winding up by tribunal

1) According to section 272 Petition for winding up

1. Subject to the provisions of this section, a petition to the Tribunal for the winding up of a company shall be presented by—

a. the company;

b. any creditor or creditors, including any contingent or prospective creditor or creditors;

c. any contributory or contributories;

d. all or any of the persons specified in clauses (*a*), (*b*) and (*c*) together;

e. the Registrar;

f. any person authorised by the Central Government in that behalf; or

g. in a case falling under clause (*c*) of sub-section (*1*) of section 271, by the Central Government or a State Government.

2. A secured creditor, the holder of any debentures, whether or not any trustee or trustees have been appointed in respect of such and other like debentures, and the trustee for the

holders of debentures shall be deemed to be creditors within the meaning of clause (*b*) of sub-section (*1*).

3. A contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder.

4. The Registrar shall be entitled to present a petition for winding up under subsection (*1*) on any of the grounds specified in sub-section (*1*) of section 271, except on the grounds specified in clause (*b*), clause (*d*) or clause (*g*) of that sub-section:

Provided that the Registrar shall not present a petition on the ground that the company is unable to pay its debts unless it appears to him either from the financial condition of the company as disclosed in its balance sheet or from the report of an inspector appointed under section 210 that the company is unable to pay its debts:

Provided further that the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition:

Provided also that the Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.

5. A petition presented by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

6. Before a petition for winding up of a company presented by a contingent or prospective creditor is admitted, the leave of the Tribunal shall be obtained for the admission of the petition and such leave shall not be granted, unless in the opinion of the Tribunal there is a*prima facie* case for the winding up of the company and until such security for costs has been given as the Tribunal thinks reasonable.

7. A copy of the petition made under this section shall also be filed with the Registrar and the Registrar shall, without prejudice to any other provisions, submit his views to the Tribunal within sixty days of receipt of such petition.

2) Powers of Tribunal

According to section 273 Powers of Tribunal

1. The Tribunal may, on receipt of a petition for winding up under section 272 pass any of the following orders, namely:—

   a. dismiss it, with or without costs;

   b. make any interim order as it thinks fit;

c. appoint a provisional liquidator of the company till the making of a winding up order;

d. make an order for the winding up of the company with or without costs; or

e. any other order as it thinks fit:

Provided that an order under this sub-section shall be made within ninety days from the date of presentation of the petition:

Provided further that before appointing a provisional liquidator under clause (*c*), the Tribunal shall give notice to the company and afford a reasonable opportunity to it to make its representations, if any, unless for special reasons to be recorded in writing, the Tribunal thinks fit to dispense with such notice:

Provided also that the Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

2. Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy.

3) Directions for filing statement of affairs

According to section 274 Directions for filing statement of affairs

1. Where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a *prima facie* case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order in such form and in such manner as may be prescribed:

Provided that the Tribunal may allow a further period of thirty days in a situation of contingency or special circumstances:

Provided further that the Tribunal may direct the petitioner to deposit such security for costs as it may consider reasonable as a precondition to issue directions to the company.

2. A company, which fails to file the statement of affairs as referred to in sub-section (*1*), shall forfeit the right to oppose the petition and such directors and officers of the company as found responsible for such non-compliance, shall be liable for punishment under sub-section (*4*).

3. The directors and other officers of the company, in respect of which an order for winding up is passed by the Tribunal under clause (*d*) of sub-section (*1*) of section 273, shall, within a period of thirty days of such order, submit, at the cost of the company, the

books of account of the company completed and audited up to the date of the order, to such liquidator and in the manner specified by the Tribunal.

4. If any director or officer of the company contravenes the provisions of this section, the director or the officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both

5. The complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorised by the Tribunal.

4) Company Liquidators and their appointments

According to section 275 Company Liquidators and their appointments

1. For the purposes of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained under sub-section (*2*) as the Company Liquidator.

2. The provisional liquidator or the Company Liquidator, as the case may be, shall be appointed from a panel maintained by the Central Government consisting of the names of chartered accountants, advocates, company secretaries, cost accountants or firms or bodies corporate having such chartered accountants, advocates, company secretaries, cost accountants and such other professionals as may be notified by the Central Government or from a firm or a body corporate of persons having a combination of such professionals as may be prescribed and having at least ten years' experience in company matters.

3. Where a provisional liquidator is appointed by the Tribunal, the Tribunal may limit and restrict his powers by the order appointing him or it or by a subsequent order, but otherwise he shall have the same powers as a liquidator.

4. The Central Government may remove the name of any person or firm or body corporate from the panel maintained under sub-section (*2*) on the grounds of misconduct, fraud, misfeasance, breach of duties or professional incompetence:

Provided that the Central Government before removing him or it from the panel shall give him or it a reasonable opportunity of being heard.

5. The terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him or it shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company.

6. On appointment as provisional liquidator or Company Liquidator, as the case may be, such liquidator shall file a declaration within seven days from the date of appointment in the prescribed form disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment.

7. While passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, appointed under clause (*c*) of sub-section (*1*) of section 273, as the Company Liquidator for the conduct of the proceedings for the winding up of the company.

5) Removal and replacement of liquidator

According to section 276 removal and replacement of liquidator

1. The Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the provisional liquidator or the Company Liquidator, as the case may be, as liquidator of the company on any of the following grounds, namely:—
   a. misconduct;
   b. fraud or misfeasance;
   c. professional incompetence or failure to exercise due care and diligence in performance of the powers and functions;
   d. inability to act as provisional liquidator or as the case may be, Company Liquidator;
   e. conflict of interest or lack of independence during the term of his appointment that would justify removal.
2. In the event of death, resignation or removal of the provisional liquidator or as the case may be, Company Liquidator, the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing.
3. Where the Tribunal is of the opinion that any liquidator is responsible for causing any loss or damage to the company due to fraud or misfeasance or failure to exercise due care and diligence in the performance of his or its powers and functions, the Tribunal may recover or cause to be recovered such loss or damage from the liquidator and pass such other orders as it may think fit.
4. The Tribunal shall, before passing any order under this section, provide a reasonable opportunity of being heard to the provisional liquidator or, as the case may be, Company Liquidator.

6) Intimation to Company Liquidator, provisional liquidator and Registrar

According to section 277 Intimation to Company Liquidator, provisional liquidator and Registrar

1. Where the Tribunal makes an order for appointment of provisional liquidator or for the winding up of a company, it shall, within a period not exceeding seven days from the date of passing of the order, cause intimation thereof to be sent to the Company Liquidator or provisional liquidator, as the case may be, and the Registrar.
2. On receipt of the copy of order of appointment of provisional liquidator or winding up order, the Registrar shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made and in the case of a listed company, the Registrar shall intimate about such appointment or order, as

the case may be, to the stock exchange or exchanges where the securities of the company are listed.

3. The winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

4. Within three weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function as provided in sub-section (*5*) and such winding up committee shall comprise of the following persons, namely:—

   i. Official Liquidator attached to the Tribunal;

   ii. nominee of secured creditors; and

   iii. a professional nominated by the Tribunal.

5. The Company Liquidator shall be the convener of the meetings of the winding up committee which shall assist and monitor the liquidation proceedings in following areas of liquidation functions, namely:—

   i. taking over assets;

   ii. examination of the statement of affairs;

   iii. recovery of property, cash or any other assets of the company including benefits derived there from;

   iv. review of audit reports and accounts of the company;

   v. sale of assets;

   vi. finalisation of list of creditors and contributories;

   vii. compromise, abandonment and settlement of claims;

   viii. payment of dividends, if any; and

   ix. any other function, as the Tribunal may direct from time to time.

6. The Company Liquidator shall place before the Tribunal a report along with minutes of the meetings of the committee on monthly basis duly signed by the members present in the meeting for consideration till the final report for dissolution of the company is submitted before the Tribunal.

7. The Company Liquidator shall prepare the draft final report for consideration and approval of the winding up committee.

8. The final report so approved by the winding up committee shall be submitted by the Company Liquidator before the Tribunal for passing of a dissolution order in respect of the company.

7) Effect of winding up order

According to section 278 Effect of winding up order

The order for the winding up of a company shall operate in favor of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories.

8) Jurisdiction of Tribunal

According to section 280 Jurisdiction of Tribunal

The Tribunal shall, notwithstanding anything contained in any other law for the time being in force, have jurisdiction to entertain, or dispose of,—

a. any suit or proceeding by or against the company;

b. any claim made by or against the company, including claims by or against any of its branches in India;

c. any application made under section 233;

d. any scheme submitted under section 262;

e. any question of priorities or any other question whatsoever, whether of law or facts, including those relating to assets, business, actions, rights, entitlements, privileges, benefits, duties, responsibilities, obligations or in any matter arising out of, or in relation to winding up of the company, whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made or such scheme has been submitted, or is submitted, before or after the order for the winding up of the company is made.

9) Submission of report by Company Liquidator

According to section 281 Submission of report by Company Liquidator

1. Where the Tribunal has made a winding up order or appointed a Company Liquidator, such liquidator shall, within sixty days from the order, submit to the Tribunal, a report containing the following particulars, namely:—

    a. the nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company:

Provided that the valuation of the assets shall be obtained from registered valuers for this purpose;

b. amount of capital issued, subscribed and paid-up;

c. the existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and in the case of secured debts, particulars of the securities given,

whether by the company or an officer thereof, their value and the dates on which they were given;

d. the debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof;

e. guarantees, if any, extended by the company;

f. list of contributories and dues, if any, payable by them and details of any unpaid call;

g. details of trade marks and intellectual properties, if any, owned by the company;

h. details of subsisting contracts, joint ventures and collaborations, if any;

i. details of holding and subsidiary companies, if any;

j. details of legal cases filed by or against the company; and

k. any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include.

2. (*2*) The Company Liquidator shall include in his report the manner in which the company was promoted or formed and whether in his opinion any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof and any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal.

3. The Company Liquidator shall also make a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximising the value of the assets of the company.

4. The Company Liquidator may also, if he thinks fit, make any further report or reports.

5. Any person describing himself in writing to be a creditor or a contributory of the company shall be entitled by himself or by his agent at all reasonable times to inspect the report submitted in accordance with this section and take copies thereof or extracts there from on payment of the prescribed fees.

10) Directions of Tribunal on report of Company Liquidator

According to section 282 Directions of Tribunal on report of Company Liquidator

1. The Tribunal shall, on consideration of the report of the Company Liquidator, fix a time limit within which the entire proceedings shall be completed and the company be dissolved:

Provided that the Tribunal may, if it is of the opinion, at any stage of the proceedings, or on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved.

2. The Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof:

Provided that the Tribunal may, where it considers fit, appoint a sale committee comprising such creditors, promoters and officers of the company as the Tribunal may decide to assist the Company Liquidator in sale under this sub-section.

3. Where a report is received from the Company Liquidator or the Central Government or any person that a fraud has been committed in respect of the company, the Tribunal shall, without prejudice to the process of winding up, order for investigation under section 210, and on consideration of the report of such investigation it may pass order and give directions under sections 339 to 342 or direct the Company Liquidator to file a criminal complaint against persons who were involved in the commission of fraud.
4. The Tribunal may order for taking such steps and measures, as may be necessary, to protect, preserve or enhance the value of the assets of the company.
5. The Tribunal may pass such other order or give such other directions as it considers fit.

11) Custody of company's properties

According to section 283 Custody of company's properties

1. Where a winding up order has been made or where a provisional liquidator has been appointed, the Company Liquidator or the provisional liquidator, as the case may be, shall, on the order of the Tribunal, forthwith take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.
2. Notwithstanding anything contained in sub-section (*1*), all the property and effects of the company shall be deemed to be in the custody of the Tribunal from the date of the order for the winding up of the company.
3. On an application by the Company Liquidator or otherwise, the Tribunal may, at any time after the making of a winding up order, require any contributory for the time being on the list of contributories, and any trustee, receiver, banker, agent, officer or other employee of the company, to pay, deliver, surrender or transfer forthwith, or within such time as the Tribunal directs, to the Company Liquidator, any money, property or books and papers in his custody or under his control to which the company is or appears to be entitled.

12) Promoters, directors, etc., to cooperate with Company Liquidator

According to section 284 Promoters, directors, etc., to cooperate with Company Liquidator

1. The promoters, directors, officers and employees, who are or have been in employment of the company or acting or associated with the company shall extend full cooperation to the Company Liquidator in discharge of his functions and duties.

2. Where any person, without reasonable cause, fails to discharge his obligations under sub-section (*1*), he shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

13) Settlement of list of contributories and application of assets

According to section 285 Settlement of list of contributories and application of assets

1. As soon as may be after the passing of a winding up order by the Tribunal, the Tribunal shall settle a list of contributories, cause rectification of register of members in all cases where rectification is required in pursuance of this Act and shall cause the assets of the company to be applied for the discharge of its liability:

Provided that where it appears to the Tribunal that it would not be necessary to make calls on or adjust the rights of contributories, the Tribunal may dispense with the settlement of a list of contributories.

2. In settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.
3. While settling the list of contributories, the Tribunal shall include every person, who is or has been a member, who shall be liable to contribute to the assets of the company an amount sufficient for payment of the debts and liabilities and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, subject to the following conditions, namely:—
    a. a person who has been a member shall not be liable to contribute if he has ceased to be a member for the preceding one year or more before the commencement of the winding up;

    b. a person who has been a member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member;

    c. no person who has been a member shall be liable to contribute unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them in pursuance of this Act;

    d. in the case of a company limited by shares, no contribution shall be required from any person, who is or has been a member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member;

    e. in the case of a company limited by guarantee, no contribution shall be required from any person, who is or has been a member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up but if the company has a share capital, such member shall be liable to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

14) Obligations of directors and managers

According to section 86 Obligations of directors and managers

In the case of a limited company, any person who is or has been a director or manager, whose liability is unlimited under the provisions of this Act, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were at the commencement of winding up, a member of an unlimited company:

Provided that —

a. a person who has been a director or manager shall not be liable to make such further contribution, if he has ceased to hold office for a year or upwards before the commencement of the winding up;

b. a person who has been a director or manager shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office;

c. subject to the articles of the company, a director or manager shall not be liable to make such further contribution unless the Tribunal deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up.

15) Advisory committee.

According to section 287 Advisory committee

1. The Tribunal may, while passing an order of winding up of a company, direct that there shall be, an advisory committee to advise the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct.
2. The advisory committee appointed by the Tribunal shall consist of not more than twelve members, being creditors and contributories of the company or such other persons in such proportion as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct.
3. The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee.
4. The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time.
5. The provisions relating to the convening of the meetings, the procedure to be followed thereat and other matters relating to conduct of business by the advisory committee shall be such as may be prescribed.
6. The meeting of advisory committee shall be chaired by the Company Liquidator.

16) Submission of periodical reports to Tribunal

According to section 288 Submission of periodical reports to Tribunal

1. The Company Liquidator shall make periodical reports to the Tribunal and in any case make a report at the end of each quarter with respect to the progress of the winding up of the company in such form and manner as may be prescribed.
2. The Tribunal may, on an application by the Company Liquidator, review the orders made by it and make such modifications as it thinks fit.

17) Power of Tribunal on application for stay of winding up

According to section 289 Power of Tribunal on application for stay of winding up

1. The Tribunal may, at any time after making a winding up order, on an application of promoter, shareholders or creditors or any other interested person, if satisfied, make an order that it is just and fair that an opportunity to revive and rehabilitate the company be provided staying the proceedings for such time but not exceeding one hundred and eighty days and on such terms and conditions as it thinks fit:

Provided that an order under this sub-section shall be made by the Tribunal only when the application is accompanied with a scheme for rehabilitation.

2. The Tribunal may, while passing the order under sub-section (*1*), require the applicant to furnish such security as to costs as it considers fit.
3. Where an order under sub-section (*1*) is passed by the Tribunal, the provisions of Chapter XIX shall be followed in respect of the consideration and sanction of the scheme of revival of the company.
4. Without prejudice to the provisions of sub-section (*1*), the Tribunal may at any time after making a winding up order, on an application of the Company Liquidator, make an order staying the winding up proceedings or any part thereof, for such time and on such terms and conditions as it thinks fit.
5. The Tribunal may, before making an order, under this section, require the Company Liquidator to furnish to it a report with respect to any facts or matters which are in his opinion relevant to the application.
6. A copy of every order made under this section shall forthwith be forwarded by the Company Liquidator to the Registrar who shall make an endorsement of the order in his books and records relating to the company.

18) Power of Tribunal to make calls

According to section 296 Power of Tribunal to make calls

The Tribunal may, at any time after the passing of a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company,—

a. make calls on all or any of the contributories for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and

b. make an order for payment of any calls so made.

19) Dissolution of company by Tribunal

According to section 302 Dissolution of company by Tribunal

1. When the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of such company.
2. The Tribunal shall on an application filed by the Company Liquidator under sub-section (*1*) or when the Tribunal is of the opinion that it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made, make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.
3. A copy of the order shall, within thirty days from the date thereof, be forwarded by the Company Liquidator to the Registrar who shall record in the register relating to the company a minute of the dissolution of the company.
4. If the Company Liquidator makes a default in forwarding a copy of the order within the period specified in sub-section (*3*), the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues. Arrest of person trying to leave India

Activity-2

Write down the procedure for tribunal winding up ----------

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Voluntary winding up

1) Commencement of voluntary winding up

According to section 308 Commencement of voluntary winding up

A voluntary winding up shall be deemed to commence on the date of passing of the resolution for voluntary winding up under section 304.

2) Publication of resolution to wind up voluntarily

According to section 307 Publication of resolution to wind up voluntarily

1. Where a company has passed a resolution for voluntary winding up and a resolution under sub-section (*3*) of section 306 is passed, it shall within fourteen days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette and also in a newspaper which is in circulation in the district where the registered office or the principal office of the company is situate.
2. If a company contravenes the provisions of sub-section (*1*), the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which such default continues.

3) Costs of voluntary winding up

According to section 323 Costs of voluntary winding up

All costs, charges and expenses properly incurred in the winding up, including the fee of the Company Liquidator, shall, subject to the rights of secured creditors, if any, be payable out of the assets of the company in priority to all other claims.

Activity -2

Write down the procedure for voluntary winding up ----------

Summary

The process of selling all the assets of a business, paying off creditors, distributing any remaining assets to the principals or parent company, and then dissolving the business. Winding up can refer to such a process either for a specific business line of a corporation or to the

dissolution of a corporation itself.

Glossary

Winding up- Winding up can refer to such a process either for a specific business line of a corporation or to the dissolution of a corporation itself.

Model question

1. Write down the procedure of voluntary winding up?
2. Write down the procedure of tribunal winding up?

Suggested readings

Garg, Sareen, Sharma, Chawla. *Mercantile Law*. Kalyani Publishers, 2010.

Kapoor, N.d. *Elements of Mercantile Law*. Sultan Chand & Sons, 2013.