Corporate Law

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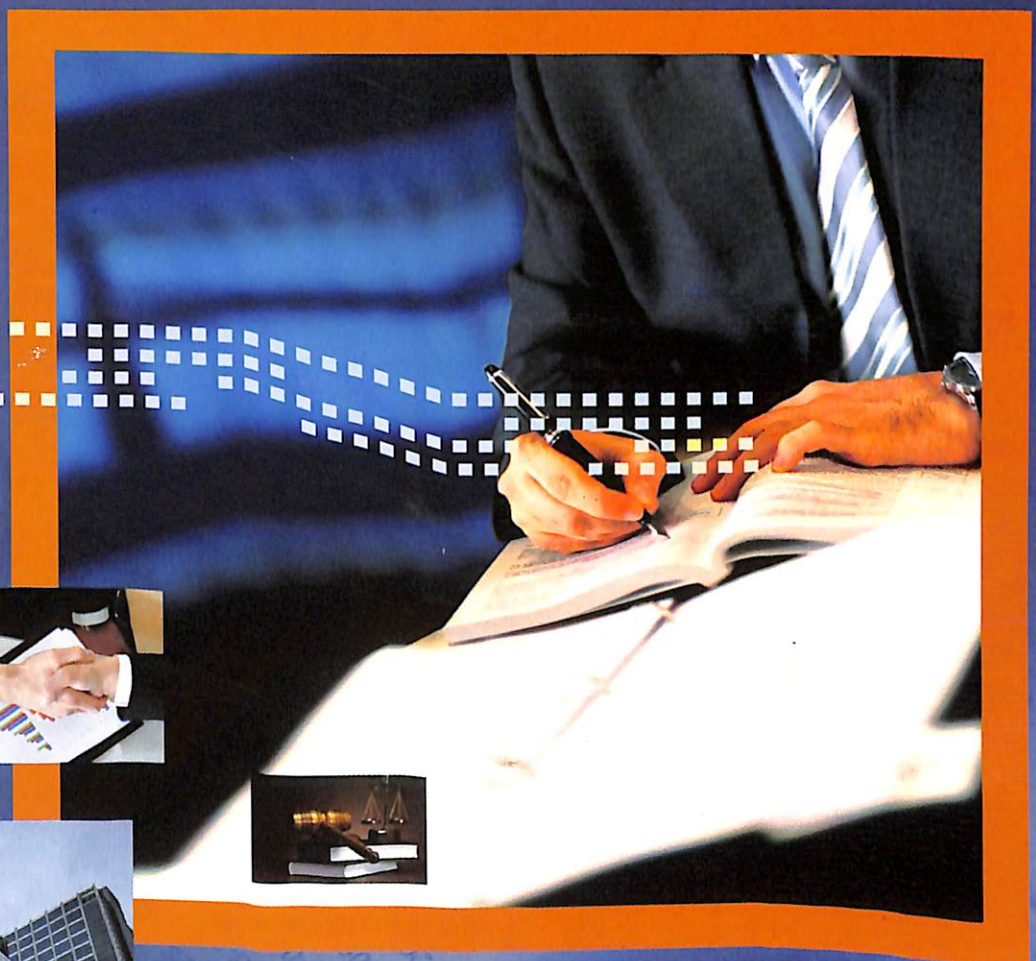

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CORPORATE LAW

For B.Com., 3rd Semester students of Gauhati University and also useful for allied courses of other Universities

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LUDHIANA – NEW DELHI – NOIDA (U.P.) – HYDERABAD – CHENNAI
KOLKATA – CUTTACK – GUWAHATI – KOCHI – BENGALURU

Assamese Mahavidyalaya Guwahati (Guwahati) Dibrugarh
D37251

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KPP N 23543 1 P-28825 07

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Fifth Revised Edition, 2017
Reprinted, 2019

Gautam Graphic Printers
(JOY-17-COR-LAW-GU3)

ISBN 978-93-272-7982-5

PRINTED IN INDIA
Ajit Printing Press, Delhi.

Preface

Fifth Edition

It is a matter of great pleasure to present a book on Corporate Law for **B.Com., 3rd Semester** students of **Gauhati University**. This book is a handy manual expounding in clear and analytical manner the statutory provisions relating to companies. The commentary is topic wise and not section wise but relevant sections have been referred. The book is up-to-date and incorporates all latest amendments. The authors are extremely thankful to Sh. Raj Kumar and Tarun of Kalyani Publishers for bringing out the edition.

2017

K. C. Garg
Vijay Gupta
Joy Dhingra

Syllabus

Gauhati University

305 : CORPORATE LAW

B.Com., (3rd Semester)

UNIT – I

Introductory formation of a Company-corporate personality, lifting of the corporate veil, Basic documents-Memorandum & Articles of association, their alternation and limitations on power of alternation, distinction between Memorandum & Articles of association, constructive notice of Memorandum & Articles, doctrine of indoor management.

UNIT – II

Financial structure ; The concept of capital and financing of company-sources of capital ; classes and types of shares, stocks & shares, share capital alteration, increase and reduction of share capital ; Prospectus-definition, statement-in-lieu-of prospectus, registration, misrepresentation and penalties there for, underwriting.

Debt capital-debentures, debenture stock, bonds, debenture trust deed, and trustees, conversion and redemption of debentures, creation of charges-fixed, floating and registration thereof.

UNIT – III

Issue of securities and membership : Application & allotment of shares, listing of security, irregular allotment, calls on shares, bonus issue, rights issues, issue of sweat equity shares, employee stock option scheme, share certificate, share warrant, lien on shares, surrender of shares, forfeiture of shares, buy back of shares, annual return, unclaimed dividend.

Membership-definition, members vs. shareholders, modes of acquiring membership including through depository mode, termination of membership, rights and liabilities of members, register of members, annual return, transfer and transmission of shares/debentures in physical and depository mode.

UNIT – IV

Company Management and Control of Companies ; Directors-appointment, re-appointment of directors, qualifications, disqualifications, remuneration, vacation of office, retirement, resignation and removal of directors, loans to directors, their powers and duties, role of directors.

Meaning and whole-time directors, managers, company secretary, their appointment, re-appointment, powers and duties.

Law relating to majority powers and minority rights, shareholder remedies, actions by shareholders, statutory remedies, personal actions, prevention of oppression, and mis-management.

UNIT – V

Meaning ; Meeting of directors, frequency, convening and proceedings of board meetings, minutes and evidence.

General meetings, kinds of meeting and resolutions, law, practice and procedure relating to convening and proceedings at general and other meetings, recording and singing of minutes, role of chairman.

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Guwahati-
Date:

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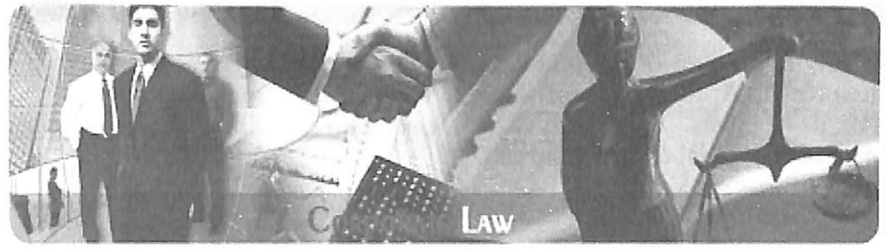

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CORPORATE PERSONALITY

COMPANY—ITS MEANING

A company in the normal sense means an association of persons united for a common object. Accordingly the term is used to represent associations formed to carry on some business for profit or to promote art, science, education or some charitable purpose.

Section 2(20) of the Companies Act, 2013 provides that "company means a company incorporated under this Act or under any previous company law."

Company is a voluntary association of persons formed for the purpose of doing business, having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from its members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession.

Lord Justice Lindley has given a comprehensive definition of a company. According to him,

"A company is an association of many persons

–who contribute money or money's worth,

–to a common stock and,

–employed for a common purpose.

–the common stock so contributed is denoted in money and is capital of the company.

–the persons who contribute it or to whom it belongs are members.

–the proportion of capital to which each member is entitled is his share.

–shares are always transferable although the right to transfer is often more or less restricted."

Another definition of company has been given by *Chief Justice* ***Marshall of U.S.A, "a corporation is an artificial being, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence."***[1]

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1. Dortmouth College v. Woodword, 4, Wheat (U.S) 518.

Thus a company exists only in the eyes of law and it has no physical existence. It is created by law and law alone can dissolve it. A company is a legal person separate from, and capable of surviving beyond the lives of, its members. A company is not merely a legal institution. It is rather a legal device for the attainment of any social or economic end.

CHARACTERISTICS OF A COMPANY

Incorporation offers many advantages to the enterpreneurs as compared with all other forms of business organisations. Partnership is a suitable form for a small scale business which can be managed by a small group of partners who take personal interest and there is mutual trust amongst them. But where the enterprise requires a large amount of capital, which the resources of a few persons cannot provide, the formation of a company is the only choice. Even for a small business, the choice of a company form is better because it offers the benefit of limited personal liability for business debts. As such, the company has become the most dominant form of business organisation.

These and other benefits (or features) of a company are discussed below.

1. Incorporated association : A company comes into existence on incorporation or registration under the Companies Act. A joint stock company may be incorporated under the Act either as a private or a public company. Minimum number of persons required for the purpose of incorporation is seven in the case of a public company and two in the case of a private company. However, Section 3 of the Company Act, 2013 permits formation of **"One Person Company"** also.

2. Separate legal entity : Once a company gets incorporated in the eyes of law, it is considered as a legal & separate entity independent of the individual persons who are its members. The company has the right to own property and right to transfer the property. No member can claim (individually or jointly) any ownership rights in the assets of the company during its existence as well as at the time of its winding up. The company can sue and be sued in its own name by its members as well as outsiders. The property of the company is not the property of the shareholders. A member can both own its shares and be its creditor at the same time. Such a member cannot be said to be a creditor of himself; but he is a creditor of the company.

The Leading case on this point is

Saloman V. Saloman and Co. Ltd. (1897)

Points decided are

(1) Company is a legal entity separate and distinct from the individuals who compose it.

(2) The company is not in law the agent of the subscribers or trustee for them.

Facts of the case are

Saloman had a boot business. He sold the business to a company named Saloman & Company Ltd., which he formed. There were seven members—his wife, daughter and four sons who took one share each and Saloman himself who took. 20,000 shares 1 UK Pounds. He purchase consideration was UK Pounds 39,000 and was discharged in the following manner. • 9,000 UK Pounds paid in cash. • Fully paid 20,000 shares of 1 UK Pounds each issued to Salomon. • Secured debentures issued to Salomon 10,000 UK Pounds. Owing to strike in the boot trade the company was wound up. After payment of mortgage debt and interest thereon, there were only 1,055 UK Pounds. While liabilities were 17,773 UK Pounds–Secured debentures held by Salomon 10,000 UK Pounds and Unsecured Creditors 7,773 UK Pounds. According to Salomon, his debentures were secured and hence he must get the remaining amount of 1,055 UK Pounds. Liquidator contention was that

Salomon should indemnify the company against whole of unsecured debt. House of Lords unanimously held that Salomon is separate from Salomon & Co. Ltd. Salomon, being secured creditor and hence got priority over unsecured creditors. Hence the secured debentures even though held by Salomon were to be paid in priority to unsecured creditors. The unsecured creditors got nothing.

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

Implications of separate legal entity. From the above characteristic that a company is distinct from the members who constitute it, the following consequences arise :—

- That the member has no insurable interest in the property of the company.;
- When the member dies, the company continues to exist. His share and not the assets of the company vest in his personal representatives;
- The nationality of the company does not depend on the nationality of the member;
- The company can sue and be sued in its own name.

3. Limited liability.

"Limited Liability" means **"you have to pay as much as you have agreed to pay."** " Unlimited Liability" means **"you have to pay as much as you owe."** It is the liability of a member to a company, which is limited. The company's liability is always unlimited. A company itself is always fully liable to pay its debts so long as there are assets available to pay the debts. Limited liability of members is another most important characteristic of a company. As a Company is a separate person, having its own name, identity, common seal and capacity to sue and be sued in its own name. Hence the liability of the Company is also its own and not that of its members. A Company's liability may be limited by shares or guarantee or unlimited as per its MOA.

Limited by Shares	Limited by Gurantee without Share Capital	Limited by Guarantee and having Share Capital	Unlimited Liability
Member's liability limited to amount unpaid on the shares held by each member.	Member's liability limited to amount guaranteed by him in the Memorandum.	Member's liability limited to the aggregate of guranteed amount and amount unpaid on Shares.	Member's liability is unlimited.

4. Separate property. Another characteristic of the company is that it is capable of owning, enjoying and disposing of property in its own name. It is a consequence of the fact that the company is a legal person. The property of the company will not be considered as the joint property of the members constituting the company, although the capital and assets of the company are contributed by members. A member does not even have an insurable interest in the property of the company.

The leading case on this point is

Macaura V. Northern Assurance Co. Ltd. (1925)

M was the holder of nearly all the shares except one of a timber company. He was also a substantial creditor of the company. He insured the company's timber in his own name. The timber

was destroyed by fire and M claimed the loss from the insurance company. It was held that the insurance company was not liable to him, because a shareholder cannot insure the company's property in his own name even if he is the owner of all or most of the company's shares.

5. Perpetual succession. Unlike a natural person a company never dies. Under Section 9 of the Companies Act, 2013, it is an entity with a perpetual succession. This means that the company being an entity separate and distinct from its shareholders, the life of a company is not measured by the life of any member; it is independent of the lives of its members.

The death or insolvency of a member does not affect the corporate existence of the company. A company is an immortal person. Members may come and members may go, but the company continues its operations unless it is wound up. A company is created by the process of law and can be put to an end only by the process of law. The existence of the company is not affected by the death of all the shareholders. Thus where all the members of a company were killed by a bomb, the company was deemed to survive. In such a case, the legal heirs of the deceased shareholders will become members.

6. Transferability of shares. Under Section 56 of the Companies Act, 2013, the shares of a company are freely transferable and can be sold or purchased in the share market. This is one of the reasons why people prefer to form companies than partnerships. A shareholder is therefore not permanently wedded to a company.

Section 44 of the Companies Act, 2013 provides that, "the shares, debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company." A shareholder can transfer his securities to any person without the consent of other members.

In a private company, there are certain restrictions and not prohibition on transfer of securities.

7. Common seal. As a company is an artificial person it cannot sign its name on a contract. So it functions with the help of a seal. Common seal is used as a substitute for its signature. Every company must have a seal with its name engraved on it. A rubber stamp does not serve the purpose. Anything done under an agreement between the company and the third party requires recognition of the company in the form of an official seal unless exempted by the Act. A document not bearing the common seal of the company is not authentic and as such is not binding on the company.

W.e.f. 29/5/15, The World "Common Seal" have been omitted from sec. 9. Therefore use of common seal is now optional and no more mandatory. If the company does not have a common seal, the authorization u/s 22(2) shall be made by 2 directors or by one director & CS-where ever company has appointed a company secretary.

Who has authority to put common seal. A company can empower any person to execute deeds under his seal (i.e. seal of the person who is authorized to sign). A deed signed by the authorized person under his seal is binding on the company as if the deed is signed under common seal of the company.

8. Capacity to sue and be sued. On incorporation a company acquires a separate and independent legal personality. As a legal person it can sue and be sued in its own name. A company may be sued for infringement of copyrights, negligence and contempt of court. A company may sue for an injury done to its business reputation by defamation.

9. **A company is not a citizen :** A company is a legal person (though artificial) in the eyes of law. It can hold property and can sue and be sued in its own name. But unlike a natural person it cannot acquire citizenship. There is no provision in the Companies Act or in constitution expressly conferring citizenship on a company. A company does not enjoy the fundamental rights which are enjoyed by a citizen. This has been very well explained in *State Trading Corporation of India Ltd. v. C.T.O. and others*[1] where

Justice Hidayatullah observed : "The members who form the incorporated company do not pool their status or personality. If all of them are citizens of India, the company does not become a citizen of India anymore than, if all are married, the company would be a married person."

ADVANTAGES OF INCORPORATION

In comparison to other business enterprices, an incorporated company enjoys the following benefits.

1. Artificial Legal Person. Unlike the partnership firm the company enjoy separate legal personality. So every associations on being incorporated, enjoys a distinct entity separate from members forming it.

2. Limited Liability. The Act limits the liability of member forming the company upto the face value of the shares or the guaranted amount as the case may be. This privilage is one of the principal advantage of doing business under a company form of organisation.

3. Prepetual Succession. On being incorporated, company enjoys a perpetual existence. The existence of company is in no way affected by the change in the constitution of company. Member may come, members may go, the company will continue for ever.

4. Transferability of Shares. As per the provisions of 2013 Act, shares are the movable property of the members & are transferrable as per the provisions of Articles of the respective company. This distinct advantage available to the company, grants liquidity to the shares, as they can be sold or purchased in the open market.

5. Infinite Membership. A public company enjoys infinite membership over the other forms of organisation. There is no restriction as to the maximum number of members in a public company. Thus, any number of persons can contribute to the functioning of public company.

6. Permanency of capital & protection to creditors. Buy back of shares is a privilage allowed to the company which enable the company to purchase its own shares. This provision gives the permanency to the capital & also protects the creditors in the events of winding up.

7. Moblisation of huge resources. Since any number of persons can contribute towards the capital of the company, huge resources can be mobilised in case the company starts an expansion & diversification activities.

8. Separate property. As established by the well known case of Macaura V. Northern Assurance Co. Ltd. that the company's property is different from the property of member. Thus member can neither use Company's property for its own personal purpose nor can claim any insurable interest in Company's property.

9. Ease in Control & Management. Since there in divorce between ownership and management in a company, the company is managed by in elected representatives called directors & moreover

1. (1963) AIR SC. 1811.

directors are highly professionalised and are capable to manage the company efficiently & effectively.

10. Capacity to Sue. A company acquires a separate and independent legal personality. As a legal person it can sue and be sued in its own name. A company may be sued for contempt of court, infringement of copy rights and negligence. It may sue for an injury done to its business reputation by defamation.

DISADVANTAGES OF INCORPORATION

1. Formalities. Incorporation of the company is coupled with many complex formalities, requiring considerable time, efforts & money. Even after the incorporation, many legal formalities are to be complied with by the company & there non compliance will attract penal consequences. Other forms of business organisations are comparatively free from such procedural formalities.

2. Corporate Disclosures. A company have to ensure maximum disclosure of information to the member of the company but the members have a limited accessability to the management & day to day working of the conern.

3. Divorce of control from ownership. Unlike the partnership firm, where partners have a direct control over its working, the members of the company do not have any effective control over its working. This is because of the fact that company is controlled by the elected representatives called directors.

4. Loss of privacy. Many corporate disclsoures are required to be made, & many documents are required to be kept at Registrar's office, its office becomes a public office & the documents so kept are public documents. So any person can inspect any document by paying a prescribed fees. Now this facility is available on the internet.

5. Detailed winding up procedure. The winding up procedure mentioned in Companies Act is very expensive & time consuming as compared to other business enterprises.

6. Control by few. The Company is controlled by only few persons with business background which are having very less financial stake in the business but on the contrary control the huge corporate economic resources.

7. More tax burden in certain cases. The tax implications have a crucial impact in the decision as to the selection of form of business organsiation. Company is liable to tax at a flat rate as compared to the sole proprietors who are taxed under slab system. Moreover different tax rates are applicable to different Companies like domestic Companies, foreign companies closely related companies etc.

8. Possibility of frauds. Since the company is controlled by few, there is a possibility that they will defraud the other parties, internal & external, related with the business. Manipulators so cleverly commit frauds, that it becomes difficult to fix the responsibilities.

LIFTING THE CORPORATE VEIL

One of the fundamental principles of company law is that a company has personality that is distinct from that of its shareholders. Once a company is formed and registered under the Act, it is a separate legal entity distinct from its members. It can sue and be sued in its own name. This rule was laid down by the House of Lords in *Salomon v. Salomon & Co*[1], in 1897 in which it was held that even if one individual held almost all the shares and debentures in a company, and if the remaining shares were held on trust for him, the company is not to be regarded as a mere shadow of that individual.

The principle of separate entity is regarded as a curtain, a veil, or shield between the company and its members, thus protecting the later from the liability of the former. The veil is impassable as an iron curtain. This theory of corporate entity is still the basic principle on which the whole law of corporations is based.

The concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Circumstances may occur which compel the courts to identify a company with its members. When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime the law will not regard the company as a corporate entity and pays regard to the economic realities behind the legal façade. It has long been established that the Courts will not allow the *Salomon* principle to be used as an engine of fraud, or to avoid pre existing legal obligations.

In reality the business of the artificial person is always carried on for the benefit of some individuals. Since an artificial person is not capable of doing anything illegal or fraudulent, the notion of corporate personality might have to be abandoned to identify the persons who are really guilty. This is known as 'lifting the corporate veil'.

The concept of lifting the corporate veil is a changing concept. It can be lifted for the benefit of the company too.

The circumstances under which the courts may lift the corporate veil may be discussed under the following two heads :—

(A) Common Law Exceptions. (Judicial interpretations)

(B) Statutory Exceptions.

(A) Common Law Exceptions :

It is very difficult to enumerate all the cases in which courts have lifted or might lift the veil. The corporate veil has been lifted or pierced by the courts in the following cases.

1. Determination of character. A company is not a natural person with mind or conscience. But it may assume an enemy character when persons in effective control of its affairs are residents in any enemy country or wherever residents are acting under the direction and control of enemies. In times of war the court will lift the veil to see whether a company is controlled by enemy aliens. Consequently, a company registered in England may be 'alien enemy' if its agents or the persons in defecto control of its affairs, are alien.

Daimler Co. Ltd. V. Continental Tyre and Rubber Co. Ltd. (1916)

Point decided is

A company may assume an enemy character when persons in *de facto control of its affairs are residents in any enemy country or wherever residents are acting under the control of enemies.*

Facts of the case are

C, a private company was incorporated in England for the purpose of selling the motor tyres manufactured in Germany by a German company. The German company held the bulk of the shares in company C and all the directors were Germans resident in Germany. During the First World War, C company commenced an action to recover a trade debt. The House of Lords held that the company C was an enemy company for the purposes of trading because its effective control was in enemy hands. Accordingly the company was debarred from maintaining the action. It would be against public policy to allow alien enemies to trade under corporate facade.

2. Where company is a sham. The court will lift the veil where the company is a mere cloak or sham i.e. where the device of incorporation is used for some illegal or improper purpose. Where a

person borrowed money from a company and invested it in three different companies in all of which he and his son were the only members, the lending company was permitted to attach the assets of all the three companies as they were created to hood wink the lending company.[1]

3. Prevention of fraud or improper conduct. Where it appears that the company was incorporated for evading contractual and statutory obligations, the court may disregard the separate existence of the company.

Gilford Motor Co. Ltd. V. Horne (1933)

Point decided is

The Court will refuse to uphold the separate existence of the company where it is formed for a fradulent purpose or to avoid legal obligations.

Facts of the case are

'Horne' entered into an agreement with his employer company that after the termination of the employment he would not socilit his employer's customers for a certain period of time. Soon after the termination of his employment he formed a company of which the two shareholders were his wife and one another person. The company sent out circulars to customers of his former employer. An injunction was granted against Horne and against the company he has formed restraining them from soliciting the plaintiff's customers.

The court held the company was a mere cloak for the purpose of enabling the defendant to commit a breach of his agreement against solicitation.

4. Where the company is acting as an agent of the share-holders. Where a company is acting as an agent of its shareholders or of another company, it will be liable for its acts.. However, it is a question of fact in each case whether the company is acting as agent for its shareholders. This question has frequently arisen in connection with government companies in India. A government company is not an agent of the State unless it is performing in substance governmental or sovereign functions.

Example : An English company was formed with a capital of 100 in 1 shares, 90 of which were held by an American the director of United States Film Company, and 10 were held by another director, a British subject. The company produced a film called 'monsoon' the production of which was financed by the company. The court refused to agree that the film was made by the British company, the company was merely the nominee or agent of United States Film Company.

[Re F.G. Films Ltd. (1953) 1 All E.R. 615.]

5. Protection of revenue. The courts may disregard the corporate entity of a company where it is used for tax evasion or to circumvent tax obligation.

Example : D was a wealthy man getting huge dividend and interest income. In order to avoid super tax, he formed four private companies and agreed with each to hold a block of investments as an agent for them. Dividends received were credited in the account of the company and the amount was handed back to him as a loan. Thus, he divided his income in four parts to avoid tax liability. The court held that as the companies did no business, the four companies were nothing more than he himself.

[In re Sir Dinashaw Mancekjee Petit A.I.R. 1927 Bom. 372].

6. Avoidance of welfare legislation. Avoidance of welfare legislation is as common as the avoidance of taxation. It is the duty of the court in such cases to get behind the smoke screen and discover the true state of affairs. Where the sole purpose for the formation of the new company was

1. P.N.B. Finance v. Shital Prashad (1983) 54 Comp. Cas 66.

to use it as a device to reduce the amount to be paid by way of bonus, the Supreme Court upheld the piercing of the veil to look at the real transaction

Example : A subsidiary was formed to split the profits of the company so that the incidence of bonus in the hands of the parent company will be reduced. The Supreme Court disregarded the existence of a separate company for the purpose of working out bonus for its employees. [Workmen of Associated Rubber Industry v. Associated Rubber Co. (1986) 59. Com. Case 132 S.C].

7. Punishment of contempt of court. Persons responsible for contempt of court can be punished, if contempt of court is done by a company. Courts can find real offender by lifting the corporate veil.

Example : A firm with two partners agreed to sell two floors to parties but cancelled the agreement. Litigation followed and the High Court restrained the firm from selling the property. In the meantime, a private company was floated by the two partners who being the only two shareholders became the Chairman and the Managing Director respectively and the property was transferred to the company. In spite of the restraint order of the High Court, the Company sold off the two floors. During the contempt proceedings, the partners of the firm took the plea that the sale had been made by the company and therefore, the firm had not disobeyed the court's order. It was held that, once the corporate veil is lifted, it is crystal clear that the orders of the court were disobyed by the respondents (i.e. partners)

[Jyoti Limited V. Kanwaljit Kaur Bhasin (1987) 62 Comp. Car. 626 (Delhi)].

8. Ascertaing true nature of transaction if alleged as sham. Court will be justified in lifting the corporate veil to ascertain the true nature of transaction as to who are the real parties to sale and whether it is genuine and *bonafide*.

Example : A private coal company sold its immovable property to the wives of directors prior to nationalisation of the company. In fact, documents were ante-dated to show that transaction was prior to nationalisation. It was held that if a transaction between company and wives of directors is alleged to be sham, the courts can pierce the veil of incorporation to ascertain the true nature of transaction. **[Subhra Mukherjee V. Bharat Cooking Coal Ltd. AIR 2000 Sc 1203].**

9. Determination of technical competence of company. The Supreme Court in a recent decision has delivered an interesting and very significant judgement with regard to lifting of corporate veil. The court held that the experience of the promoters and directors is the experience of the company.

Example :- A new company was formed as joint venture by other companies for the purpose of applying for a telecom tendor. The Company was new and had no experience in this field. However, its promoters had vast experience in the telecom field. The tender evaluation committee rejected the tender on the ground that the company has no experience in the field. The Supreme Court observed that in respect of such a joint venture, the experience of the company would include the experience of the constituents of the joint venture as well. **[New Horizons Ltd. V. Union of India (1995)].**

10. Formation of subsidiary Company to act as an agent. The Concept of lifting the corporate veil is a changing concept. It can be lifted for the benefit of the company too. The supreme Court in one of its recent decisions held that where the holding company hold 100% shares in a subsidiary company and the latter is created only for the purpose of the holding company, corporate veil can be lifted. [State of UP.V. Renusagar Power Co. (1991) 70 Comp. Car. 127].

(B) Statutory exceptions

The Act disregards the separate existence of the company in certain cases to check the misuse of the corporate personality by directors or members of the company. In other words, the benefit of 'separate entity' and limited liability may not be allowed to be enjoyed in certain circumstances.

Such cases are :—

1. Mis-statements in Prospectus (Sections 34 and 35)

A person, who has sustained any loss or damage as a consequence of mis-statement in prospectus, the company and every person who–

(a) is a director of the company at the time of the issue of the prospectus ;

(b) has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time ;

(c) is a promoter of the company ;

(d) has authorized the issue of the prospectus ; and

(e) Is an expert referred to in section 26(5).

Is liable to pay compensation to every person who has sustained such loss or damage (Section 35)

Further, these persons may be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable for fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. (Sections 34 and 447).

2. Mis-description of Company's name (Section 12)

According to Section 12 of the Companies Act, 2013, every company shall have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed. If any default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

Thus, the directors were held personally liable on a cheque signed by them in the name of the company stating the company's name as "L.R. Agencies Ltd.", the real name being "L and R Agencies Ltd."[1].

3. Failure to Refund Application Money (Section 39)

Where a company issues shares to the public and the minimum subscription as stated in the prospectus has not been received within 30 days of the issue of prospectus or such other period as may be prescribed by the SEBI, the application money shall be refunded within a period of 15 days from the closure of issue. Where such money is not refunded within such period, the directors and officers of the company in default shall be jointly and severally liable to repay that money with interest at the rate of 15 percent per annum.

In case of default, the company and its officers who are in default shall be liable to a penalty of one thousand rupees for each day during which such default continues to a maximum of ₹ one lakh.

4. Investigation of Ownership of Company (Section 216)

Section 216 empowers the Central Government to appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons –

1.Hendon V. Adelman and others 1973 New L. J. 637.

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

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

5. Fraudulent Conduct (Section 339)

Where in the course of the winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the Tribunal, on the application of the Official Liquidator, or the Company Liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that any person, who is or has been a director, manager, or officer of the company or any persons who were knowingly parties to the carrying on of the business in the manner foresaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Tribunal may direct.

Every person who was knowingly a party to the carrying on of the business in the manner as stated above, shall be punishable with imprisonment for a term which may extend to years, or with fine which may extend to fifty thousand rupees or with both.

6. Liability for *ultra vires* Acts

Every director and officer of the company will be personally liable for all those for all those acts which they have done on behalf of the company if the same are *ultra vires* the company.

Distinction Between Companies, and Partnership Firm

Sr. No.	Particular	Company	Partnership Firm
1.	**Governing Law**	Companies Act, 2013 and various Rules made thereunder	The Indian Partnership Act, 1932 and various Rules made thereunder
2.	**Registration/ Incorporation**	Compulsory	Optional
3.	**Nature**	A company is a body corporate formed and incorporated under the Companies Act, 2013 and which has legal entity separate from its members, having perpetual succession and liability of its members shall be limited.	Partnership is a relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all with unlimited liability.
4.	**Minimum Number of Members**	Minimum two for private Company and minimum seven for public company and minimum one for one person company as per the Companies Act, 2013.	Minimum two partners.
5.	**Maximum number of Members**	Maximum 200 in case of Private Company and no cap of maximum number of Member in Public Company as per the Companies Act, 2013.	Maximum 10 for banking business and 20 for other business.
6.	**Digital Signature**	Atleast one director of the company should have their Digital signature. Digital signature is a pre-requisite for e-filing.	Not Applicable. Documents are filed manually.

7.	**Director Identification Number/ Designated Partner/ Identification Number**	Each Director required to have a Director Identification Number before being appointed as a Director of any company.	No such require-ment.
8.	**Memorandum and Articles of Association/Partnership deed/Partnership Agreement**	Memorandum and Articles of Association is a charter of the Com-pany which defines its scope of operation.	Partnership Deed is a charter of the firm which denotes its scope of operation.
9.	**Drawing**	Drawings are not permitted.	Drawings are permitted.
10.	**Admission as partner/member**	A person can become a member by buying shares of a company.	A person can be admitted as a partner with the consent of all the partners.
11.	**Creation**	Created by law	Created by contract
12.	**Agency Relationship**	The Directors act as an agents of the company.	Partners are agents of the firm and each other.
13.	**Separate Legal Entity**	It is separate legal entity, separate from its member, directors.	It is not separate legal entity from partners. Partners are collectively referred as firm.
14.	**Perpetual succession**	It has perpetual succession.	It does not have perpetual succession.
15.	**Separate Property**	A company can purchase movable/ immovable property in its name.	Partnership firm cannot purchase movable/immovable property in its name, the same must be purchased in the name of partners.
16.	**Common Seal**	It denotes the signature of the Company and every company shall have its own common seal.	Not required
17.	**Formalities of Incorporation**	Various documents/ declarations executed in prescribed formats pre-filled in designated e-forms are required to be filled with ROC along with filing fee.	Partnership deed along with form/ affidavit required to be filed with Registrar of Firms alongwith requisite filing fees.
18.	**Legal Proceeding**	A company can sue and be sued	Only registered partnership can sue.
19.	**Taxation**	It is a separate taxable entity	It is a separate taxable entity
20.	**What must be included in Name**	Suffix 'Limited' or 'Private Limited' has to be added to the name	No such requirement.
21.	**Change of name**	The name of the company can be changed with the prior approval of Central Government.	The name of the Partnership firm can be changed.
22.	**Liability**	Liability of members is only limited to the shares held by them.	Liability of partners is **unlimited.**
23.	**Contracts/Business transaction by Member/ Directors/ Partners**	A director/member can enter into contract with the company.	A partner can not enter into contract with the firm.

24.	**Power of Member/ Partner /Director**	Directors have power to conduct day to day affairs of the company, Member practically have no say in the management.	All the partners have say in the day to day management of the firm or as specified in the partnership deed if there is any
25.	**Offences**	Company/directors are liable	Partners are personally liable
26.	**Electronic filling of documents**	Any documents required to be filed/ recorded/ registered has to be e-filed through affixing digital signature.	Any documents required to be filed/ recorded/ registered has to be submitted manually.
27.	**Transferability of shares or interest**	Shares of every company except private company are freely transferable.	Transferability of Interest subject to the mutual consent of all the members.
28.	**Share Certificate**	Right/Interest of the members in the company is denoted by share certificate.	There are no provisions for issuing of Share Certificate. Rights/Interest of the Partners in the firm are evidenced by Partnership deed, if any.
29.	**Jurisdiction of Company *Law Board (CLB)**	CLB has jurisdiction over the affairs of the company.	CLB has no jurisdiction.
30.	**Minimum Capital requirement**	Minimum paid up capital of Rupees One lac for incorporation of Private company and Rupees five lacs for incorporation of Public Company to be required.	No such requirement.
31.	**Books of Accounts**	Books of accounts must be prepared as specified in the Companies Act, 2013.	Not applicable
32.	**Manner of Keeping Books of Accounts**	Accrual basis	Cash or accrual basis
33.	**Filing of Annual Accounts**	Balance Sheet and Profit and loss account are required to be filled with the ROC annually in the prescribed format.	Not applicable
34.	**Audit of Accounts**	As per the provisions of companies Act, 2013 accounts have to be audited annually.	The Audit of accounts is as per the provisions of income tax act.
35.	**Mode of Service documents**	Documents to be served on company/directors may be served through electronic means.	Service of documents can not be served through electronic means.
36.	**Annual Return**	Annual Return is required to be filed with the ROC annually in the prescribed format.	Not applicable
37.	**Designated partner/Director/ Managing Partner**	Minimum two directors in case of Private company and minimum three in case of Public company.	No cap on the minimum number of Managing partner.
38.	**Need for Designated partner/ Director/ Managing Partner to be partner/ member**	Directors need not be a member of the company.	Managing partner shall be a partner of the firm.
39.	**Meetings**	Meeting of Board of Directors/Shareholders have to be held at specific time period as per the provisions of Companies Act, 2013.	No such requirement.

40.	**Publication of name**	Official correspondence/ publication/letter head/ invoices must mention the full name of the company and address of the registered office.	Not applicable
41.	**Rights/Duties/ obligation of Partners/ Managing/ Partners/ Directors**	*Rights/Duties/obligation of directors are governed by AOA and resolution passed by shareholders or directors.*	Rights/ Duties/ obligation of directors are governed by partnership deed.
42.	**Minutes**	*Decisions taken in the meeting of board of directors/shareholders must be recorded as minutes.*	Not applicable
43.	**Oppression and Mismanagement by majority shareholders**	Elaborate provision relating to redressal in case of oppression and mismanagement.	No such provisions
44.	**Voting Rights**	Voting rights are in proportion to the shares held by members.	Not applicable

SHORT ANSWER QUESTIONS

1. What do you understand by separate legal personality of a company ?
2. What do you understand by 'perpetual succession' of a company ?
3. State whether a company is a natural person, a legal person or an artificial person.
4. What is meant by limited liability ? Explain with the help of an example.
5. A shareholder of a company cannot claim to be the owner of its property during its existence. Why ?
6. A company continues to exist even if there is a death of all of its members. Why ?
7. Define corporate veil.

TEST QUESTIONS

1. Define the term 'company'. What are its characteristics ?
2. "A company is an artificial person, created by law with a perpetual succession and a common seal." Explain this statement.
3. "The fundamental attribute of corporate personality is that the corporation is a legal entity distinct from its members". Discuss fully.
4. Give the Advantages and Disadvantages of Incorporation.
5. What is a corporate veil ? When can it be lifted ?
6. "A company is a legal person distinct from its members taken individually or collectively". Discuss? Are there any circumstances in which the law would disregard the legal personality of a company ?
7. "A joint stock company is a legal person with perpetual succession and common seal." Examine this statement.
8. Distinguish between a Company and Partnership.

PRACTICAL PROBLEMS

Q. 1. S formed a company with a capital of 40,000. He sold his business to the company for 30,000, As a part payment for sale, he accepted 20,000 shares of 1 each. The balance of 10,000 was considered as loan and S secured the amount by the issue of debentures. His wife, daughter and four sons took one share each. Owing to strike the company was wound up. The assets of the company were valued at 6,000. The debts due to unsecured creditors were 7,000, S retained the entire sum of 6,000 as part payment of loan. The other creditors objected. Their contention was that a man could not own any money to himself, and the entire sum of 6,000 should be paid to them.

Examine the rights of S and other creditors. Who will succeed ?

Ans. S was entitled to the assets of the company as he was a secured creditor and the contention of the creditors that S and the company are one and the same person is wrong.

Q. 2. A public limited company has only seven shareholders. All the shares were fully paid up. The shares of one of the shareholders were sold in a court auction and were purchased by another shareholder of the company to the knowledge of all other shareholders. The company continued to carry on business thereafter. What would be its consequences ?

Ans. The remaining shareholders would be severally liable for the debts of the company contracted after six months of a shareholder having ceased to be a member.

□□□

2

KINDS OF COMPANIES

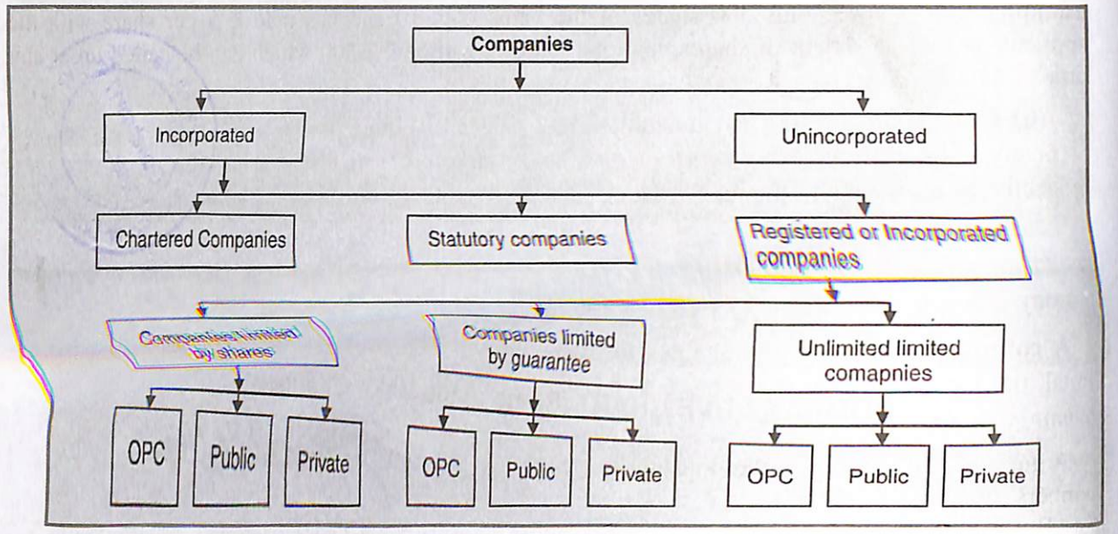
COMPARATIVE CHART (Some of the Major Changes)

Point of comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
Types of companies that can be formed	*15 Types of Companies.* In addition to the 10 types that could be formed under the 1956 Act as per Col. (3), following 5 new types of Cos. can be formed under 2013 Act: ♦ One person company (OPC) limited by shares ♦ OPC limited by guarantee & having share capital ♦ OPC limited by guarantee having no share capital ♦ OPC Unlimited Company having share capital ♦ OPC Unlimited Company having no share capital (For rules governing OPCs, see rules 3 to 7 of the Companies (Incorporation) Rules, 2014)	*10 Types as under.* ♦ Public company limited by shares ♦ Public Company limited by Guarantee & having share capital ♦ Public Company limited by Guarantee & having no share capital ♦ Public Unlimited company having share capital ♦ Public Unlimited Company having no share capital ♦ Private Company limited by shares ♦ Private Company limited by guarantee & having share capital ♦ Private Company limited by guarantee & having no share capital ♦ Private unlimited company and having share capital ♦ Private unlimited company and having no share capital

CLASSIFICATION

The following chart gives the classification of companies into various categories :

1. Chartered companies. The 'Crown' in the exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as chartered companies. Examples of this type of companies are Bank of England (1694), East India Company (1600). The powers and the nature of business of a chartered company are defined by the charter which incorporates it.



In earlier times trading companies were often created by a royal charter, but after it became possible to form companies by registration, this happened only in rare instances and these days charters are mainly issued to non-trading corporations. After the country attained independence, these types of companies do not exist in India. Moreover, the provisions of Companies Act, 2013 do not apply to such companies.

2. Statutory companies. A company may be incorporated by means of a special Act of the Parliament or any State Legislature. Such companies are called statutory companies. Such companies are generally formed to carry out some special public undertaking, for example, railway, waterworks, gas, electric generation etc. Instances of statutory companies (which are also known as public corporations) in India are Reserve Bank of India, the Life Insurance Corporation of India, the Food Corporation of India, Unit Trust of India, State Trading Corporation etc.

Statutory companies are governed by the Acts creating them. They are not required to have any memorandum or articles of association. Changes in their structure are possible only by amendments in the Acts creating them. The annual report on the working of each statutory company is required to be placed on the table of the Parliament or the State Legislature as the case may be. A statutory company though owned by the government has a separate legal entity. It cannot be regarded as a department of the government.

The provisions of the Companies Act, 2013, apply to the statutory companies except where the said provisions are inconsistent with the provisions of the Act creating them.

3. Registered or Incorporated companies. Companies registered under the Companies Act, 2013, or the earlier Companies Acts are called registered companies. Such companies come into existence when they are registered under the Companies Act and a certificate of incorporation is granted to them by the Registrar. A company registered under the Act may be *(a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.*

(a) Companies limited by shares. [Sec. 2(22) of Companies Act, 2013]. In a company limited by shares the liability of the members is limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them. The liability can be enforced during the existence of the company as well as during the winding up. Where the shares are fully paid up, no further liability rests on them. The Companies limited by shares may be either 'private' or public companies. For

example, if a person holds 500 shares of the value of ₹ 10 and has paid ₹ 5 per share with the application and allotment of shares, his total liability will be ₹ 2,500 which can be called up at any time.

(b) Companies limited by guarantee. [Sec. 2(21) of Companies Act, 2013]. It is a registered company public or private, in which the liability of members is limited to such amounts as they may respectively undertake in the memorandum to contribute to the assets of the company in the event of its being wound up. In the case of such companies, the liability of its members is limited, to the amount of guarantee undertaken by them. The members are not required to contribute while the company is a going concern.

A **company limited by guarantee may or may not have a share capital**. If it has a share capital, the liability of the members is two fold ; *(i) liability to pay the share amount ; and (ii) the amount guaranteed.*

A guarantee company without share capital does not obtain its initial and working funds from its members, but from some other source or sources *e.g.*, grants, endowments, fees, subscriptions and the like. But a gurantee company having a share capital raises its initial capital from its members, while the normal working funds would be provided from other sources such as fees, charges, etc. The Companies limited by guarantee may also be either Private or Public Companies.

Every company limited by guarantee must have its memorandum and articles of association. The memorandum shall state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member for payment of the debts and liabilities of the company such amount as may be required not exceeding a specified amount. In other words, the members give guarantee that when the company is to be wound up, they will contribute a certain fixed amount towards the assets of the company, if those assets are not sufficient to pay its debts.

(c) Unlimited companies. [Sec. 2(92) of Companies Act, 2013]. A company not having any limit on the liability of its members is termed as unlimited company. In such a company the liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members. The articles shall state the number of members with which the company is to be registered and if the company has a share capital, the amount of share capital with which the company is to be registered. Such companies are rarely formed.

There are two varieties of each of these kinds of companies. *i.e.* companies limited by shares, companies limited by gurantee and unlimited companies. A company may be companies limited by gurantee and unlimited companies either a public company or a private company.

PRIVATE AND PUBLIC COMPANIES

Private Company [Sec. 2(68)]. A private company is a very suitable form for carrying on the business of family and small concerns as the minimum number of members required is only two. [Sec. 2(68)] of the Companies Act, 2013 deals with the definition of a private company.

Note. Companies (Amendment) Act, 2015 has amended section 2(68) of the Companies Act, 2013. Now there is no requirement of minimum paid up capital for a private company. [w.e.f. 29-5-15].

The definition of private company is quoted u/s 2(68) of the Companies Act, 2013. **It means a company which has *a minimum paid-up capital as may be prescribed, and* by its articles :—**

(i) **restricts** the right to transfer its shares ;

(ii) **limits** the numbers of its members to two hundred (excluding members who are or were in the employment of the company) ; [Maximum no. has been increased from 50 to 200 as per Companies Act, 2013].

(iii) **prohibits** any invitation to the public to subscribe for any shares or debentures of the company; and

Features of Private Company

(i) Restriction on transfer of shares [Sec. 2(68)(i)]. The shares of public companies are freely transferable as they are now in the demat form. But in case of private companies the Articles contain a provision restricting the right to transfer its shares.

(ii) Limitation of membership [Sec. 2(68)(ii)]. The articles must contain a provision whereby the company limits the number of its members (exclusive of employees who are members and ex-employees continuing to be members) to 200 ; in counting the number of shareholders, joint-shareholders are treated as a single member.

It is worth noting that it is only the number of members that is limited to two hundred (200). Private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures cannot be made.

(iii) Prohibition on inviting Public to Subscribe for Securities [Sec. 2 (68) (ii)]. The articles of a private company must prohibit an invitation to the public to subscribe for any shares, debentures or any other securities of the company. In other words' this requirement will mean that a private company must not make public issue or publish any advertisement inviting investments or adopt any other method of inviting public investment in its securities. A private company can only collect its capital through private sources. 'Private sources' shall mean giving opportunity of investment to the persons approached and not to others.

Other requirements for a private company

- It may be noted that there should be minimum of two persons to form a private company. According to section 3, for forming a private company, two or more persons are required to subscribe their names to a Memorandum of Association.
- Any person who is competent to contract can be a subscriber. A company being a legal person can subscribe but a partnership firm cannot do so.
- A minor cannot be a signatory to the Memorandum since he is not competent to contract. A private company must write at the end of its name 'private limited' or any other acceptable abbreviation, such as 'Pvt. Ltd.'.
- If a private company fails to company with any of the restrictions contained in the articles, it ceases be entitled to some of the privileges of a private company.

Public Company [Sec. 2(71)]. The definition of a public company has undergone a substantial change with the passing of the Companies (Amendment) Act, 2015. *According to the Section 2(71) of the Companies Act, 2013, A public company means a company which*

(a) is not a private company

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

(c) is a private company which is a subsidiary of a public company.

Thus, a public company is one that is not a private company.

Note. As per Companies (Amendment) Act 2015, there is no requirement of minimum paid up capital for a Public Company (w.e.f. 29/5/15).

Further, a private company which is a subsidiary of a public company will also be a public company. *All private companies that are subsidiaries of public companies shall continue to avail the privileges of a private company.*

The requirements as to minimum capital adequacy at the time of incorporation of a private company/public company and maintenance of minimum capital by existing private and public companies have been abolished by the Companies (Amendment) Act, 2015.

There must be at least seven persons to form a public company. Generally speaking, any member of the public many acquire shares in a public company on payment of the share money. Only the shares of a public company are capable of being dealt in on a stock exchange. A company is a public company unless it is clear from its constitution that it is a private company.

Privileges of a private company. The provisions of the Companies Act apply to public and private companies alike. But certain provisions of the Companies Act do not apply to private companies but are applicable to public companies. These may be regarded as the privileges or advantages of a private company.

The basic reason for granting these privileges and exemptions is because in a private company the money is raised from few people and generally they belong to the same family or group. But in case of public companies where the money is raised from general public and the number is quite large, it is necessary to safeguard their interests, hence several restrictions are put on public companies.

The following privileges and exemptions are available to a private company.

1. Number of Members. A private company may consist of two members only (except in the case of one person company,) as against seven persons in the case of public company.

2. Minimum Number of Directors. A private company need not have more than two directors whereas a public company must have minimum three directors. (Section 149).

3. Quorum for General Meeting. Unless Articles provide for a higher number, quorum required for the general meeting of the shareholders of a private company is two persons personally present as against five persons in case of a public company. (Section 103).

4. Rotation of Directors. Directors of a private company need not retire by rotation every year whereas directors of a public company have to retire by rotation every year. (Section 152)

5. Managerial Remuneration. No restrictions have been imposed on the remuneration payable to the directors of a private company. But certain restrictions have been imposed on the remuneration payable to the directors of a public company. Section 197 of the Companies Act, 2013 provides that total managerial remuneration payable to the directors of a public company cannot exceed 11 percent of the net profits.

6. Special disqualifications for appointment as directors. A private company may, by its articles of association, provide for special disqualifications for appointment of directors in addition to those contained in section 164(1 and 2) [Section 164(3)].

7. Rotational Retirement of Directors - All directors of a private company can be non-rotational directors [Section 152]. However, it does not mean that they cannot be removed throughout their life or life of the company or before the expiry of the period for which they were appointed.

8. Filling casual vacancies - The provisions relating to manner of filling of casual vacancies among directors and the duration of the period of office of those so appointed do not apply to a private company [Section 161].

9. Independent Directors - A private company is exempted from the requirement of appointment of independent director [Section 149].

10. Audit Committee - A private company is not required to constitute audit committee of the Board [Section 177].

11. Under section 43, a private company may issue shares other than equity or preference shares, if so provided in its Memorandum or Articles of Association – (*Vide MCA Notification* dated 5-6-2015)

12 In case of rights issue under section 62, as against minimum period of 15 days, a private company may close its offer of rights issue before that. In other words, it need not keep its rights issue open for minimum period of 15 days – (*Vide MCA Notification dated 5-6-2015*)

13. For issue to its employees under Employee's Stock Option Scheme, a private company may pass an ordinary resolution as against special resolution – (*Vide MCA Notification* dated 5-6-2015)

14. Under section 67, if certain conditions are satisfied, a private company may purchase its own shares or finance purchase of its own shares – (*Vide MCA Notification dated 5-6-2015*)

15. Provisions of section 101 to 107 and section 109 relating to general body meetings shall not apply to a private company if Articles of the company Provide otherwise – (*Vide MCA Notification dated 5-6-2015*)

16. As per MCA Notification dated 5-6-2015, provisions of sections 160, 162 and 180 shall not apply to private companies.

17. Under section 185, if certain conditions are satisfied, a private company may give loan to its directors – (*Vide MCA Notification dated5-6-2015*)

18. With respect to the number of companies (maximum 20) of which a person may be appointed as an auditor under section 141, private companies will not be included – (*Vide MCA Notification dated 5 – 6 – 2015*)

When a Private Company Loses its Privileges ?

A private company loses its privileges when it fails to comply with the essential requirements of a private company as given in section 2(68). Default in complying with the said provisions shall disentitle a private company from the privileges and exemptions it is entitled to. Also when a private company ceases to be a private company by choice or by operation of law, it loses its privileges.

Disadvantages of a Private Company

(i) A private company cannot issue share warrants payable to bearer.

(ii) U/s 92, a private company has to file its annual list of member and summary with the registrar.

(iii) A private company's member cannot appoint more than one proxy to attend and note in the company meeting.

(iv) A private company has to send certificate to Registrar stating its annual turnover in the preceding 3 years never reached rupees one crore or more.

Distinction between a public company and a private company

Public Company	Private Company
Minimum Number of Members	
1. The minimum number of persons required to form a public company is seven.	The minimum number of members required to form a private company is only two (except for a one person company).
Maximum Number of Members	
2. There is no limit on the maximum number of members of a public company.	A private company cannot have more than two hundred members excluding past and present employees.
Restriction on Name	
3. The name of public company must end with the word 'Limited'.	But a private company must add the words 'Pvt. Ltd.' at the end of its name.
Invitation to Public	
4. A public company by issuing a prospectus may invite public to subscribe to its shares	A private company cannot extend such invitation to the public.
Transferability of Shares	
5. There is no restriction on the transfer of shares in the case of a public company. Demat Shares are now freeely transperable.	A private company by its articles must restrict the right of members to transfer the shares.
Issue of Share Warrants	
6. A public company can issue Share Warrants.	Private Company can not issues Shares Warrants
Further Issue of Capital	
7. A public company proposing further issue of shares must offer them to the existing members.	A private company is free to allot new issue to outsiders.
Number of Directors	
8. A public company must have at least three directors.	A private company may have two directors.
Statutory Meeting	
9. A public company must hold a statutory meeting and file with the Registrar a Statutory Report.	A private company need not hold statutory meeting and hence no such obligations.
Quorum	
10. If the articles of a company do not otherwise provide the quorum is five members personally present in the case of a public company.	The quorum in the case of private companies is two members personally present.
Restrictions on the Appointment of Directors	
11. A director of a public company shall file with the Registrar consent to act as such. He shall sign the memorandum and enter into a contract for qualification shares. He cannot vote or take part in the discussion on a contract in which he is interested. Two-thirds of the directors of a public company must retire by rotation.	These restrictions do not apply to a private company.

Managerial Remuneration	
12. Total managerial remuneration in the case of a public company cannot exceed 11% of net profits.	This restriction does not apply to a private company.

CONVERSIONS

CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

Section 14 of the Companies Act, 2013, lays down the following procedure for conversion of a public company into a private company.

1. Special Resolution. A special resolution shall be passed authorizing the conversion of a public company into a private company altering the articles so as to remove the restrictions contained in Section 2(68).

2. Name of the Company. Company's name shall be changed by adding the words 'Private' before the word *'limited'*.

3. Approval of the Tribunal. Section 14(1) of the Companies Act, 2013 provides that any alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Tribunal and the Tribunal shall make such orders as it may deem fit.

4. Filing with the Registrar. A copy of the approval along with a printed copy of the altered Articles are to be filed with the Registrar within a period of fifteen days in the prescribed manner and the Registrar shall register the same. [Section 14(2)].

Any alteration of the articles registered under section 14(2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

According to Section 14 of the Companies Act, 2013, a private company can be converted into a public company by undertaking the following steps :

1. Special Resolution. A private company can convert itself into a public company by amending its articles of association. Section 14 of the Companies Act provides that a private company can amend its articles by passing a special resolution altering the articles so as to delete the restrictions specified in section 2(68).

2. Changing the Name. Company's name shall be changed by adding the word 'Private' before the word 'Limited'.

3. Approval of the Tribunal. Section 14(1) of the Companies Act stipulates that no alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Tribunal which shall make such order as it may deem fit.

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

Any alteration of the articles registered under this section shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

CONVERSION OF COMPANIES ALREADY REGISTERED

Section 18 of the Companies Act, 2013 provides that a company of any class registered under this Act may re-register itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of Chapter II of the Act.

The registration of a company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before re-registration and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done.

ONE PERSON COMPANY

A new concept of 'one person company' has been incorporated in the Companies Act, 2013. This concept is widely accepted in developed countries like the UK and one of our neighbouring countries-China. Minimum two members are required to form a private company and minimum seven members are required for a public company under the Companies Act. This is looked as a barrier by businessmen and professionals who do not want any participant in business. But with introduction of one person company it will be possible to form a company with only one member. One person company provides benefit of both forms of business– Proprietorship and Company. With formation of an one person company business can be run in same way as a proprietorship, of course, by complying with law and keeping liability of the member limited by share or guarantee, as the case may be.

Section 2(62) of the Act defines one person company. As the name suggests, it means a company which has only one person as a member and where legal and financial liability is limited to the company only and not to that person (i.e., liability is limited). Section 2(68) of the Act provides for the definition of a private company to include one person company. This implies that all the provisions of the Act applicable to a private company shall also be applicable to an one person company, unless otherwise excluded from the compliance. Also section 3 of the Act, further clarifies the fact that one person company shall be treated as a private company for all legal purposes with only one member.

FORMATION OF ONE PERSON COMPANY (OPC)

The 2013 Act allows the formation of a one person company (OPC).

The following provisions regarding formation of OPCs may be noted :

1. For forming a private company being a one person company, *one person should subscribe his name to memorandum and comply* with the requirements of the 2013 Act in respect of registration. (Section 3(1)(c) of the 2013 Act.)
2. Only an Indian citizen and resident of India is eligible to incorporate a one person company. This means body corporates and persons resident outside India cannot set up.
3. To ensure smooth perpetual succession of OPCs, the first proviso to section 3(1) of the 013 Act *provides that the memorandum should indicate the name of the other person (nominee) who shall become the member* of the company in the event of the subscriber's death or his incapacity to contract. Prior consent of the nominee should be obtained in prescribed form for mentioning his name in memorandum. Such written consent shall be filed with Registrar of Companies at the time of incorporation of the OPC along with its memorandum and articles.

4. *The nominee person may withdraw his consent* in such manner as may be prescribed. (Second proviso to section 3(1) of the 2013 Act).
5. *The member of the OPC may at any time change the nominee* in such manner as may be prescribed. (Third proviso to section 3(1) of the 2013 Act).
6. *The member of a One Person Company shall intimate the company the change*, if any, in the name of the person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed. The company shall intimate such change to ROC within such time and in such manner as may be prescribed. (Fourth proviso to section 3(1) of the 2013 Act). Such change in the name of the nominee shall not be deemed to be an alteration of the memorandum (Fifth proviso to section 3(1) of the 2013 Act).

Penalty. Where a one person company or any of its officer contravenes the provisions, then a fine shall be composed which may extend to ten thousand rupees and a further fine which may extend to one thousand rupees for everyday of default.

CONVERSION OF OPC INTO PRIVATE COMPANY OR PUBLIC COMPANY

One Person Company to convert itself into a public company or a private company in certain cases.

(1) Where the paid up share capital of an One Person Company exceeds fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees, it shall cease to be entitled to continue as a One Person Company.

(2) Such One Person Company shall be required to convert itself, within six months of the date on which its paid up share capital is increased beyond fifty lakh rupees or the last day of the relevant period during which its average annual turnover exceeds two crore rupees as the case may be, into either a private company with minimum of two members and two directors or a public company with at least of seven members and three directors in accordance with the provisions of section 18 of the Act.

(3) The One Person Company shall alter its memorandum and articles by passing a resolution in accordance with sub-section (3) of section 122 of the Act to give effect to the conversion and to make necessary changes incidental thereto.

(4) The One Person Company shall within period of sixty days from the date of applicability of sub-rule (1), give a notice to the Registrar in **Form No. INC. 5** informing that it has ceased to be a One Person Company and that it is now required to convert itself into a private company or a public company by virtue of its paid up share capital or average annual turnover, having exceeded the threshold limit.

(5) A One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to two or minimum of seven members and two or three directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion.

Conversion of Private Company into One Person Company

(1) A private company other than a company registered under section 8 of the Act having paid up share capital of fifty lakhs rupees or less or average annual turnover during the relevant period is two

crore rupees or less may convert itself into one person company by passing a special resolution in the general meeting.

(2) Before passing such resolution, the company shall obtain No objection in writing from members and creditors.

(3) The one person company shall file copy of the special resolution with the Registrar of Company within thirty days from the date of passing such resolution in **Form No. MGRT. 14.**

(4) The company shall file an application in **Form No. INC 6** for its conversion into **One Person Company** along with fees as provided in the Companies (Registration Offices and Fees) Rules, 2014, by attaching the following documents, namely :–

(i) the directors of the company shall give a declaration by way of affidavit duly sworn in confirming that all members and creditors of the company have given their consent for conversion, the paid up share capital company is fifty lakhs rupees or less or average annual turnover is less than two crores rupees, as the case may be ;

(ii) the list of members and list of creditors ;

(iii) the latest Audited Balance Sheet and the Profit and Loss Account ; and

(iv) the copy of No Objection letter of secured creditors.

(5) On being satisfied and complied with requirements stated herein the Registrar shall issue the Certificate.

DIFFERENCE BETWEEN ONE PERSON COMPANY AND SOLE PROPRIETORSHIP

OPC is a separate legal entity that distinguishes between the promoter and the company which is not the same as sole proprietorship. An important difference between a sole proprietorship and OPC is the way liability is treated in the latter. A start-up that registers as an OPC is that it de-risks the business by transferring the promoters' liability to the company. Thus, OPC allows an individual to take risks without risking his or her personal assets.

The promoter's liability in sole proprietorship is not restricted and extends to the individual and his entire assets. In OPC, on the other hand, promoter's liability is limited in the event of default. The OPC is an artificial entity separate from its owner. Creditors should be warned that their claims against the business cannot be pressed against the owner.

The law requires all OPCs to have a suffix a such as OPC to warn creditors about this risk. In addition to this, OPC has to abide by other legal requirements as well to register itself. This is not true for sole proprietorship. Lastly, there is a difference between the two in terms of the taxes paid. Under sole proprietorship tax is paid by the owner whereas under OPC it is separate.

GOVERNMENT COMPANIES

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

(i) the Central Government ; or

(ii) any State Government or Governments ; or

(iii) partly by the Central Government and partly by one or more State Governments. A subsidiary of a government company will also be treated as a government company.

Bharat Heavy Electricals Ltd., State Trading Corporation of India Ltd. are examples of government companies.

Certain special provisions have been laid down in the Act regarding government companies.They are discussed below :

1. Appointment of auditor. The auditor of a government company shall be appointed or re-appointed by the Comptroller and Auditor-General of India. The Comptroller and Auditor- General of India will have the power to direct the manner in which the company's accounts shall be audited by the auditor. [u/s 139(5)]

2. Audit report. The auditor will submit a copy of the audit report to the Comptroller and Auditor General of India who may comment upon or supplement the audit report in such manner as he may think fit. Such comments or supplementary report shall be placed before the annual general meeting alongwith the audit report.

3. Annual reports. Where the central government is a member of the government company it shall cause an annual report on the working and affairs of the company to be prepared and laid before both houses of Parliament alongwith the audit report and the comments, if any, of the Comptroller and Auditor General of India. The report shall be prepared within 3 months of the annual general meeting. Where the state government is also a member, the report shall also be laid before the state legislature. But where the central government is not a member of the government company, the state government concerned shall cause the above documents prepared and laid before the state legislature. [u/s 394]

FOREIGN COMPANIES [SEC. 2(42)]

Section 2(42) of the Companies Act, 2013 defines foreign company as, "any company or body corporate incorporated outside India which –

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

(b) conducts any business activity in India in any other manner.

The Companies Rules, 2013 explain the meaning of the phrase electronic mode.

The phrase 'electronic mode' means carrying out, business electronically including, but not limited to :

(i) business to business and business to consumer transactions, data interchange and other digital supply transactions ;

(ii) offering to accept deposits or subscriptions in India or from citizens of India;

(iii) financial settlements, web based marketing, advisory and transactional services database services and products, supply chain management ;

(iv) online services such as telemarketing, telecommuting, telemedicine, education and information research ; and

(v) all related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

Whether a company is a foreign company or Indian company, will mainly depend on the incorporation of the company. Incorporation is the nationality of the company, and it may have

nationality different from its shareholders. A company having all foreign shareholders may be incorporated in India and in that case the company will be an Indian company. Similarly a company may be incorporated in England having shareholders who are all Indian citizens and the company will be a foreign company.

Sections 379 to 393 of the Companies Act, 2013 deal with companies incorporated outside India. The provisions of these sections are discussed as under :

1. Act to apply to Foreign Companies (Section 379)

According to Section 379, where not less than fifty per cent of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXII and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India. Thus, this section provides that where not less than 50 percent of the paid-up capital of a foreign company is held by one or more citizens of India, such company shall comply with provisions as if it were a company incorporated in India.

2. Delivery of Documents (Section 380)

Every foreign company shall, within 30 days of the establishment of the business in India, furnish with the Registrar for registration the following documents :

(i) A certified copy of the charter, statute, memorandum and articles of the company, containing the constitution of the company and if the instrument is not in English language a certified translation thereof.

(ii) The full address of the registered or principal office of the company.

(iii) A list of the directors and secretary of the company with particulars as to name, nationality etc.

(iv) The name and address of any person or persons resident in India, authorized to accept service of legal processes and notices on behalf of the company.

(v) The full address of the principal place of business in India.

(vi) Particulars of opening and closing of a place of business in India on earlier occasion or occasions.

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

(viii) Any other information as may be required.

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

3. Accounts of Foreign Company (Section 381)

Every foreign company shall, in every calendar year :

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

(b) deliver a copy of those documents to the Registrar. However, the Central Government may, by notification, direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) shall not apply, or shall apply subject to such exceptions and modifications as may be specified in that notification. [Section 381 (1)].

If any such document as is mentioned in sub-section (1) is not in the English language, there shall be annexed to it a certified translation thereof in the English language. [Section 381 (2)].

(c) Every foreign company shall send to the Registrar along with the documents required to be delivered to him under sub-section (1), a copy of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in sub-section (1) is made out. [Section 381 (3)].

4. Display of name, etc. (Section 382)

Every foreign company shall :

(a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated;

(b) cause the name of the company and of the country in which the company in incorporated, to be stated in legible English characters in all business letters, bill-heads and letter paper, and in all notices, and other official publications of the company; and

(c) If the liability of the members of the company is limited, cause notice of that fact :

(i) to be stated in every such prospectus issued and in all business letters, bill-heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and

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

5. Service of documents (Section 383)

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

6. Debentures, annual return, registration of charges, books of account and their inspection (Section 384)

(1) The provisions of section 71 which deal with issue of debentures shall apply to a foreign company as well.

(2) The provisions of section 92 which deal with the preparation and filing of annual return shall, subject to such exceptions, modifications and adaptations as may be made therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.

(3) The provisions of section 128 shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India the books of account referred to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

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

(5) The provisions of Chapter XIV shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

7. Fee for registration of documents (Section 385)

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

8. Interpretation (Section 386)

For the purposes of the foregoing provisions of this Chapter :

(a) the expression "certified" means certified in the prescribed manner to be a true copy or a correct translation;

(b) the expression "director", in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act; and

(c) the expression, "place of business" includes a share transfer or share registration office.

9. Particulars to be contained therein (Section 387)

A foreign company may, even if it has no place of business in India, issue a prospectus offering shares or debentures for subscription. But, the prospectus shall have to comply with the provisions of sections 387 to 389 of the Act relating to prospectus.

In addition to the general requirements of the Act, section 387 requires the prospectus of a foreign company to contain particulars with respect to the following matters : -

(a) contains particulars with respect to the following matters, namely :-

(i) the instrument constituting or defining the constitution of the company;

(ii) the enactments or provisions by or under which the incorporation of the company was effected;

(iii) address in India where the said instruments, enactments or provisions, or copies thereof, and if the same are not in the English language, a certified translation thereof in the English langauage can be inspected;

(iv) the date on which and the country in which the company would be or was incorporated; and

(v) whether the company has established a place of business in India and, if so, the addr

10. Registration of prospectus (Section 389)

No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless before the issue, circulation or distribution of the prospectus in India, a copy thereof certified by the chairman and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered, and there is endorsed on or attached to the copy, any consent to the issue of the prospectus required by section 388 and such documents as may be prescribed.

11. Offer of Indian Depository Receipts (Section 390)

Notwithstanding anything contained in any other law for the time being in force, the Central Government may make rules applicable for :

(a) the offer of Indian Depository Receipts.

(b) the requirement of disclosures in prospectus or letter of offer issued in connection with Indian Depository Receipts;

(c) the manner in which the Indian Depository Receipts shall be dealt with in a depository mode and by custodian and underwriters; and

(d) the manner of sale, transfer or transmission of Indian Depository Receipts, by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

12. Penalty for contravention (Section 392)

Without prejudice to the provisions of section 391, where a foreign company fails to comply with any of the provisions of this Chapter, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees for every day during which the default continues and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

HOLDING AND SUBSIDIARY COMPANIES

Hodling and subsidiary companies are relative terms. A company which controls another company is known as the 'holding company' and the company so controlled is called as 'subsidiary company'.

Holding Company. According to section 2(46) of the Companies Act, 2013, "holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary Company. According to section 2(87) of the Companies Act, a "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company :

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

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies. Total share capital means paid up equity share capital and paid up preference share capital.

However, such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation. For the purposes of this clause, :

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

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

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

The following illustration will make the definition of holding and subsidiary company clear. A company (say X) is a subsidiary of another company 'Y' and Y is X's holding company if :

(i) Y is a member of X and controls the composition of X's board of directors; or

(ii) Y holds more than half of X's equity share capital ; or

(iii) X is Subsidiary of a third company (Z), which is itself a subsidiary of Y.

Subsidiary Company Not to Hold Shares in its Holding Company (SECTION 19)

No company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void. However, this provision will not apply in the following cases :

(a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a trustee; or

(c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

It is further provided that the subsidiary company referred to in the preceding proviso shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee, as referred to in clause (a) or clause (b) of the said proviso.

Although a holding company is a large shareholder of its subsidiary, yet both are distinct legal entities and in the absence of a contract of agency between two companies, one cannot be said to be the agent of the other.[1] A holding company cannot sue to enforce rights which belong to its subsidiary company.

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1. Turner Morrison & Co. Ltd. v. Hungerford Investment Ltd. AIR (1969) Cal 238.

COMPANIES WITH CHARITABLE OBJECTS

Section 4 of the Companies Act, 2013 requires that the name of a public company must end with word 'limited' and in the case of a private company with the words 'private limited'. Section 8, however, provides that the Central Government may by licence direct that any association be registered as a company with limited liability without using the words 'limited' or the words 'private limited'.

(a) the association about to be formed as limited company aims at the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object; and

(b) it intends to apply its profits, if any, in promoting its objects; and

(c) it prohibits the payment of any dividend to its members.

On the above conditions being fulfilled such an association may be registered accordingly and on registration shall enjoy all the privileges and be subject to all the obligations of limited companies. Thus, a association registered under section 8 becomes a body corporate with perpetual succession. [Section 8(1) and (2)].

It can adopt in lieu of company a more suitable name such as club, chamber, society, association. It can sue and be sued in its own name. A firm may be a member of the company registered under this section [Section 8(3)]. A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government. A company registered under this section may convert itself into company of any other kind only after complying with such conditions as may be prescribed [Section 8(4)].

OTHER KINDS OF COMPANIES

1. Small Company [Section 2(85)]

The concept of small company has been incorporated for the first time in the Companies Act, 2013. According to section 2(85) of the Companies Act, small company means a company, other than a public company :

(i) paid up share capital of which does not exceed 50 lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

(ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

However, the following companies are not treated as small companies :-

(a) a holding company or a subsidiary company ;

(b) a company registered under section 8 ; or

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

2. Listed Company [Section 2(52)]

A listed company, according to Section 2(52) of the Companies Act, means a company which has any of its securities listed or any recognized stock exchange.

3. Dormant Company (Section 455)

According to Section 455 of the Companies Act, where a company is formed and registered under the Companies Act, 2013 for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar seeking the status of a dormant company.

The term *inactive company* means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

The term *significant accounting transaction* means any transaction other than–

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

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

(c) allotment of shares to fulfil the requirements of this Act ; and

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

4. Unregistered Companies (Section 375)

According to section 375 of the Companies Act, an unregistered company is defined as to include any partnership firm, limited liability partnership or society or co-operative society, association or company consisting of more than seven members at the time when the petition for winding up the partnership firm, limited liability partnership or society or co-operative society, association or company, as the case may be, is presented before the Tribunal.

The term 'unregistered' company shall not include :

(i) a railway company incorporated under any Act of Parliament or other Indian law or any Act of Parliament of the United Kingdom ;

(ii) a company registered under this Act ; or

(iii) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden, Pakistan immediately before the separation of that country from India.

5. Public Financial Institution [Section 2(72)]

According to section 2(72), the following financial institutions shall be regarded, for the purposes of this Act, as public financial institution :

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

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

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

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

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

(A) it has been established or constituted by or under any Central or State Act ; or

(B) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

ILLEGAL ASSOCIATIONS

The aim of Companies Act is to prevent the mischief arising from large trading association being carried on by large fluctuating and un-incorporated bodies making it difficult for persons dealing with them to know with whom they are contracting and so might be put to great difficulty and expense. In order to protect public from the mischief of trading associations, the Companies Act prohibits association or partnership of persons exceeding a certain number.

The law has put a ceiling on the number of persons constituting an association or partnership. An unicorproated company, association or partnership consisting of large number of persons has been declared illegal.

The law requires these associations to be compulsorily registered under the Companies Act, before they can function as legal associations. It is provided that association or partnership consisting of more than 10 persons in case of banking business or more than 20 persons in the case of any other business which has for its objects the acquisition of gain can be legally formed unless it is registered under the Companies Act or is formed in pursuance of some other Indian law. If they are not so registered they would be considered as illegal associations.

Section 464 of the Companies Act, 2013 deals with prohibition of association or partnership of persons exceeding certain number. It provides that no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. However' the number of persons which may be prescribed under this section shall not exceed one hundred. [Section 464(1)].

Nothing in sub-section (1) shall apply to :

(a) a Hindu undivided family carrying on any business ; or

(b) an association or partnership, if it is formed by professionals who are governed by special Acts. [Section 464(2)].

Every number of an association or partnership carrying on business in contravention of sub-section (1) shall be punishable with fine which may extend to one lakh rupees and shall also be personally liable for all liabilities incurred in such business. [Section 464(3)].

PRODUCER COMPANIES

The Companies (Amendment) Act, 2002 has inserted Part IX A after Section 581 in the Companies Act, 1956. This part contains specific provisions relating to incorporation of producer companies and the conversion of an existing co-operative society into a company. Further the provisions of Section 465 of the Companies Act, 2013 provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if

the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

One of the objectives of effecting these changes in the Companies Act is to provide an opportunity to co-operative sector to corporatise itself so that it can invite greater investments and modernise itself. The new provisions will open up avenues for progressive and forward looking societies as they can take advantage of the liberal provisions under the Act. Another objective of these amendments is that it would enable a co-operative society to function more efficiently after it converts itself into a company.

Sections 581A to 581 ZT contained in Part IX A relating to producer companies are discussed as under.

Definition of Producer Company. According to Section 581A(l), a producer company means a body corporate having objects or activities specified in Section 581B and registered as producer company under this Act.

Objects of Producer Company

A producer company shall be formed with such objects as are specified in the Act. The objects specified in Section 581B are :

(a) Production; harvesting, procurement and marketing of primary produce of its members;

(b) processing produce of its members;

(c) manufacture, sale or supply of equipments and consumables to its members;

(d) providing education on the mutual assistance principles to its Members and others;

(e) rendering technical services, consultancy services, and all other activities for the promotion of the interests of its Members;

(f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communication relatable to primary produce;

(g) insurance of producers or their primary produce;

(h) promoting techniques of mutuality and mutual assistance;

(i) welfare measures or facilities for the benefit of the Members as may be decided by the Board;

(j) any other activity, ancillary or incidental to any of the activities referred to in clauses *(a) in (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner;*

(k) financing of procurement, processing, marketing or other activities specified in clauses *(a) to (j) which include extending of credit facilities or any other financial services to its Members.*

Every Producer Company shall deal primarily with the produce of its active Members for carrying out any of its objects specified in this section.

SHORT ANSWER QUESTIONS

1. What are the three important characteristics of a private company ?
2. Define a company limited by guarantee.
3. When is a company not a private company ?
4. What is a statutory company ?

5. Give three examples of statutory companies functioning in India.
6. How can a private company be converted into a public company ?
7. A private company issues debentures to public. Does the private company become a public company ?
8. Can a company with 'unlimited liability' be formed under the Companies Act, 2013 ?
9. A private company need not issue a prospectus. Why ?
10. What is a holding company ?
11. Define a Government Company.
12. What is a one man company ?
13. Is it necessary to add the word 'limited' after the name of a company ?
14. Mention five privileges of a private company.
15. What is a foreign company ?

TEST QUESTIONS

1. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
2. Define a private company and state the special "privileges which it enjoys under the Companies Act, 2013".
3. 'Not only does the legislature recognise the private company, it is said to bestow its benediction upon it." Comment.
4. Explain why many of the provisions of the Companies Act, 2013, have been made inapplicable to private companies or have been made rigorous in their application to private companies.
5. What are the privileges and exemptions enjoyed by a private company when compared with a public company ? Mention eight such items. Can a private company which is a subsidiary of a public company enjoy such privilages as are mentioned above ?
6. Distinguish between a private and a public company.
7. What is the procedure for converting a private limited company into a public limited company ?
8. Narrate the full procedure for conversion of a public company into a private company ?
9. State the consequences which follow where a private company infringes the special conditions contained in its articles of association constituting it a private company.
10. Distinguish between a holding company and a subsidiary company. Explain under what circumstances and conditions a company may become the holding company or a subsidiary of another when the latter is incorporated as a body corporate *(a) in India (b) in a country outside India.*
11. Define a government company. Summarise the special provisions of the Companies Act relating to government companies. Can the Central Government modify or exempt the provisions of the Companies Act in their application to government companies ?
12. What is a foreign company ? How far is it governed by the Companies Act. 2013 ?
13. State and discuss the obligations of a foreign company under the Companies Act, 2013.
14. What is an illegal association ? What are its effects ?
15. Give the circumstances in which a company may be incorporated without having the words 'Limited' as part of the name.

PRACTICAL PROBLEMS

Q. 1. A Hindu undivided family, consisting of a father and five major sons and another family consisting of father, five major sons and one minor son carried on banking business, as owners thereof. Discuss if the organisation requires registration under the companies Act ?

Ans. Yes in the present case registration under the Companies Act is required.

Q. 2. An association of 12 persons starts a banking business without being registered. Four members retire and thereafter a suit is instituted by one of the continuing members for the partition of the assets of the business. Is the suit competent ?

Ans. By virtue of section 11 of the Act an association consisting of more than ten persons formed to carry on a banking business if not registered under the Companies Act or any other Indian Law is deemed as an illegal association. In the present case the association is an illegal association. It cannot become legal by reduction of its members to the limit prescribed by section 11. So the suit is incompetent.

Q. 3. A partnership consisting of four firms was formed. Each firm had six partners. The partnership was not registered under the Companies Act. The partnership sold certain goods valued at ₹ 10,000 to Mr. X. X refused to pay the money. Can the partnership recover by a suit ?

Ans. Under the present case the partnership consists of four firms having a total of 24 partners. It must be registered under the Companies Act counting each individual partner as member otherwise it would be deemed to be illegal association. Since the partnership in the present case is an illegal association, therefore it will not be in a position to bring a suit against X for the recovery of ₹10,000.

Q. 4. The Bombay Stock Exchange has 200 members. It is not registered under the Companies Act. One of the members has filed a suit for declaring it illegal. Do you think the suit is maintainable ?

Ans Associations with more than 20 persons as members and which carry on business but whose object is not the earning of profit are not compulsorily registerable. In the present case the association is meant not for the purpose of carrying on any business for the acquisition of any gain for itself. As such the suit is not maintainable.

Q. 5. Five persons are the only members of a private company. All of them go in a boat on a pleasure trip into an open sea. The boat capsizes and all the five die being drowned. Is the private company no longer in existence ?

Ans. The existence of a company is independent of the lives of its members. It has a perpetual succession. In this problem the company will continue as a legal entity. The company's existence is in no way affected by the death of all its members.

Q. 6. In a Private Limited Company it is discovered that there are in fact 54 members. On an enquiry it is ascertained that 6 of such members have been employees of the company in the recent past and they acquired their shares while they were still employees of the company. Is it necessary to convert the company into a Public Limited Company ?

Ans. In this case it is found that out of 54 members 6 were in the employment of the company when they purchased the shares. Hence these 6 persons shall be excluded in counting the maximum limit of fifty. Hence the company still continues to be a private company and therefore it is not necessary that the private limited company should be converted into a public limited company.

Q. 7. Maha Vir Traders Limited was registered as a public company. There are 64 members in the company as noted below.

(i) Directors and their relatives	34
(ii) Employees	10
(iii) Ex Employees (Shares were allotted when they were employees)	5
(iv) 5 Couples holding shares jointly in the name of husband & wife (5 × 2)	10
(v) Others	5
	64

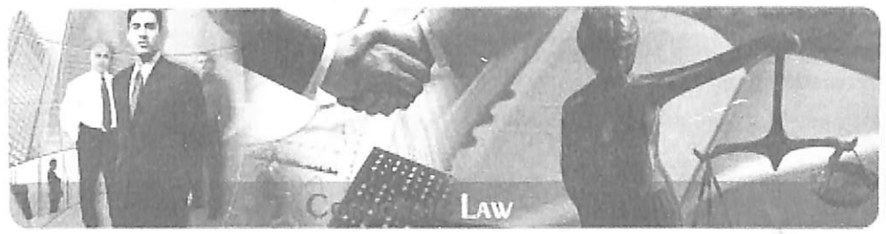
The Board of Directors of the Company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary.

Ans. In this case, there is no need for reduction in the number of members and the company can be converted into a private company.

Q. 8. The number of members in a Public Limited Company got reduced to six on 6th September 2010. The company incurs trade debts on 8th September 2010, 10th December 2010, 4th March 2011, 16th March 2010 and 4th April 2011. How far the remaining six members liable for the debts ?

Ans. The Companies Act 2013 lays down that if the number of members in a Public Limited Company becomes at any time less than seven and if the company carries on business with the reduced number of members, the members will be severally liable for all the debts of the company contracted during that time, that is after six months. Hence in this case each member will be liable severally for the debts incurred on 16th March and 4th April 2011.

□□□



3

PROMOTION & INCORPORATION OF COMPANIES

COMPARATIVE CHART (Some of the Major Changes)

Point of comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	FORMATION OF COMPANY	
Minimum No. of persons required to form a company	One Person can form a One Person Company. Minimum 2 for a private company other than OPC. Minimum 7 for a public Co.	One person can't form a company. Minimum 2 for a private company. Minimum 7 for a public Co.
Maximum number of members allowed in private company	200 (for a private company other than OPC)	50
	CERTIFICATE OF INCORPORATION	
Conclusiveness of certificate of incorporation	Where a company is incorporated by furnishing any false or incorrect information or representation or suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, –	Section 35 of the 1956 Act laid down the rule of certificate of incorporation being conclusive evidence.
	(a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or	
	(b) direct that liability of the members shall be unlimited; or	
	(c) direct removal of the name of the company from the register; or	

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

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

Before making any order in (a) to (e) above:

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

(ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability [Section 7(7) of the 2013 Act]

The above provisions of section 7(7) of the 2013 Act which enable the Tribunal to direct the removal of the name of the company from the register run counter to the concept of certificate of incorporation being conclusive evidence that all formalities and requirements of incorporation have been duly completed. Hence, the 2013 Act omits section 35 of the 1956 Act which laid down this rule of certificate of incorporation being conclusive evidence.

COMMENCEMENT OF BUSINESS

Commencement of business

As per Companies (Amendment) Act, 2015 – The section 11 governing commencement of Business has been completely omitted. Now there is no requirement to obtain certificate of Commencement of Business.

[w.e.f. 29/5/15].

A public company having a share capital cannot commence business or exercise borrowing powers, unless it has complied with formalities as under:–

(A) where the company has issued a prospectus

(i) The minimum number of shares which have to be paid for in cash have been allotted.

(ii) Every director has paid on his shares an amount equal to what is payable on shares offered on shares offered to public on application and allotment.

(iii) No money is or may become refundable due to failure to apply for or obtain permi-ssion for listing from any recognized stock exchange/ (s); and

(iv) A statutory declaration by the secretary or one of the directors that the above requirements have been complied with is filed with ROC.

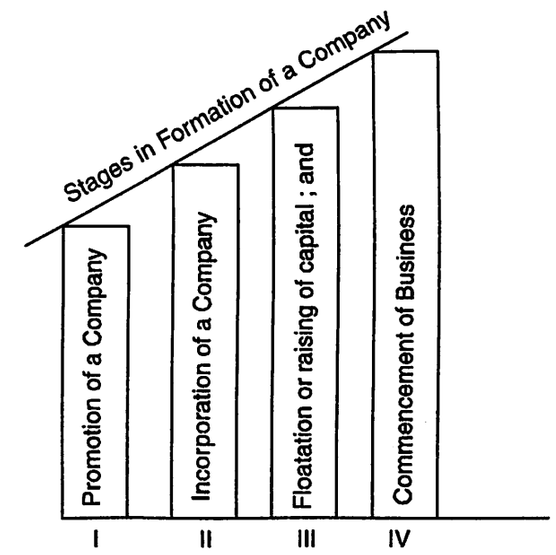
(B) where the company has not issued a prospectus

(i) It has filed with ROC a statement in lieu of prospectus at least 3 days before allotment; and

(ii) The conditions at (ii) and (iv) in (A) above are complied with.

A company, generally, comes into existence when a number of persons come together with a view to forming an association to exploit the business opportunities by bringing together men, material, money and management.

STEPS TO FORM A COMPANY



PROMOTION

Promotion of a company is the first important preliminary stage where in recessary steps are taken for the registration of a company. Promotion is the process of organizing and planning the finances of a business enterprise under the corporate form. In other words promotion means the taking of such steps as would persuade a number of persons to come together for the achievement of a common objective through the company form of organisation. It is the discovery of business opportunities and subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits thereform. The persons who undertake the task of promotion are called promoters.

WHO IS A PROMOTER

U/S 2(69) of the Companies Act 2013

Promoter means a person :

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

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

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

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

Thus the following four categories of persons fall within the definition of the expression 'promoter'–

- a person who has been named as such in a prospectus or
- a person identified by the company in the annual return referred to in section 92 or
- a person who has control over the affairs of the company or
- a person in accordance with whose advice, directions of instructions the Board of Directors of the company is accustomed to act.

The promoter is a person who brings a company into existence. A company may have several promoters. A promoter may be an individual, a firm or body corporate. One existing company may promote another new company. Everyone who is connected with the formation of a company may not be a promoter. A person who merely acts in a professional capacity on behalf of a promoter such as a solicitor, engineer, accountant or a valuer is not a promoter in the eye of law.

FUNCTIONS OF A PROMOTER

A promoter takes all the necessary steps to create and mould a company and set it going. The promoters function till the board of directors of a company is legally constituted and starts governing the company.

Promoters perform the following functions :

1. Discovery of Idea. It promotion stage begins with the discovery of idea to set up a business. It can be an idea to set up a new business or an idea to expand the existing business. Promoter also analyses the amount of capital required and the degree of risk involved.

2. Detailed Investigation. After analysing all the concepts related to the idea discovered, the promoter starts doing the detailed investigation regarding cost, profitability, production process, demand of the product etc. While doing the detailed investigation the promoter takes the help of the specialist or experts such a chartered accountants, engineers etc. The reports of specialists help the promoter to take decision regarding the size of the business, location of the plant, amount of capital etc.

3. Assembling of Resources. In this stage a practical shape is given to the idea which is investigated and also verified by specialists. The promoter starts collecting all the resources necessary to form a company. Promoter makes contracts for purchase of material, land, machinery, recruitment of staff, etc.

4. Preparing Preliminary Documents. After assembling the physical, financial and human resources, the promoter prepares or gets prepared the necessary documents which are compulsory to be prepared for the formation of a company.

The important documents prepared by the promoter are :

(*a*) Memorandum of Association

(*b*) Articles of Association

(*c*) Prospectus.

5. Entering into Preliminary Contracts. The promoter signs a contract with different parties before the incorporation of the company. Generally company approves these contracts after incorporation but in case company does not approved these contracts, then promoter is personally liable for these contracts.

6. Naming a Company. The promoter has to select a name of the company. While selecting the name the promoter keeps in mind that the name should not be identical to the name of any other company.

7. Appointment of Bankers, Brokers, Solicitors and Underwriters. The promoter appoints the brokers and underwriters to ensure the availability of capital by sale of company's securities, solicitors are appointed to deal with the legal matters of the company and the bankers are appointed to have smooth financial dealings.

LEGAL POSITION OF A PROMOTER

There is no doubt that the promoters occupy an important position and have wide powers relating to the formation of a company. It may, however, be noted that a promoter is not an agent because there is no trust in existence.

The correct way to describe his legal position is that from the moment he acts with the company in mind, he stands in a fiduciary position towards the company. Lord Cairns has correctly stated the position of a promoter in *Erlanger v. New Sombrero Phosphate Co.* ***"The promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how, and when, and in what shape and under what supervision, it shall come into existence and begin to act as a trading corporation."***[1]

The importance of the rule which creates a fiduciary relationship between the promoter and the company he brings into existence, can be seen when we consider its consequences which are as follows :

1. A promoter cannot make either directly or indirectly any profits at the expense of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it. Any profit which the promoter makes after he has begun to promote the company and the benefits of any contracts into which he enters during that period belongs to the company.

Where the promoter fails to make full disclosure of the profit that he is making, the company may sue him for damages for breach of his fiduciary duty and recover from him any secret proift made. In relation to disclosure it may be noted that half disclosure is worse than none.

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1. (1878) 3 A.C. 1218.

Example : The old 'Olempia' Co. was in difficulties and the debentures were worth very little. A syndicate consisting of X, Y and Z purchased a great number of debentures very cheaply. Then they purchased Olempia for 1,40,000 pounds and sold it to a new company which they promoted for 1,80,000 pounds. Consequently the debentures were paid in full out of 1,40,000 pounds and the syndicate made a profit of 20,000 pounds on debentures. X, Y and Z became directors of the new company. They disclosed their profit of 40,000 pounds but not their profit of 20,000 pounds. It was held that there was not sufficient disclosure and X, Y and Z must pay 20,000 pounds to the company **[Gluckstein v. Barnes (1900) A.C. 240]**

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

The leading case on this point is

Erlanger V New Sombrero Phosphate Co. (1878)

Point decided is

Promoters must make an honest disclosure to the company of all relevant facts which might affect the willingness of the company to purchase the property.

Facts of the case are

A syndicate of which E was the head purchased an island containing mines of phosphate for 55,000 pounds. E then formed a company to buy this island. A contract was made between X a nomine of the syndicate and the company for its purchase at 1,10,00 pounds. The detalis of the sale were not disclosed to the shareholders or to an independent Board of directors. The company now sought to rescind the contract of sale. It was held that as there had been no dislosure by the promoters of the profit they were making, the company was entitled to rescind the contract.

3. A promoter who wishes to sell his own property to the company must make a full disclosure of his interest in the transaction. The disclosure may be made (a) to an independent board of directors, or (b) in the articles or association of the company, or (c) in the prospectus, or (d) to the existing and intended shareholders directly.

4. The promoter shall not make an unfair or unreasonable use of his position. He must take care to avoid anything which has the appearance of undue influence or fraud.

RIGHTS OF PROMOTERS

The promoters being in a fiduciary relation with the company they form, have certain rights and liabilities vis-a-vis the company. The rights of a promoter of the company are :—

1. Right to Receive Preliminary Expenses

The promoters are entitled to receive all the expenses incurred in setting up and registering the company from the Board of Directors. The articles may provide for payment of preliminary expenses to the promoters. The company may pa the expenses to the promoters even after its formation but such payments should not be ultra vires the articles of the company.

2. Right to Recover Proportionate Amount from the Co-promoters

The promoters are held jointly and severally liable for the secret profits made by them in formation of a company. Therefore, if the entire amount of secret profits is paid to the company by a single promoter, he is entitled to recover the proportionate amount from his co-promoters. Likewise, if the entire liability arising out of mis-statement in the from his co-promoters. Likewise, if the entire liability arising out of mis-statement in the prospectus is borne by one of the promoters, he is entitled to recover proportionately from the co-promoters.

3. Right to Remuneration

A promoter having made proper disclosure, has a right to be paid remuneration for his efforts. The payment of remuneration to a promoter in consideration of his services may be in the form of fully or partly paid-up shares, debenture or commission or it can even be in the form of a lump sum-amount.

However, it may be noted that a promoter has no right against the company for his remuneration unless there is a contract to that effect. In the absence of such a contract, he cannot recover from company payments he has made in connection with the formation of the company.

Example : A syndicate promoted a company and paid 416.25 pounds in respect of registration fees and slamt duty. The company shortly afterwards went into liquidation. It was held that syndicate could not recover the payments it has made [Clinton's Claim (1908) 2. Ch. 515].

LIABILITY OF PROMOTERS

A promoter plays a pivotal role right from the formation of the company until it is finally incorporated and commences its business. If a promoter fails to perform his duties, he can be held liable under the provisions of the Companies Act, 2013. Some of these liabilities are as under :

1. Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters shall each be liable for action under section 447. [Section 7(6)].
2. Section 26 of the Companies Act, 2013 lays down matters to be stated and reports to be set out in the prospectus. The promoter may be held liable for non-compliance of this provision.
3. Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the promoter of the company, without prejudice to any punishment to which he may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage. [Section 35(1)]
4. It a company makes an offer or accepts monies in contravention of section 42 i.e. making an offer or invitation of securities to a section of the public otherwise than through issue of a prospectus by way of private placement basis without complying with the requisites under the said section, inter alia its promoters shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher. [Section 42(10)].

5. Failure to make full disclosure or non-disclosure concerning each item of special business to be transacted at a general meeting will entail inter alia the promoter a fine which may extend to fifty thousand rupees or five times the amount of benefit accruing inter alia to the promoter or any of his relatives, whichever is more. Section 173 of the Companies Act, 1956 did not provide for such fine, except for the general provision under section 629A. [Section 102(5)].
6. If the Tribunal is satisfied on the basis of the information and evidence in its possession with respect to any person who is or was a director or an officer or other employee of the sick company, that such person by himself or along with others had diverted the funds or other property of such company for any purpose other than the purposes of the company or had managed the affairs of the company in a manner highly detrimental to the interests of the company, the Tribunal shall, by order, disqualify inter alia the said promoter from being appointed as a director in any company registered under this Act for a maximum period of six years. [Section 266(2)].
7. The promoters, inter alia, who are or have been in employment of the company or acting or associated with the company who did not, without reasonable cause, extend full cooperation to the Company Liquidator in discharge of his functions and duties shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, to with both [Section 284(2)].
8. If a company is being wound up by an order of the Tribunal and the liquidator's report alleges any fraud in the promotion and formation of the company, the promoter shall be liable to public examination. (Section 300).
9. Where a promoter has misapplied or retained any property of the company or is guilty of misfeasance or breach of trust in relation to the company, he can be sued by the company for breach of duty or deceit, as the case may be (Section 340).

INCORPORATION OR REGISTRATION OF A COMPANY

A company comes into existence when a number of persons come together with a view to exploit some business opportunity. These persons are called promoters. **Under Section 3,** any seven or more persons (2 or more in the case of a private company and 1 person in case of a one person company) may form an incorporated company for a lawful purpose by subscribing their names to the memorandum of association (*i.e.* by putting signatures in the Memorandum) and complying with the other requirements in respect of registration. Such an incorporated company may be a company (a) limited by shares, (b) limited by guarantee, or (c) an unlimited company.

The purpose for which a company is going to be incorporated must be lawful. It means a purpose not forbidden by law or contrary to public policy. If one of the objects is unlawful the purpose is not lawful. A certificate of incorporation is not conclusive as to the fact that the objects of the company are lawful.

Steps before Proceeding with the procedure of filing documents :

1. DIN (Directors Identification Number) has to be obtained.
2. Digital Signatures of the Promoters.

Both DIN and Digital Signatures will be registered with the MCA (Ministry of Corporate Affairs)

Portal. **After registration and verification of DIN and Digital Signatures of the Promoter the following steps will be taken. :**

(1) Availability of name. Section 4 of the Companies Act provides that a company cannot be registered by a name, which in the opinion of the Central Government, is undesirable. So, it is advisable that promoters find out the availability of the proposed name of the company from the Registrar of Companies. The promoters are required to select at least six alternative names in the order of preference for the proposed company and secure the name availability by making an application to the Registrar of Companies of the State in which they want to have the proposed company incorporated. The application is required to be made in the prescribed form (e-form INC-1) alongwith the prescribed fees and shall be with Digital Signatures of the promoter as per Companies (Registration Offices and Fees) Rules, 2014.

Registrar of Companies is required to inform about the approval of name or rejection of proposed name within seven days. Once name is approved, it is kept reserved for 60 days. If application for incorporation is not submitted within 60 days, the name can be allotted to other applicant.

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

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

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

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

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

In order to get 'certificate of incorporation' for a new company, an application in the prescribed form along with the prescribed fee shall be submitted to the registrar of the State in which the registered office of the proposed company is to be situated. The application must specify the name of the company to be incorporated and the kind of company, whether it is a public or a private company.

(2) Documents to be filed with the Registrar

After ascertaining the availability of name, the promoter should proceed to file with the Registrar of companies along with the fee and the required documents :

(a) Memorandum of Association (MoA). The Memorandum of Association, is the charter of the company. This includes its objectives, its name, the address of its registered office, the capital which the company is authorised to raise, the nature of liability of members as well as the names, addresses and agreement of people who agree to form a company.

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

(b) Articles of Association (AoA). The other important document is the articles of association which contains the rules and regulations relating to the interenal management of the company. The AoA should be duly signed by all the subscribers to the Memorandum in the prescribed manner.

(c) Declaration. A declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.

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

(e) Address. The address for correspondence till its registered office is established.

(f) Particulars of Subscribers. The particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.

(g) Particulars of First Directors. The particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

(h) Particulars of the interests of first directors in other firms or bodies Corporate. The particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as director of the company in such form and manner as may be prescribed.

(i) **Power of Attorney.** With a view to fulfilling various formalities that are required for incorpoaration of acompany, the promoters may execute a power of attorney in favour of one of them or an advocate or some other professional like the Chartered Accountant or a Company Secretary. The power of attorney to be given on a non judicial stamp paper of appropriate value with reference to the State in which the office of the ROC is situated or on a paper affixing non-judicial special adhesive stamps of same value.

(j) Consent of the directors [Sec. 152(5)]. According to section 266, in the case of a public limited company having share capital, person cannot be appointed as a director by the Articles of Association unless, he has, before the registration of the articles, either himself or through his agent signed and filed, with the Registrar, his consent in writing to act as director. *Consent of the director is not required in case of private company.*

(k) Particulars of Directors along with DIN (Directors Identification Number). Where a company by its articles of association appoint any person or persons as a directors, manager or secretary it may also file their particulars with the Registrar at the time of incorporation.

(l) Filing of Agreement. The agreement if any, which the company proposes to enter into with any individual for appointment as its

(a) managing director

(b) whole-time director

(c) manager.

Note : A public company or a subsidiary of a public company with paid-up capital of ₹ 5 crores or more is required to have a managing or whole-time director or manager.

(m) Notice of Registered address must also be made

(n) Statutory Declaration of Compliance. A declaration is to be filed in Form INC-8 with the

Registrar of companies. This is known as 'Statutory Declaration of Compliance'. The promoters must file a statutory declaration stating that all requirements of the Companies Act and its rules relating to registration have been complied with.

This declaration may be signed by any of the following :

(a) an advocate of the Supreme Court or of a High Court, or

(b) an attorney or a pleader entitled to appear before High Court, or

(c) a secretary or a Chartered Accountant in whole-time practice in India and who has been engaged in the formation of the company, or

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

(e) Filing of documents for registration. It is pertinent to mention that the documents are required to be filed with the Registrar of companies of the state in which the company is proposed to be incorporated. On presentation of documents to the Registrar, the requisite fee is payable, which fee is not refundable even though the documents are rejected and registration refused.

(f) If the Registrar is satisfied that all the requisite documents delivered to him are in order, he shall retain and register the memorandum and the articles, if any, provided he is satisfied on the following points.

(g) The name selected by the company is acceptable.

(h) The relevant provisions of the Act have been complied with.

(i) The objects of the company are lawful.

(j) The requisite number of persons required under the Act have subscribed and duly signed.

(k) The memorandum and the articles comply in all respects with the provisions of the Act.

(l) The statutory declaration has been properly made.

(3) Registration by ROC If the Registrar of Companies is satisfied that all the aforesaid requirements have been complied with, he will register the company and place its name on the register of companies. It is not competent for him to refuse registration on any extraneous considerations or for any reasons other than non-compliance. If there is any minor defect in any document, the Registrar may ask for its rectification. But if there is a material defect, he may refuse registration. It is clear that once the statutory requirements have been complied with, the Registrar has no option but to register it.

INTEGRATED PROCESS FOR INCORPORATION

The companies Incorporation (Amendment) Ruler, 2015 (w.e.f. 1 – 5 – 2015) have simplified the filing of forms for incorporation of a company.

(1) The integrated process shall apply with effect from **01/05/2015.**

(2) The application for allotment of Director Identification Number up to three Directors, reservation of a name, incorporation of company and appointment of Directors of the proposed company shall be filed in **Integrated Form No. INC-29, for One Person Company, private company, public company and Producer Company,** with the Registrar within whose jurisdiction the registered office of the company to the regisration fee as specified in Companies (Registration of Offices and Fees) Rules, 2014.

(3) For the purpose of filing Integrated Incorporation form, the particulars of maxiemum of three directors shall be allowed to be filled in INC-29 and allotment of Director Identification Number of maximum of three proposed directors shall be permitted in Form INC-29 in case of proposed directors not having approved Director Identification Number.

(3) For the purposes of filing Integrated Incorporation form, the particulars of maximum of three directors shall be allowed to be filled in INC-29 and allotment be permitted in Form INC-29 in case of proposed directors not having approved Director Identification Number.

(4) The promoter or applicant of the proposed company shall propose only one name in e-form No. IC-29

(5) The promoter or applicant of the proposed company may prepare Memorandum of Association as per templates in Form INC-30 and may opt for templates of Articles of Association in Form INC-31 accordance with the provisions of rule 13 for preparation of Memorandum of Association and Articles of Association.

(6) The promoter or the applicant shall sign and witness, the Memorandum of Association and Articles of Association in the forms downloaded from the portal 29 in accordance with the provisions of rule 13 for preparation of Memorandum of Association and Articles of Association.

(7) The facility to file integrated application for incorporation in Form INC-29 is available as an option to the process for separate applications for allotment of Director Identification Number, reservation of name and Incorporation of a company as provided in these rules.

(8) For an application filed using the Integrated process of incorporation as provided in this rule, the provisions of sub-clause (i) of sub-section (5) of section 4 of the Act the rule 9 of these rules shall not apply.

(9) A company using the provisions of this rule may furnish verification of its registered office under sub-section (2) of section 12 of the Act by filing-Form INC-29 in which case the company shall attach along with such-e Form INC-29, any of the documents referred to in sub-rule (2) of rule 25.

(10) The requirement of filing e-form INC-28 may be dispensed with if; the proposed company maintains its registered office at the given correspondence address.

(11) The Registrar within whose jurisdiction the registered office of the company is proposed to be situated shall process INC-29 including application for allotment of Director Identification Number.

(12) (a) Where the Registrar, on examining e-form INC-29, finds that it is necessary to call for further information or finds such application or document to be defective or incomplete in any respect, he shall give intimation to the applicant to remove the defects and re-submit the e-form within fifteen days from the date of such intimation given by the Registrar.

(b) After the resubmission of the document, if the Registrar still finds that the document is defective or incomplete in any respect, he shall give one more opportunity of fifteen days to remove such defect or deficiencies.

(c) In case, the Registrar is of the opinion that the document is defective or incomplete in any respect after giving such two opportunities, the e-form INC- 29 of the proposed company shall be rejected.

(13) The Certificate of Incorporation shall be issued by the Registrar in Form NO. INC-11.

(4) Certificate of Incorporation [Sec. 7(2)]

On registration, the Registrar will issue a certificate of incorporation in Form INC-11 whereby he certifies that the company is incorporated and in the case of a limited company, that the company is limited. On and from the date mentioned in the Certificate of Incorporation issued under section 7(2) the Registrar shall allot to the company a **"Corporate Identity Number",** which shall be a distinct identity for the company and which shall also be included in the certificate.

From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers to the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum. It becomes capable of exercising all the functions of an incorporated company having perpetual succession and a common seal. From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from its shareholders.

The legal effect of incorporation as per section 9 is as under :

1. A company becomes a body corporate distinct from its members. The life of the company dates from the first moment of the day of incorporation. The company would be treated as having been in existence for the whole of the day on which it was incorporated.

2. A company has a perpetual succession and common seal. It is an immo-rtal being. The death, bankruptcy or lunacy of any of its members does not affect the existence of the company. It remains in existence until it is dissolved by liquidation.

3. A company can sue and be sued in its own name.

4. A company has a right to hold and alienate its own property. The property of the company belongs to the company itself and not to the individual members, so that even the largest shareholder has no insurable interest in the property of the company.[1]

5. Company's debts and obligations are the liabilities of the company only and cannot be enforced against the individual shareholders.

When the memorandum is signed and registered, the subscribers are a body corporate capable immediately of exercising all the functions of an incorporated company. The company thus attains maturity at its birth.

Conclusiveness of the Certificate of Incorporation

The certificate of incorporation is conclusive evidence that the requirements of the Act have been complied with and prevents the reopening of matters prior and incidental thereto, and it places the existence of the company as a legal person beyond doubt.

The certificate of incorporation shall be conclusive evidence that

(i) all the requirements of the Act have been complied with in respect of registration,

(ii) the company is duly registered, and

(iii) that the company came into existence on the date mentioned in the certificate.

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1. Macaura v. Northern Assurance Company Ltd. (1925) AC 619.

Example : The memorandum and articles of association were accepted by the Registrar on January 6, 1920. The certificate of incorporation was dated January 6, but was not signed by the Registrar until January 8. The company allotted shares on January 6. It was objected that the allotment was void on the ground that it was made before the company came into existence. It was held that the allotment was valid. The certificate of incorporation was conclusive as to the date on which the company was incorporated.

[Jubilee Cotton Mills v. Leevis (1924) A.C. 958]

However, where the object of a company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose.

The validity of the certificate of incorporation cannot be disputed on any grounds whatsoever. It prevents the re-opening of the e matters prior to the registration and essential to it. The reason underlying is that once a company is registered and has begun business and entered into contracts it would be disastrous if any person could allege that the company was not duly registered.

It is worth noting that any person who deliberately furnishes any false or incorrect particulars of any information or suppresses any material information in any document filed at the time of registration of a company will be **punishable with a minimum six months imprisonment which may extend upto ten years and also fine which shall not be less than the amount involved in the fraud but which may extend to three times the amount involved in the fraud.** (Section 447).

Besides the above mentioned penalty and imprionsment, the Tribunal may, on an application made to it, order for the following :

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

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

(c) direct removal of the name of the Company from the register ; or

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

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

However' before making any order as mentioned above :

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

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

It is further provided in the Act that any person may challenge the validity of certificate of incorporation before the Tribunal. If the Company is formed by furnishing false, incorrect information or suppressing any material fact [Section 7].

CAPITAL SUBSCRIPTION

When a company has been registered and has received certificate of incorporation, it is ready for 'floatation', *i.e.,* it can go ahead with raising capital necessary to commence business and to carry on its operations satisfactory.

It may be noted a private company is prohibited from inviting public to subscribe to its share capital. It has to raise the necessary capital from friends and relatives by private agreement.

The promoters of a public company may not invite the public for raising capital and may arrange

privately as in the case of a private company. However, majority of the public companies raise their capital in the very first instance by inviting public to subscribe to its share capital.

The Companies Act requires every public company to take either of the following two steps :

(i) Issue a Prospectus if public is to be invited to subscribe to its share capital, or

(ii) File A Statement in Lieu of prospectus' in case capital has been arranged privately.

COMMENCEMENT OF BUSINESS

Note. W.e.f. 29/5/15, as per the Companies (Amendment) Act, 2015, Section 11 regarding commencement of Business has been completely abolished from the 2013 Act, thereby all companies (private or public or OPC) can commence business immediately after obtaining the certificate of Incorporation.

PRE-INCORPORATION CONTRACTS

Sometimes contracts are made on behalf of a company before it is duly incorporated. Such contracts are called pre-incorporation or preliminary contracts. These contracts may relate to property which the promoters wish to purchase for the company or they may be made with persons whose know-how is vital to the success of the company and whose services it is essential to secure.

Before its incorporation, a company has no capacity to contract. A contract entered into by promoters on behalf of a proposed company is void so far as the company is concerned. The promoters cannot be the agent for a principal which has not yet come into existence. In such a case the company cannot sue or be sued on it. The company has no legal existence until it is incorporated.

The following implications may be noted.

1. That when the company is registered, it is not bound by the preliminary contract.

Example : A solicitor prepared the memorandum and articles of association and paid the necessary registration fees on the instructions of persons who later became directors. He claimed his fees and expenses on the liquidation of the company. It was held that the company was not liable to pay the solicitor's costs though it had taken the benefit of his work. "The company could not be sued in law for those expenses, as it was not in existence at the time when the expenses were incurred."

[Re English & Coloinal Produce Co. Ltd. (1906) 2 Ch. 435 (C.A.)].

2. That the company when registered cannot ratify the agreement. The company was not a principal with contractual capacity at the time when the contract was made. A contract can be ratified only when it is made by an agent for a principal who is in existence and who is competent to contract at the time when the contract is made.

3. That if the agent undertook any liability under the agreement, he would be personally liable notwithstanding that he is described in the agreement as an agent and that the company may have attempted to ratify the agreement.

Example : An agreement was made between K and B. B was acting on behalf of the proposed hotel company. Wine supplied under the contract was used by the company which had 'ratified' the agreement after incorporation. The company went into liquidation before paying the debt. It was held that B was personally liable and no ratification could release *him from his liability.*

[Kelner v. Baxter (1866) LR 2 C.P. 174].

4. The company cannot enforce the preliminary agreement. A company cannot sue a person who before its incorporation had contracted to buy its shares.

Examples : N company agreed with Mrs. C an agent of a syndicate before its incorporation that N company would grant a mining lease to the syndicate. The syndicate was incorporated as P company. P company discovered coal whereupon N company refused to grant the lease. It was held that there was no binding contract between N company and the P company as the latter was not in existence when the contract was signed. **[Natal Land and Colonisation Company v. Pauline Colliery and Development Syndicate Ltd. (1904) A.C. 120].**

The preliminary contracts made by promoters generally provide that if the company adopts the agreement the promoters liability shall cease and if the company does not adopt the agreement within a certain time either party may rescind the contract. In such a case the promoters liability would cease after the lapse of the fixed time.

SHORT ANSWER QUESTIONS

1. Name the documents which have to be filed with the Registrar at the time of incorporation of a public limited company.
2. What is meant by subscribing names to a memorandum of association ?
3. Write short note on certificate of incorporation ?
4. Who is a promoter ?
5. What is the position or status of a promoter ?
6. What are pre-incorporation contracts ?
7. Can a company ratify pre-incorporation contracts made for the benefit of the company ?
8. When a public limited company can commence its business ?

TEST QUESTIONS

1. Enumerate the different steps to be taken by the promoters from the formation of a company to the commencement of business.
2. Describe the procedure relating to the formation of companies under the Companies Act, 2013. Enumerate the various documents to be filed with the Registrar.
3. What is the effect of issuing a certificate of incorporation ? Can a court annul a certificate of incorporation which has been improperly issued ?
4. "A certificate of incorporation is conclusive evidence that all the requirements of the Companies Act have been complied with." Comment.
5. Who are the promoters ? State the duties and liabilities of promoters.
6. "A promoter is not a trustee or agent for the company but he stands in a fiduciary position towards it." Discuss.
7. "The services of a promoter are very peculiar." Explain with reference to the activities of a promoter and discuss his legal relationship with the company he promotes.
8. Can a promoter be remunerated for the services rendered by him in connection with the formation of a company ? How can he realise such remuneration ?
9. Are contracts entered into on behalf of a company by a promoter binding upon the company after the incorporation ? Give reasons.
10. A company cannot be a party to a contract before it has come into existence. Comment.
11. Discuss the steps that are to be taken before a company can commence its business.

PRACTICAL PROBLEMS

Q. 1. The Memorandum and the Articles Of Association of a company were delivered to the Registrar of companies for registration on January 6, 2011. On January 8, 2010 the Registrar issued the certificate of incorporation but dated it January 6, 2011. On that very day (January 6, 2011), the company made allotment of its shares. The allotment was challenged on the ground that it was made before the actual issue of the certificate of incorporation. How would you decide and why ?

Ans. A certificate of incorporation by the Registrar of Companies is a conclusive evidence that the company is entitled to commence business from the date of the certificate. In this case though the certificate was issued by the Registrar on 8th January 2011, it was dated 6th January, 2011. So the company was legally incorporated on the 6th January, 2011. Therefore the issuing of the shares by the company on 6th was perfectly in order because the company existed on the 6th January, 2011. So allotment of shares is perfectly valid and it cannot be challenged.

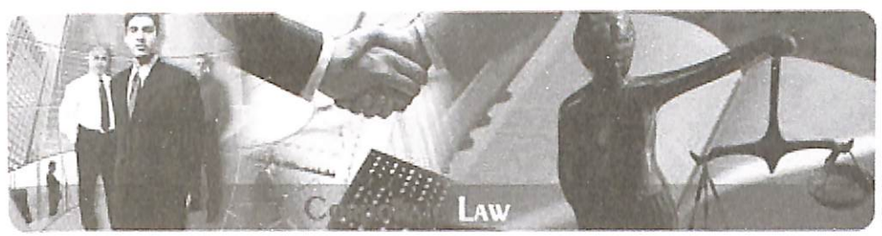
Q. 2. Six of the seven signatures to the memorandum of association of a company were forged. The memorandum was duly presented, registered and a certificate of incorporation was issued. The existence of the company was subsequently challenged on the ground that the registration was void. Decide.

Ans. Once the certificate is issued the existence of the company cannot be challenged. Any irregularity in the process of obtaining it, which is subsequently discovered does not vitiate it.

Q. 3. X, a solicitor on the instructions of promoters who became the directors of the company, prepared the Memorandum and the Articles before its formation. X claims his costs and charges from the company. The company refuses to pay on the ground that it was not in existence when he was appointed. Will the contention of the company succeed ?

Ans. The company is not bound to pay X because the expenses were incurred and the services were rendered at a time when the company was not in existence. It could not enter into a contract at that time and undertake any liability. The contention of the company will succeed.

□□□



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MEMORANDUM OF ASSOCIATION

COMPARATIVE CHART (Some of the Major Changes)

Points of comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	MEMORANDUM OF ASSOCIATION (MOA)	
Objects clause of Memorandum	Objects of the company to be classified and stated in MOA as: (i) the objects for which the company is proposed to be incorporated and (ii) any matter considered necessary in furtherance thereof.	Objects of the company should be classified and stated in the MOA as (i) the main objects of the company; (ii) objects incidental or ancillary to the attainment of the main objects and (iii) other objects of the company.
Succession clause	Compulsory for OPC to state in MOA the name of the person (nominee) who shall become member in the event of the subscriber's death or his incapacity to contract. Prior written consent of nominee required to be obtained in Form No. INC 3. Nomination, in Form No. INC 2 along with written consent in Form No. INC 3 shall be filed with ROC at the time of incorporation of the OPC along with its memorandum and articles.	No requirement of such clause under the 1956 Act as the 1956 Act did not allow formation of OPCs.
Name Clause-consultation with Registrar of Trade Marks	Consultation provisions omitted by the 2013 Act.	Section 20(3) of the 1956 Act provided that Central Govt. shall consult Registrar of Trade marks before deeming a name as undersirable on account of resemblance with registered trade mark of any other person.
Company's name not to contain certain words	Section 4(3) (b) of 2013 Act Company's name shall not contain such word or expression as may be prescribed. (Se rule 8 of the Companies (Incorporation) Rules, 2014)	No such provision.

Company's name act to contain words indicting Govt. patronage or connection	Section 4(3) (a) of the 2013 Act provides that company's name shall not contain word or expression likely to give impression of connection with or patronage of Central Govt./State Govt./local authority/statutory corporation. (See rule 8 of the Companies (Incorporation) Rules, 2014.	No such provision
MOA of Unlimited companies MOA	The MOA shall state the liability of members of the company, whether limited or unlimited. Therefore in case of unlimited companies, MOA shall state "The liability of member(s) is unlimited". [See Table D & Table E of Schedule I of the 2013 Act]	Unlimited companies were not required to state in the MOA that liability of members of the company is unlimited.
Availability of name	Section 4(4) and 4(5) (i) of the 2013 Act incorporate the procedural aspects of application for availability of name of proposed company of or proposed new name for existing company. [See rule 9 of the Companies (Incorpo-ration) Rules, 2014]	Procedural aspects of application for availability of name find no place in the 1956 Act.
Action which ROC may take if name was applied for by furnishing wrong or incorrect information	◆ If the company has not been incorporated, the reserved name shall be cancelled and the person making the application for reservation of name shall be liable to penalty not exceeding ₹ 1,00,000; and	The 1956 Act contained no provisions in this regard.
	◆ if the company has been incorporated, the ROC may, after giving the company an opportunity of being heard–	
	(i) Direct the company to change its name within 3 months by passing an ordinary resolution, or	
	(ii) Take action for striking off the name of the company from the register of companies, or	
	(iii) Make a petition for winding up of the company.	
Memorandum Forms	Must comply with applicable model forms in Schedule I of the 2013 Act	Sufficient if MOA in a Form as near to the applicable model form in Schedule I of the 1956 Act as the circumstances admit.

ALTERATION OF REGISTERED OFFICE CLAUSE		
From which date, company must have a registered office?	On and from the 15th day of its incorporation.	From the earlier of the following two dates: ■ the day on which it begins to carry on business, ■ the thirtieth day after the date of its incorporation.
Consequences of not furnishing verification of registered office/ notice of change in registered office	■ The company and every officer who is in default shall be liable to a penalty of ₹ 1,000 for every day during which the default continues but not exceeding ₹ 1,00,000.	The company, and every officer of the company who is in default, shall be punishable with fine which may extend to ₹ 500 for every day during which the default continues.
	■ A company having share capital shall not be entitled to commence any business or exercise any borrowing power until it is furnished.	
Notice of change of registered office address to ROC-Time limit	To be given to ROC within 15 days of such change. [See rule 25 of the Companies (Incorporation) Rules, 2014]	To be given to ROC within 30 days of such change.
ALTERATION OF NAME CLAUSE		
Where a company has changed its name or names during the last two years	Where a company has changed its name or names during the last two years it shall paint affix or print, as the case may be (on the outside of every office or place of business, business letters, bill heads, letter papers, hundis, pronotes, etc.) along with its name, the former name or names so changed during the last two years.	No such requirement was there in the 1956 Act
Where name of the company too nearly resembles or is identical with Registered trade mark–Time –limit for Central Govt. to issue direction to company for rectification of name	No time–limit in the 2013 Act for issue of direction by the Central Govt. to the company to rectify its name.	Under the 1956 Act three was a time-limit for issue of direction by the Central Government the company to rectify its name by passing an ordinary resolution. The time limit was within 12 months of first registration/registration by new name.
ALTERATION OF OBJECTS CLAUSE		
Purposes for which objects clause may be altered	■ No requirement in the 2013 Act that alteration of objects clause should be for specified purposes. Provisions of section 17(1) of the 1956 Act have been omitted by the 2013 Act.	■ Alteration of objects clause should be for one of the specified purposed [See section 17(1) of the 196 Act].
Where company has unutilised proceeds of public issue	■ New restrictions on alteration of objects clause of memorandum – Where company has any unutilized amount from proceeds of public issue – where a company which has raised	■ No restrictions on alteration of objects clause where company has any unutilised proceeds of public issue.

	money from public through prospectus and still has any unutilized amount out of the money so raised, shall not change its objects unless a special resolution is passed by the company and–	
	(a) The details, as may be prescribed [See Rule 32(1) of the Companies (Incor-poration) Rules, 2014], of the notice in respect of such resolution to share-holders, shall also be published in the news-papers (one English and one vernacular) in the city where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating clearly the justiflcation for such change. Rule 32(2) requires that the adver-tismen giving details of each resolution be passed for change in objects which shall be published simultaneously with dispatch of postal ballot notices to shareholders. Rule 32(3) requires that the notice should be placed on the website of the company, if any.	
	(b) The dissenting share-holders shall be given an opportunity to exit by the promoters and share-holders having control in accordance with regulations specified by SEBI.	
Registration of objects clause alteration by ROC	To be registered within 30 days from date of filing special resolution altering the objects clause	No time-limit within which ROC is to register the alteration
	ALTERATION OF LIABILITY CLAUSE	
Alteration of liability clause	Condition of member's written consent for alteration (stipulated by section 38 of the 1956 Act) omitted by the 2013 Act	The 1956 Act required that member's written consent as to be bound by the alteration must be taken before or after the alteration. [See Sec. 38 of the 1956 Act]

INTRODUCTION

Hence, MOA contains the objects for which the company is formed and therfore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers, that will be ultra vires (beyond powers of) the company and so void.

Meaning. Memorandum of Association is one of the documents which has to be filed with the Registrar of companies at the time of incorporation of a company. The memorandum of association of a company contains the fundamental conditions upon which alone the company has been incorporated.

Sec. 2(56) of the Companies Act, 2013	Memorandum means "Memorandum of Association of a Company as originally framed or altered from time to time in pursuance of any previous Companies Law or of this Act."
Cairns	Memorandum of Association of a Company is its charter and defines the limitations of the powers of a Company. [Ashbury Railway Carriage Co. vs. Riche]
Palmer	Memorandum of Association is a document of great importance in relation to the proposed Company. It contains the objects for which the Company is formed and identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the Company. If anything is done beyond these powers, that act will be ultra vires the Company and so void.
Bowen L.J.	Memorandum contains the fundamental conditions upon which alone the Company is allowed to be incorporated.

Importance

The memorandum of association is an extremely important document in relation to the affairs of the company. It is a document which sets out the constitution of the company and is really the foundation on which the structure of the company is based. It contains the fundamental conditions upon which alone the company is allowed to be incorporated. Its five clauses provide the basic features of the company's constitution. A company may pursue only such objects and exercise only such powers as are conferred expressly in the memorandum or by implication therefrom *i.e.,* such powers as are incidental to the attainment of the objects. A company cannot depart from the provisions contained in its memorandum, however, great the necessity may be. If it does, it would be ultra vires the company and therefore wholly void. It defines its relation with the outside world and the scope of its activities.

After registration of the company, the memorandum becomes a public document. While the memorandum must comply with the provisions of the Companies Act, all other documents of the company must comply with the memorandum.

Purpose of Memorandum

The memorandum of association is a public document available for inspection.

It serves two purposes :

1. The intending shareholder who contemplates the investment of his capital shall know within what field it is to be put at risk. Thus he can find out from the memorandum the purpose for which his money is going to be used by the company and what risk he is taking in making the investment.

2. Anyone who deals with the company shall know without reasonable doubt whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects. Thus a supplier of goods or money will know whether the transaction he intends to make with the company is within the objects of the company and not ***Ultra vires its objects.***

In short, the memorandum enables the shareholders, creditors and all those who deal with the company to know what its powers are and what the range of its activities is.

Printing and signing of Memorandum [Under Rule 13 of Companies (Incorporation) Rules, 2014]

U/S 3(1) of the companies Act, 2013:-

- At least seven persons in case of a public company;
- At least two persons in case of a private company;
- One person in case of a one person company (OPC)

must subscribe their names to the Memorandum.

Only a person capable to enter into a contract on his own can subscribe to the memorandum. Both artificial and natural persons can subscribe to the memorandum.

In the case of an illiterate subscriber to the memorandum, the thumb impression or mark duly attested by the person writing for him should be given.

The memorandum shall be printed. Computer printing is recognised for this purpose. It shall be divided into paragraphs numbered consecutively and shall be signed by each subscriber, with his address, description and occupation added, in the presence of at least one witness who will attest the same.

Forms of memorandum U/s 4 and 5. The memorandum of association of a company shall be in such one of the forms in Tables A, B, C, D and E in Schedule I to the Companies Act, 2013 as may be applicable in the case of the Company.

Table A is a form for memorandum of association of a company limited by shares.

Table B is a form for memorandum and articles of association of a company limited by guarantee and not having a share capital.

Table C is a form for memorandum and articles of association of a company limited by guarantee and having a share capital.

Table D is a form for memorandum and articles of association of an unlimited company and not having share capital.

Table E is a form for memorandum and articles of association of anunlimited company and having share capital.

Copies of Memorandum and Articles of the Company

Copies of memorandum and articles must be given to a member on token fee as may be prescribed. Failure to give copy within seven days will involve fine which may extend upto ₹ 1000 per day during which the default continues but not exceeding ₹ 1 lac. [Section 17].

CONTENTS OF MEMORANDUM

According to Section 4 the memorandum of association of every company must contain the following clauses :

1. The *name of the company* with 'Limited' as the last word of the name in the case of a public limited company and with 'Private Limited' as the last word in the case of a private limited company. One person company shall also describe as "One Person Company" in brackets under section 12.

2. The *name of the State* in which the registered office of the company is to be situated.
3. The *objects* of the company to be classified as—
   (i) Objects for which the company is proposed to be incorporated; and
   (ii) Any matter considered necessary in furtherance thereof.
4. The *liability of members is limited* if the company is limited by shares or by guarantee.
5. In the case of a *company having a share capital,* the amount of share capital with which the company proposes to be registered and its division into shares of a fixed amount.
   - The memorandum shall conclude with an 'association clause' which must state the desire of the subscribers to be formed into a company.
   - An unlimited company need not include clause 5 and 6 in its memorandum.
   - In the case of a company limited by guarantee, its memorandum of association shall state that each member undertakes to contribute to the assets of the company, in the event of its being wound up.
   - In case of a one person company, the name of the person who in the event of the death of the subscriber, shall become the member of the company.
   - The above clauses are compulsory, and are designated as 'conditions' prescribed by the Act, on the basis of which alone a company is incorporated.

A brief discussion of the various clauses of memorandum of association follows :

(A) NAME CLAUSE [SECTION 4(1) (a)]

The first clause of the memorandum requires a company to state its name. A company being a legal person, must have a name to establish its identity.

The general rule is that a company may be registered with any name it likes. But no company shall be registered by name which in the opinion of the Central Government is undesirable and in particular which is identical with or which too nearly resembles the name of an existing company.

A company which carries on or proposes to carry on business under a name calculated to deceive the public by confusion with the name of an existing concern commits the civil wrong of *passing off and can be restrained by injunction from doing so.*

Example : Plaintiff was carrying on business under the trade name of Buttercup Dairy Company. Another company was registered under the name of Buttercup Margarine Company Limited. It was held that the plaintiff was entitled to restrain the newly registered company from carrying on business on the ground that the public might reasonably think that the registered company was connected with his business. [Ewing v. Butter cut Margarine Company Ltd. (1917) 2 Ch. 1 (C.A.)].

According to Rule 8 of the **Companies (Incorporation) Rules, 2014** a proposed name is considered to be undesirable if it is identical with or too nearly resembling with :

(i) Name of a company in existence; or

(ii) A registered trade-mark or a trade mark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999.

(iii) The name shall also be considered undesirable if :
   - it attracts the provisions of Sec. 3 of the Emblems and Names (Prevention & Improper use) Act, 1950.
   - it includes any word or words which are offensive to any section of the people.

[Refer Rule 8 of Companies (Incorporation) Rules, 2014 for detailed information on other reasons for an undesirable name].

As per **Companies (Incorporation) Rules, 2014,** in determining whether a proposed name is identical with another, the following shall be disregarded.

(i) The words Private, Pvt., Pvt., (P), Limited, Ltd, Ltd., LLP, Limited Liability Partnership;

(ii) The words appearing at the end of the names–company, and company, co., co, corporation, corp, corpn, corp.;

(iii) The plural version of any of the words appearing in the name;

(iv) The type and case of letters, spacing between letters and punctuation marks;

(v) Joining words together or separating the words does not make a name distinguishable from a name that uses the similar, separated or joined words;

(vi) The use of a different tense or number of the same word does not distinguish one name from another;

(vii) Using different phonetic spellings or spelling variations does not distinguish one name from another. For example, J.K. Industries limited is existing then J and K Industries or Jay Kay Industries or J n K Industries or J & K Industries will not be allowed. Similarly if a name contains numeric character like 3, resemblance shall be checked with 'Three' also;

(viii) Misspelled words, whether intentionally misspelled or not, do not conflict with the similar, properly spelled words;

(ix) The addition of an internet related designation, such as .COM, .NET, .EDU, .GOV, .ORG, .IN does not make a name distinguishable from another, even where (.) is written as 'dot';

(x) The addition of words like New, Modern, Nav, Shri, Sri, Shree, Sree, Om, Jai, Sai, The, etc. does not make a name distinguishable from an existing name such as New Bata Shoe Company, Nav Bharat Electronic etc. Similarly, if it is different from the name of the existing company only to the extent of adding the name of the place, the same shall not be allowed. For example, 'Unique Marbles Delhi Limited' cannot be allowed if 'Unique Marbles Limited' is already existing;

Such names may be allowed only if no objection from the existing company by way of Board resolution is produced/submitted;

(xi) Different combination of the same words does not make a name distinguishable from an existing name, e.g., if there is a company in existence by the name of "Builders and Contractors Limited", the name "Contractors and Builders Limited" should not be allowed;

(xii) If the proposed name is an exact Hindi translation of the name of an existing company in English especially an existing company with a reputation, e.g., Hindustan Steel Industries Ltd. will not be allowed if there exists a company with name 'Hindustan Ispat Udyog Limited';

Declaration by the Applicant

As per **Companies (Incorporation) Rules, 2014,** while applying for a name in the prescribed e-form-1A, using Digital Signature Certificate (DSC), the applicant shall be required to furnish a declaration to the effect that :

(i) he has used the search facilities available on the portal of the Ministry of Corporate Affairs (MCA) i.e., *www.mca.gov.in/MCA21* for checking the resemblance of the proposed name(s) with the companies and Limited Liability Partnership (LLPs) already registered or the names already approved.

(ii) the proposed name(s) is/are not infringing the registered trademarks or a trademark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999;

(iii) the proposed name(s) is/are not in violation of the provisions of Emblems and Names (Prevention of Improper Use) Act, 1950 as amended from time to time;

(iv) the proposed name is not offensive to any section of people, e.g., proposed name does not contain profanity or words or phrases that are generally considered a slur against an ethnic group, religion, gender or heredity;

(v) he has gone through all the prescribed guidelines, given in these Rules, understood the meaning thereof and the proposed name(s) is/are in conformity thereof;

(vi) he undertakes to be fully responsible for the consequences, in case the name is subsequently found to be in contravention of the prescribed guidelines.

CAN COMPANIES USE THE WORD STATE

According to Section 4(3) of the Companies Act, 2013, a company shall not be registered with a name which contains :

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

(b) such word or expression, as may be prescribed.

Use of the word 'Limited' or 'Private Limited' or "One Person Company"

Every public company must write the word limited after its name and every private limited company must write the word 'private limited' after its name and a one person company must write "One Person Company" after its name. The use of the word 'company' is however, not compulsory. Companies whose liabilities are not limited, are prohibited from using the word 'limited'.

If a limited company makes a contract without using the word 'limited', the effect may be most serious for the officers of the company because in that every the contract could be binding personally upon those who purported to act on behalf of the company.

Examples : (1) A the company was registered as Bastille Syndicate Ltd. but the defendants who were two directors and the Secretary of the company accepted a bill of exchange on its behalf giving the name of the company as the Old Paris and Bastille Ltd. The Court held that the name of the company mentioned by the defendants was quite different from its registered name and the company not having paid the bill, defendants were personally liable since they were responsible for this misdescription [Nassan Steam Prers v. Tyler (1894) 21 TLR 510].

When the Word 'Limited' may be Dropped

The word 'limited' may be dispensed with in the case of charitable companies. But companies formed to promote art, science, religion etc. which do not propose to pay dividend but intend to apply

all its profits toward the working of the company, can be registered without the word 'limited' under licence granted by the Central Government (Section 8).

Publication of name

Section 12(3) of the Companies Act, 2013 provides that every company shall:-

(a) paint or affix name, and the address of its registered office, on the outside of every office or place in which its business is carried on;

(b) have its name engraved in legible characters on its 'seal, if any';

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

(d) have its name printed on *hundies,* promissory notes, bills of exchange and such other documents as may be prescribed.

If a company fails to paint or affix its name and the address of its registered office in the prescribed manner, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

(B) REGISTERED OFFICE CLAUSE [SECTION 4(1)(b)]

This clause states the name of the State where the registered office of the company is to situate. A company shall have its registered office. Such office must be in existence on and from the 15th day of its incorporation. Notice of situation of registered office and every change therein must be given to the registrar within 15 days. (Section 12). Registered Office is really the permanent address of the company. It is residence of the company. It decides domicile of the company.

Address of registered office to be specified in correspondence, bills etc. Address of registered office must be specified in company's letter heads, bill books and in all notices and official publications. Name board of company and address of registered office should be painted or affixed in a conspicuous position on the outside of every office or place in which business in carried out.

If default is made in complying with these requirements, the company and every other officer who is in default shall be punishable with fine which may extend to ₹ 1000 for every day during which the default continues, but not exceeding ₹ 1,00,000.

Verification of the Registered Office

Sub-section (2) of Section 12 of the Companies Act, 2013 requires that the company must furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation by filing any of the prescribed documents.

Rule 25 of the Companies (Incorporation) Rules, 2014, in this regard, provides was follows :

1. The verification of the registered office shall be filed in Form No. INC-22 along with the prescribed fee; and
2. There shall be attached to the Form, any of the following documents, namely–
   (a) Registered document of the title of the premises of the registered office in the name of the company; or

(b) Notarized copy of lease/rent agreement in the name of the company along with a copy of rent paid receipt not older than one month;

(c) Authorization from the owner or authorized occupant of the premises along with proof of ownership of occupancy authorization, to use the premises by the company as its registered office; and

(d) Proof of evidence of any utility service like telephone, gas, electricity, etc. depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than 2 months.

(C) OBJECTS CLAUSE [SECTION 4(1)(c)]

The third and important clause which defines the limits and extent of the activities of a company is its objects clause.

Section 4(1)(*c*) requires a company to divide its objects clause into two parts.

(i) Objects to be pursued on incorporation ; and

(ii) Matters necessary for furtherance thereof.

According to section 4(1 [(c)], the object clause must state the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. Choice of objects lies with the subscribes to the memorandum and their freedom in this respect is almost unfettered. The only obvious restrictions are that the objects must no be against the law of the land and the provisions of the Companies Act. The objects must not be illegal, immoral or opposed to public policy.

Purpose of Objects Clause. The objects clause in the memorandum serves two purposes :

(1) It enables the subscribers to know the use to which their investment money is put and thus extends protection to shareholders.

(2) It extends certain degree of protection to creditors also in as much as the company cannot spend its capital on any activities which are not within the scope of the objects clause.

The objects clause in the memorandum of a company is construed positively and negatively. Objects not mentioned in it are not the objects of the company, but this clause should not be construed too strictly and the company may not do anything which is fairly incidental to the main objects specified in it. Thus a company which has its main object the making of steel may want to run its own transport in order to supply its products to its purchasers. The transport aspect of the business would really be ancillary to the running of the business of making of the steel and ought to be implied so that it should not be necessary to provide for transport business in the memorandum.

Importance of the Objects clause : This clause is the most important clause in the memorandum of association of a company, 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. It is essential that the public who purchase its shares should know clearly what are the objects for which they are paying and which they want to encourage. To give this information the statement of the objects should be clear. It must not be too vague and too general and too wide for in that case it will defeat its very purpose and object.[1]

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1. In re Bhutoria Bros (P) Ltd. 1975 Calcutta 593.

Lord Parkar in the case of *Cotman v. Brougham*[1] has beautifully summed up importance of the objects clause.

"The truth is that the statement of the company's objects in its memorandum is intended to serve a double purpose. In the first place it gives protection to the subscribers who learn from it the purpose to which their money can be applied. In the second place it gives protection to persons who deal with the company and who can infer from it the extent of the company's powers. The narrower the objects expressed in the memorandum the less is the subscribers risk, but wider such objects the greater is the security of those who transact business with the company."

(D) LIABILITY CLAUSE [SECTION 4(1)(d)]

This clause has to state the nature of liability that the members incur. In the case of a company limited by shares, the members are liable only to the amount unpaid on the shares taken by them. If his shares are fully paid up his liability is nil. Where a shareholder holding a ₹ 10 share has paid ₹ 5 on it, he can be called upon to pay the balance of ₹ 5. In case he has paid the full value of ₹ 10 he cannot be required to pay anything more even if the company owes huge debts to its creditors. In the case of a company limited by guarantee the members are liable to the amount undertaken to be contributed by them to the assets of the company in the event of its being wound up.

The liability clause is omitted from the memorandum of association of unlimited companies.

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

(E) CAPITAL CLAUSE [SECTION (4)(1)(e)]

The memorandum of a company limited by shares must state the authorised or nominal share capital, the different kinds of shares and the nominal value of each share. Provisions as to the nature of these shares are more properly to be made in the articles.

The amount of the capital with which company is to be registered is left to the discretion of those promoting it. It depends upon the needs of the company and the availability of finance. Moneys borrowed on debentures do not form part of the capital of a company.

Publication of authorized as well as subscribed and paid up capital

If a company publishes its authorized capital in any notice, advertisement or official publication or bill head or letter head, it shall also mention with equal prominence the amount subscribed and paid up. Otherwise, just looking at authorized capital, a person may be mislaid to believe that the company is big, though actually, it may be a small company.

(F) ASSOCIATION OR SUBSCRIPTION CLAUSE [SECTION 13(4)(f)]

This clause provides that those who have agreed to subscribe to the memorandum must signify their willingness to associate and form a company. The association clause generally runs in the following form, "We the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the memorandum of association and we respectively agree to take the number of shares in the capital of the company set opposite our respective names."

The memorandum has to be signed by each subscriber in the presence of at least one witness who must attest the signatures. One witness to all the signatures is sufficient. But a subscriber cannot

1. 1918 AC 514

attest the signatures of another subscriber. Each subscriber must write opposite his name the number of shares he shall take. No subscriber to the memorandum shall take less than one share. This clause need not be numbered.

(G) NOMINATION OR SUCCESSION CLAUSE (IN CASE OF ONE PERSON COMPANY)

In case of a one person company, there is a requirement to have 7th clause to describe the nominee in the event of the death of the subscriber. Prior written consent of nominee required to be obtained in Form No. INC 3. Nomination, in Form No. INC 2 along with written consent in Form No. INC 3 shall be filed with ROC at the time of incorporation of the OPC along with its memorandum and articles.

ALTERATION OF MEMORANDUM

The clauses in the memorandum as regards name, situation, objects, capital, liability of members and the undertaking of subscribers to take at least one share each are conditions. Since 'Memorandum of Association' is the constitution of the company, there are more restrictions on change of any of the clauses in the memorandum. Alteration of the memorandum only to the extent necessary for efficient and fair working of the company would be permitted.

The procedure for the alteration of the compulsory clauses or conditions of the memorandum is discussed below.

(A) CHANGE OF NAME [SECTION 13(2)]

By Special resolution. A company can change its name. For this purpose it must first pass a special resolution and then obtain approval of the Central Government in writing. However, no such approval is necessary for merely including or deleting the word 'Private' consequent on the conversion of the public company into private company and vice versa.

By Ordinary resolution. If through inadvertence or otherwise a company is registered by a name, which in the opinion of the Central Government is indential with or too nearly resembles the name of an existing company, it can change its name by passing an ordinary resolution and with the previous approval of the Central Government signified in writing.

Direction for changing name. The Central Government may also, within twelve months of registration, direct the company to change its name. Within three months of such directions the company must change its name by passing an ordinary resolution and with the previous approval of the Central Government. Default in complying with the direction is punishable with fine upto ₹ 1000 for every day during which the default continues.

Defaulting Companies Prohibited to Change the Name. Change of name shall not be allowed to a company which is defaulting in filing its due Annual Returns or Balance Sheets or which has defaulted in repayment of matured deposits and debentures and/or interest thereon.[1]

New Certificate of Incorporation. The Registrar shall enter the new name in the register in place of former name and shall issue a fresh certificate of incorporation. The change of name shall be complete and effective only on the issue of such a certificate. An application shall be filed in Form No. INC. 24 along with the fee for change in the name of the company and *a new certificate of*

1. Companies (Incorporation) Rules, 2014.

incorporation in Form NO. INC. 25 shall be issued to the company consequent upon change of name. **[Under Rule 29 of Companies (Incorporation) Rules, 2014]**.

The Registrar shall also make the necessary alteration in the memorandum of association of the Company.

Rights and obligations to remain unaffected. The rights and obligations of a company will not be affected on the change of its name. Thus a company can continue legal proceedings which had been commenced by it in its former name. Similarly, the rights of the creditors will not be prejudiced by the change of name. But a company is not authorised to commence a legal proceeding in its former name at a time when it had acquired its new name.

Example : A company had changed its name from 'Malhati Tea Syndicate Ltd.' to 'Malhati Tea Industries Ltd.' Thereafter it filed a writ petition in its former name. The Court declared the petition to be incompetent. [Malhati Tea Syndicate Ltd. v. Revenue Officer AIR 1973 Cal. 78]

(B) CHANGE OF REGISTERED OFFICE

The change of registered office may involve any of the following :

(i) Change of registered office from one place to another place in the same city, town or village.

(ii) Change of registered office from one town to another town in the same State.

(iii) Change of registered office from one State to another State.

(i) Change within the City. If a company wants to change its registered office from one place to another within the same city, town or village, the board of directors will pass a special resolution and the Registrar must be informed of the change in eForm 18 within 30 days. Non compliance shall render the company and its every officer liable to punishment of fine of ₹1000 per day of default, not exceeding ₹1 lakh.

(ii) Change within the State.

- **Special Resolution** under the jurisdiction of same ROC. Where the registered office is to be changed outside the local limits of any city, town or village in the same State, a **special resolution** to that effect must be passed. A notice of such change shall be given to the Registrar within 30 days of the change.

- **Confirmation by Regional Director** in case of jurisdiction of different ROC within the same state. The confirmation by the Regional Director will be necessary for changing registered office of a company from one place to another if the change of registered office is from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the state.

- Company shall give notice of new location to ROC within 30 days of change in registered office.

(iii) Change of Registered Office from one State or Union Territory to another State. Section 13 deals with the change of place of registered office from one State to another State. According to it, a company may alter the provisions of its memorandum so as to change the place of its registered office from one State to another for certain purposes referred to in Section 13 of the Act. These purposes are discussed under the heading 'Change of objects clause'. In addition the following steps will be taken.

- **Special resolution.** For effecting this change a special resolution must be passed by the company and a copy thereof must be filed with the Registrar within 30 days. Special resolution must be passed in a duly convened meeting otherwise the Central Government cannot exercise jurisdiction.

- **Confirmation by Central Government.** The alteration of the provisions of memorandum relating to the change of the registered office from one state to another state shall take effect only when it is confirmed by the Central Government on petition. Under Rule 30 of the companies (Incorporation) Rules, 2014 an application for approval of the Central Government shall be made in Form No. INC. 23 along with the prescribed fee The Central Govt. shall dispose off the application within a period of 60 days u/s 13(5).

Example : A company desired to shift its registered office from the State of West Bengal to the State of Maharashtra. The petition was opposed by the State on the ground of loss of revenue. The Calcutta High Court allowed the petition and observed that "the question of loss of revenue to one state would have to be considered in the total conspectus of revenue for the Republic of India and no parochial consideration should be allowed to turn the scale in regard to change of registered office from one State to another within India." **'[In re Machinnon Mackenzie and Co. (1967) 37 Com. cas. 516].**

The company shall file with the Registrar in Form No. INC. 28 a certified copy of the order of the Central Government confirming the alteration, within 30 days from the date of order together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand within one month from the date of filing of such documents.

The certificate shall be conclusive evidence that all the requirements of this Act with respect to the alteration and the confirmation there of have been complied with and henceforth the memorandum so altered shall be the memorandum of the company.

A certified copy of the order confirming the alteration shall be filed by the company with the Registrars of each of the States and the Registrar of each State shall registrar the same. The Registrar of the State from which such office is transferred shall send to the Registrar of the other State all documents relating to the company registered, recorded or filed in his office.

Change outside India. A Company cannot change its registered office from India to another country and the Central Government has no power to sanction such alteration of the memorandum.

(C) CHANGE OF THE OBJECT CLAUSE.

A company has no unlimited right to alter the objects clause of the memorandum, however, urgent or benefical such alteration may be. A company exists only for the purposes as are defined in the objects clause. The alteration of the objects clause is, therefore, subject to many restrictions and limitations which are intended to protect the interests of shareholders and creditors.

1. Alternation of objects by a company which has not issued a prospectus

A company which has not issued a prospectus may change its objects by passing special resolution. The special resolution is required to be passed by postal ballot except in case of OPCs and other companies having members up to 200 [Rule 22(16) of the Companies (Management and Administration) Rules, 2014

2. Alternation of objects by a company which has issued a prospectus

Section 13(8) read along with Rule 32 of the Companies (Incorporation) Rules, 2014 provides that a company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus and still has any unutilized amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot is passed by the company.

Note :- Requirement of passing of resolution through postal ballot is not applicable to a company having members up to 200 [Rule 22/916) of the Companies (Management and Administration) Rules, 2014

Besides,

I. The notice in respect of the resolution for altering the objects shall contain the following particulars.

(i) total money received;

(ii) total money utilized for the objects stated in the prospectus;

(iii) unutilized amount out of the money so raised through prospectus,

(iv) particulars of the proposed alteration/change in the objects;

(v) justification for the alternation/change in the objects;

(vi) amount proposed to be utilized for the new objects;

(vii) estimated financial impact of the proposed alteration on the earnings and cash flow of the company;

(viii) other relevant information which is necessary for the members to take an informed decision on the proposed resolution;

(ix) place from where any interested person may obtain a copy of the notice of resolution to be passed.

II. The advertisement giving details of each resolution to be passed for change in objects shall be published in the newspapers (one in English and one in vernacular language) which are in circulation at the place where the registered office of the company is situated.

III. The advertisement shall be published simultaneously with the dispatch of postal ballot notices to shareholders.

IV. The notice shall also be placed on the website of the company, if any, indicating therein the justification for such change.

V. The dissenting shareholders shall be given an opportunity to exist by the promoters and shareholders shall having control in accordance with regulations to be specified by the Securities and Exchange Board.

VI. The Registrar shall register the alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution

(D) CHANGE OF LIABILITY CLAUSE

Limited Company	Unlimited Company	Club or Association
– Ordinarily liability clause cannot be altered so as to make the liability of members unlimited. – Member's Consent may, be given either before or after the alteration.	– Section 18 permits an unlimited company to register as a limited company. – On alteration,, the Registrar shall close the former registration of the company and new registration shall take effect as if it were the first registration.	– Where as a result of alteration of Liability Clause of a Company which is a Club or any other similar Association. – A member is required to pay recurring or periodical subscription or charges at a higher rate.

– Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner. – Any alteration in the memorandum will be void if the effect of the alteration is the enhancement of the liability of members. – This provision, however, will not apply to a case where the members agree in writing to be bound by the alteration.	– The registration of an unlimited company as a limited company shall not, however, affect any debts, liabilities obligations or contracts incurred or entered into before the conversion.	– It shall be binding on him, even though he does not agree in writing to be bound by such alteration.

(E) CHANGE OF CAPITAL CLAUSE U/S 61(1)

Section 61 of the Companies Act, 2013 provides for alteration of Share Capital, **whereas Section 62** provides for increase in share capital. A limited company, having a share capital may alter its capital clause subject to the provisions of its articles by an ordinary resolution in the general meeting.

The confirmation of the Court is not required if alteration is made for any of the following purposes :

1. To increase its authorised share capital.
2. To consolidate and divide its share capital into shares of larger amount.
3. To convert its fully paid shares into stock and reconvert the stock into fully paid up shares.
4. To sub-divide its shares into shares of smaller amount.
5. To cancel its shares.

A change in the description of shares from, say, ₹ 100 to ₹ 10 is no a change in the fixed amount of the share and therefore, is not an alteration of a condition of the memorandum, so that no formalities are required by virtue of the Act.

But in case of reduction of share capital, special resolution is necessary.

Filing With Roc [Sec. 64]

(a) Where a Company has done any of the above alterations with regard to its Share Capital, it shall within 30 days, give Notice to the ROC specifying the shares consolidated, divided, converted, sub-divided, redeemed or cancelled or the stock reconverted.

(b) Upon such Notice, the Registrar shall record the same and make any alterations that may be required in the Company's MOA and AOA.

(c) Default in giving Notice to Registrar shall render the Company and every Officer of the Company liable to fine upto ₹ 1000 per day of continuing default or ₹ 5 lakhs, which ever is less.

DOCTRINE OF ULTRA VIRES

The Companies Act requires that the memorandum of every company must state the object of the

company. The objects clause must "delimit and identify the objects in such plain and unambiguous manner as that the reader can identify the field of industry within which corporate activities are to be confined." A company has power to carry out the objects set out in the memorandum and also everything which is reasonably necessary to enable it to carry out those objects. The objects clause requires that the company should devote itself only to the objects set out in the memorandum and to no others. The memorandum is thus the area beyond which a company cannot travel. Any activities not expressly or impliedly authorised by the memorandum are *ultra vires the company.*

'Ultra' means beyond, 'vires' means powers. An action outside the memorandum is *ultra vires the company. An act is said to be ultra vires when it is performed which, though legal in itself, is not authorised by the objects clause in the memorandum of association or the statute. Such an act is void and cannot be ratified even by unanimous resolution of all the shareholders.*

Purpose. The doctrine serves two purposes :

1. It protects the shareholders. The shareholders are assured that their investment is not spent on activities which they did not have in mind when they invested in the company.

2. It safeguards the interests of the creditors as the property of the company cannot be diverted to unauthorised objects.

The purpose of the ultra vires rule is to ensure, 'that an investor in a gold mining company did not find himself holding shares in fried fish shop and to give those who allowed credit to a limited company some assurance that its assets would not be dissipated in unauthorised enterprises.

Rationale Behind the Doctrine

The rationale behind the doctrine is competency to enter into a contract. For an individual, competency is determined by age and soundness of mind. But a company being an artificial person, does not have a body or mind. Hence competency for a company is determined by its own charter namely the memorandum. The corporate life cannot be spent for any purpose other than those specified in the memorandum.

The doctrine of ultra vires was put in its modern form in the leading case of 'Ashbury Railway Carriage and Iron Co. Ltd. v. Riche.'

Ashbury Railway Carriage and Iron Co. Ltd. V. Riche (1875)

Points decided are

1. If an act is ultravires the memorandum, it is not binding upon the company.
2. A contract ultravires a company is void and incapable of ratification, even if every member wishes to ratify it.

Facts of the case are

The memorandum gave the company power to make and sell, or lend on hire railway carriages and wagons and to carry on the business of mechanical engineers and general contractors. The Company entered into a contract with Riche for the financing of the construction of a railway line in Belgium and there was evidence that the contract had been ratified by all the members. The company repudiated the contract. The other party brought an action for damages for breach of contract. His contentions were: (1) that the contract in question came well within the meaning of the words 'general contractors' and was, therefore, within the powers of the company, and (2), that the contract was ratified by the majority of the shareholders.

It was held by the house of lords that the contract was entirely beyond the objects in the memorandum of association and hence void.

Lord Cairns[1] observed in this case, "It is not a question whether the contract ever was ratified or was not ratified. If it was a contract void at its beginning it was void because the company could not make the contract. If .... every shareholder of the company had said 'That is a contract which we desire to make....' the case would not have stood in any different position from that which it stands now. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by the Act of Parliament, they were prohibited from doing."

An ultra vires contract can never be made binding on the company. It cannot become intra vires by reasons of estoppel, lapse of time, ratification etc. The rule is meant to protect prospective shareholders and the public at large who deal with the company.

> **Example :** A company was authorised by its memorandum of association to carry on the business of costumiers, gown-makers etc. The company decided to undertake the business of making veneer panels which was ultra vires. The company erected a factory at Bristol for this purpose. The company later went into liquidation. The creditors filed a suit for the recovery of debts. It was held that the creditors cannot recover the money because the business of the company was ultra vires
>
> **[In Re Jon. Beauforte-London Ltd. (1953) Ch. 131]**

The doctrine of *ultra vires* was recognised in India from 1866[2] and since then this rule has been applied in a number of cases. The rule has been recently affirmed by the Supreme Court in A Lakshamanasawami Mudaliar v. Life Insurance Corporation of India[3] the facts of which are as under.

The directors of a company were authorised **"to make payments towards any charitable or for any general public or useful object."** In accordance with a shareholder resolution the directors paid two lakh rupees to a trust formed for the purpose of promoting technical and business knowledge. The company's business having been taken over by L.I.C. it had no business left of its own. It was held by the court that directors could not spend company's money on any charitable objective which they might choose. The payment was, therefore ultra vires.

There may be cetain acts which are ultra vires the directors or ultra vires the articles but which are intra vires the company. If an act is ultra vires the directors only and the shareholder have ratified it, the company would be bound by it. Where an act is ultra vires the articles, it can be ratified by altering the articles through a special resolution. Further, if an act is within the powers of the company, any irregularities can be cured by the consent of all the shareholder.

he whole position in relation to the doctrine of **ultra vires may be summed up as follows :**

1. When an act is perfomed which, through legal in itself, is not authorised by the objects clause of the memorandum, it is said to be *ultra vires the company.*
2. Transactions which are *ultra vires. do not bind the company and a third party cannot sue the company to enforce the transaction.*
3. If a transaction is *ultra vires* the company, it cannot be ratified subsequently even if all the shareholders approve the transaction and it continues to be *ultra vires.*

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1. (1875) L.R. 7 H.L. 653.
2. Jahangir R. Modiv. Shamji Ladh (1866) Bombay H.C.R. 1855.
3. AIR 1963 SC 1185.

4. If a person lends money to the compnay for purposes which are *ultra vires, he cannot recover the money from the company ; but he may recover the goods, if any, purchased out of these monies, provided they can be properly identified.*
5. If an act is *ultra vires* the directors, but *intra vires* the company, it can be reatified by all the members of the company.
6. It the act is ultra vires the articles, it can be ratified by altering the aricles by passing a special resolution in the general meeting.

Effects/Consequences of Ultra Vires Acts

The effects of ultra vires transactions are discussed under the following heads.

1. Void ab intio. Where a company does an act, which is ultra vires, no legal relationship or effect ensues thereform. Such as act is absolutely void and cannot be ratified even if all the shareholders agree.

The company is not bound by these acts ; even the company can not sue or be sued upon it.

A complaint alleging that a Company was indulging in activities not mentioned in Objects Clause of its MOA has to be filed within six months of the date of knowledge. [NEPC India Ltd. vs. ROC [1999]22SCL94]

2. Injunction. The company has the capacity to do those acts which are within the scope of the powers conferred on it by its memorandum. As such a company may be restrained by an injunction to do an act if it is *ultra vires of its objects.*

Example : The Council had power to run tramways. It ran omnibuses to feed the tramways. It was held that the running of omnibus was ultra vires and the council was restrained from running the omnibus. [London Country Council v. Attorney General (1902) A.C. 165].

3. Breach of warranty of authority. The directors of a company are its agents and as such it is their duty to act within the limits of the company's powers. Every agent warrants that his principal has power to make the contract which the agent is making on his behalf. Where the directors of a company persuade a third party to enter into a transaction which is *ultra vires the company, an action may lie against them for breach of warranty of authority. The fact that the company cannot be made liable as a result of the ultra vires rule does not militate against allowing an action against the company's agents. Certainly a third party cannot be denied such a right.*

Example : A railway company had already exhausted its borrowing powers. The directors of the company invited proposals for a loan on debentures. Mr. Week offered a loan of 500 pounds, which was accepted and debentures were issued. The loan being ultra vires was held to be void. It was held that the directors by inserting the advertisement had warranted that they had the power to borrow which in fact they had not. The directors therefore were personally liable for the beach of warranty.

[Weeks v. propert. (1873) L.R. 8 C.P. 427]

4. Personal liability of directors. It is the duty of the directors to see that the corporate money is used only for the legitimate business of the company. If any money is unlawfully disbursed, the directors shall be personally liable to make good the amount. Thus, the shareholders can maintain an action against the directors to compel them to restore to the company the funds of the company that have been employed in transactions that they have no authority to enter into.

Example : A company was engaged in the business of life insurance. The directors in pursuance of a special resolution donated rupees two lakh to a trust formed with the object of promoting technical or business knowledge. The Supreme Court held that the donation was ultra vires and the directors must refund the amount paid to the trust.

[A Lakshmanaswami Madaliar v. Life Insurance Corporation AIR 1963 SC 1185].

The directors who refunded the money could get indemnity as against the person who received the payment with the knowledge that the payment to him was *ultra vires*[1]

Example : The directors of a company paid dividend on shares out of capital. It was an ultra vires act. The company was afterwards wound up. The directors were held liable to refund the money to the company. But the person who receives the money with the knowledge that the payment to him is ultra vires is liable to indemnify the directors who refunded the money to the company as he is in effect a constructive trustee of the money **[Sharpe Re (1892) 1 Ch. 154].**

5. Ultra vires contracts. A contract by a company outside its objects is wholly void and of no legal effect. Neither side is capable of enforcing the contract against the other. The knowledge of the third party is immaterial. Persons dealing with company are deemed to have knowledge of the memorandum. Accordingly if they make a contract which is to their knowledge, actual or constructive, ultra vires the company, they cannot enforce it.

Example : A company operated a rice mill beyond its powers. The company sold rice to certain persons who had paid the price. The purchasers had to sell the rice, owing to its inferior quality, at considerable loss. The company gave them drafts promising to pay for the loss. The company went into liquidation. It was held the purchasers could not sue the company for damages as trading in rice was a transaction ultra vires the company.

[In Re Port Canning and Land Investment company (1871) 7.Bengal L.R.]

6. Ultra vires acquired property. A company can protect its property acquired by an ultra vires expenditure. Thus, in a case where the company's telephone wires were cut, and it had no power in the memorandum to put up the wires, it was held entitled to recover damages for the injury.[2]

7. Ultra vires borrowing. Where a person lends money to a company and the company either has no borrowing powers or has already exceeded them, or the borrowing is for the purpose which is ultra vires, then the contract of loan is void and no action can be brought under it to recover the money lent. Ultra vires borrowing does not create the relationship of creditor and debtor and the only possible remedy in such case is in rem and not in personam.

The lender may be able to recover his money by the following methods.

(i) He may be able to assert a claim to 'subrogation'. Where the company has used the loan to pay of intra vires debts, the lender can take the place of the original creditor and enforce the same rights. Thus if A lends ₹ 10,000 to B Co. Ltd. the loan being ultra vires. A will not be able to recover the loan as such. But if the company has used the money to pay off ₹ 5,000 worth of enforceable debts, A may stand in the shoes of the creditor paid off and sue the company as the creditors could have done. A will have an action for ₹ 5,000.

(ii) The lender may be able to trace his money into an asset which the company has purchased with it, or into the funds of the company. In equity the lender of money can obtain redress by means of a tracing order provided the lender can identify his money or any property purchased with it. The company in such a case is regarded as holding the money lent to it on trust for the lender.

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1. Jahangir R. Modi v. Shamji Ladha (1866) Bombay, H.C.R. 1855.
2. National Telephone Co. v. Constables of St. peter Port. (1900) A.C. 317.

Example : A Building society started an ultra vires banking business and borrowed large sums of money. The society went into Liquidation. The House of Lords held that the customers who had lent on an ultra vires contract could not sue, but they were allowed to trace their funds into the money of the society. **[Sinclair v. Brougham 1914 A.C. 398].**

8. Ultra vires torts. A company will be liable for torts or crimes committed in the pursuit of its stated objects. But a tort or crime committed in the course of activity which is ultra vires the company, the company would not be liable in respect of it. However, the officer, agent or servant of the company who commits the act would be personally liable in such a case.

It is worth noting that the doctrine of ultra vires is now-a-days very largely frustrated by the Smartness of company promoters, who, by enumerating all objects possible under the sun have in actual practice fouled the doctrine and made it ineffective, except in very rare cases.

Exceptions to the Doctrine of Ultra Vires

There are, however, certain exceptions to this doctrine which are as follows :

1. An act which is *intra vires* the company but outside the authority of the directors may be ratified by the shareholders in proper form.
2. An act which is *intra vires* the company but done in an irregular manner, may be validated by the consent of the shareholders. The law, however, does not require that the consent of all the shareholders should be obtained at the same place and in the same meeting.
3. If the company has acquired any property through an investment which is *ultra vires,* the company's right over such a property shall still be secured.
4. While applying the doctrine of *ultra vires,* the effects which are incidental or consequential to the act shall not be invalid unless they are expressly prohibited by the Companies Act.
5. There are certain acts under the Company Law which though not expressly stated in the memorandum are deemed impliedly within the authority of the company and therefore they are not deemed *ultra vires.* For example, a business company can raise its capital by borrowing.
6. If an act of the company is *ultra vires* the articles of association, the company can alter its articles in order to validate that act.

DRAFTING OF MEMORANDUM OF ASSOCIATION

The following steps are required for drafting a M.O.A of a company.

CONTENTS OF MEMORANDUM

Name

While drafting the M.O.A. the name should be written in full without any abbreviation including the words ''LIMITED'' or ''PRIVATE LIMITED'' or "ONE PERSON COMPANY".

The name should be mentioned exactly as made available by the Registrar of Companies.

The word(s) ''Limited'' or ''Private Limited'', or "One Person Company" as the case may be, should be added as the last word(s) in the name. The Registrar of Companies should have permitted

The Registrar may exempt the use of words ''Limited'' or ''Private Limited'' in the case of companies which have been granted licence.

Place

While drafting the memorandum we should name the State in which the registered office is situated.

It is not required to mention the address or the place name of registered office. Even mention of such place name does not make it an unalterable condition.

Objects

The objects clause of a company formed should specify the objects of the company under the following heads :

(a) Objects to be pursued on incorporation ; and

(b) Matters necessary for furtherance thereof.

The number of objects to be included in the Main Objects would depend upon the activities proposed to be carried on by the company.

In the case of non-trading companies, power to borrow should be specifically included. Such companies will have only those powers, which will enable them to carry out their objects.

If the promoters so desire, other objects need not be mentioned. In such case under the heading Other Objects there should be written NIL

Limited liability

Where the liability of the members is limited, it should be so stated. The limited liability may be in respect of shares or guarantee.

Share Capital

The Memorandum shall state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount. It is not necessary to classify the shares into equity and/or preference.

Form of memorandum

The memorandum should be in one of the forms given in Tables A, B, C, D and E of Schedule I, as may be applicable, or in a form near thereto.

Printing, etc.

The Memorandum should be printed and divided into paragraphs numbered consecutively.

Offset system is as good as normal printing, hence memorandum may be printed by offset method.

Computer printing is also recognised for this purpose.

Xerox copies of the Memorandum and Articles of Association for the purposes of registration are not permissible.

Stamping

Stamp the Memorandum as per the Stamp Act provisions prevailing in the State where the registered office is situated.

Subscribers to Memorandum

It may be noted that 7 persons are required for public companies and 2 for private companies and 1 person for One Person Company.

The liability of the subscriber is equal to the total amount due on the shares subscribed by him. It cannot be discharged by taking on transfer of shares from another.

The subscribers to the Memorandum should be the same as the promoters/directors stated in Form 1A. Revise Form 1A, in case there is any change in the subscribers. To remove a subscriber, obtain a ''No Objection Letter'' from such subscriber.

Subscription of memorandum

The Memorandum as finally printed is thereafter signed by each, subscriber who shall add, in his own handwriting, his address, description and occupation, if any.

The subscriber shall also write opposite to his name the number of shares he takes.

The subscriber must take at least one share.

The signatures should be made in the presence of at least one witness who shall attest the signatures and shall likewise add his address, description and occupation, if any.

Then the memorandum should be dated.

A subscriber need not be beneficially interested. An agent may sign if he is authorised by a power of attorney to do so.

A guardian of a minor can sign in his capacity. Karta of a HUF may similarly sign.

In the case of an illiterate subscriber the thumb impression or mark should be duly attested. The person attesting the mark should state by way of an endorsement on the Memorandum and Articles that the contents have been read and explained to the subscriber.

In case of signature other than in English, there shall be attached an affidavit made by either the subscriber or the witness stating that the signature made is the usual signature of the subscriber.

In the case of Central and State Governments, subscription will be made in the name of the President or the Governor.

SHORT ANSWER QUESTIONS

1. 'A memorandum of association is a fundamental document of a company.' Why ?
2. Mention the two purposes of a memorandum of association ?
3. List the various clauses of a memorandum of association.
4. How a cornpany can change its name ?
5. Is it necessary for a company to have a registered office ?
6. 'The object clause is the most important clause in the memornadum of association of a company.' Why ?
7. Define the doctrine of *ultra vires.*

8. Set out the steps to be followed by a company which desires to alter the objects clause of its memorandum of association.
9. What is the relation of memorandum of association with articles of association ?
10. Can a company ratify an act which is *ultra vires the company ?*
11. What procedure is to be followed by a company when it wants to change its registered office from one town to another town in the same State ?

TEST QUESTIONS

1. What do you understand by the memorandum of association ? What is its purpose ?
2. "Memorandum of association is a charter of the company." Comment upon the statement and explain the clauses which are included in a memorandum of association of a company.
3. Explain the necessity of setting out clearly the objects in the memorandum. To what extent may a company lawfully undertake business and perfrom acts not expressly set out in the objects clause ?
4. Explain the procedure for changing the situation of the registered office of a company from one State in India to another State in India.
5. What is the procedure for alteration of a memorandum of association ? Can new objects be added by way of alteration ? Can it be alltered in any respect without reference to the Tribunal.
6. By what methods and to what extent may a company alter its memorandum? By whom may an alteration be opposed and in what way ?
7. Explain fully the doctrine of *ultra vires in relation to companies ? What are the liabilities of a company and its agents for ultra vires acts ?*
8. "A company's objects clause is of fundamenetal importance not only to members but also to non-members." Comment.
9. What is the importance of the objects clause of the memorandum of association ? If a company undertakes to do anything which is not either expressly or impliedly provided for by the objects clause, what would be the consequences ?

PRACTICAL PROBLEMS

Q. 1. **P.K. Ltd. had its registered office at Lucknow. The company applied to the Registrar of Uttar Pradesh to seek permission to transfer its registered office to Patna. The Registrar of Uttar Pradesh granted such permission to P.K. Ltd. which accordingly transferred its registered office to Patna. Is the transfer of registered office valid.**

Ans. If a company wants to shift its registered office from one State to another, it must pass a special resolution and obtain confirmation of the change from the Central Government. If the Central Government after being satisfied issues the confirmation order, the company within three months from the date of confirmation must file with the Registrar a certified copy of the order alongwith a printed copy of the altered memorandum. The Registrar of each state then certifies the change. Within 30 days of the change the company must give notice of the new location of its registered office to the Registrar of the state to which the office is shifted. So in the present case it appears that P.K. Ltd. have not complied with all the aforesaid provisions of the Companies Act and therefore, the transfer of its registered office is not valid.

Q. 2. **A.K. Ltd. has its registered office in Calcutta. The company is mainly engaged in the production and distribution of films. The company passes a special resolution for shifting its registered office from Calcutta to Bombay. The move is opposed by the State of West Bengal on the ground that it will affect the revenues of the State. Decide giving reasons.**

Ans. The petition will be allowed. The Calcutta High Court observed that the question of loss of revenue to one state would have to be considered in the total conspectus of revenue for the republic of India and

no parochial consideration should be allowed to turn the scale in regard to change of registered office from one State to another within India.

Q. 3. The directors of a company paid rupees one thousand out of the capital of the company as interest to 'A' on the shares held by 'A' in the company. The company later on went into liquidation. The liquidator asked the directors to refund rupees one thousand to the company. Can the liquidator compel the directors for the refund ?

Ans. The act of the directors amounted to ultra-vires transaction. As such the liquidator can ask the directors to refund the amount to the company on liquidation.

Q. 4. A telephone company did not have the powers to lay telephone lines in a particular area as per its M.O.A. The company laid down the lines and a miscreant X cut them down. Can the company sue X for damages done to the wires ?

Ans. If a company has acquired some property under an ultra vires transation, it has the right to hold that property and protect it against damage by other persons. The property which is legally and by formal transfer or conveyance transferred to the company is in law duly vested in such company even though the company was not empowered to acquire such property. Thus in this case where the company's telephone wires were cut, and it had no powers in the memorandum to put up the wires, it will be entitled to recover damages for injury caused to its property.

Q. 5. A company had been formed to permit, assist and protect the use of bicycles, tricycles, and other similar vehicles on the public roads and for further objects connected with same road users. The company proposes to alter its objects clause to include motorists as well for benefits under the schemes of the company. Should the Tribunal confirm such an alteration ?

Ans. The alteration should not be confirmed. In this case the company's main object was to permit, assist and protect the use of bicycles and tricycles which are foot driven and not mechanically operated with the help of petrol or diesel. Therefore if the motorists were to be included, the main object of the company is unlikely to be achieved which was to protect cyclists against motorists.

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ARTICLES OF ASSOCIATION

COMPARATIVE CHART (Some of the Major Changes)

Points of comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	ARTICLES OF ASSOCIATION	
Entrenchment provisi-ons in Articles	Articles may contain such provisions [See rule 10 of the Companies (Incorporation) Rules, 2014]	No enabling provisions in 1956 Act for articles to contain entrenchment provisions
Whether compulsory for every company to have its articles	Yes. Section 5(1) and Section 7(1) (a) of the 2013 Act make it compulsory for every company to have its own articles and file the same with ROC for registration.	▪ Optional for a public com-pany limited by shares. ▪ Compulsory for other com-panies.
Form of Articles of unlimited companies and companies limited by guarantee	(i) The articles of a company shall be in the respective forms specified in Tables G, H, I and J in Schedule I as may be applicable to such company. The liberty to have articles "or in a Form as near thereto as circumstances admit" which was available in the 1956 Act is no longer available in the 2013 Act.	(i) The articles of any company, not being a company limited by shares, shall be in one of the forms in Table C/Table D/ Table E in Schedule I as may be applicable, or in a From as near thereto as circumstances admit.
	(ii) A company may adopt all or any of the regulations contained in the model articles applicable to such company. Unlike the 1956 Act, the 2013 Act allows company limited by guarantee/unlimited company to modify or exclude the regulations contained in the applicable model articles.	(ii) The company may include additional matters in its articles in so far as they are not in–consistent with the provisions contained in the Form in any of the Tables C,D and E, adopted by the company.

MEANING

Articles of Association is another important document which has to be filed with the Registrar at the time of the incorporation of the company. The articles of association sets out the regulations for

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

- **Rules of internal management** The articles of association contains the rules and regulations of a company framed for the purpose of management of its internal affairs. They lay down the mode and manner in which the business of the company is to be conducted. They define the powers of its officers. They also establish a contract between the company and members and the members *interse*. The articles are framed for carrying out the aims and objects of the memorandum of association.
- **Subordinate to MOA** The articles of association of a company are subordinate to and are controlled by the memorandum of association. The memorandum of association contains only the fundamental conditions upon which alone the company is allowed to be incorporated. The memorandum is as it were, the area beyond which company cannot go; inside that area, the shareholders may make such regulations for their own governance as they think fit.[1]

Though the articles are subordinate to the memorandum, yet if there be any ambiguity in the memorandum, the articles may be used to explain it. Articles must not contain anything the effect of which is to alter a condition contained in the memorandum or which is contrary to its provisions.

The articles should also not authorise the company to do anything which contravenes the provisions of the Companies Act. If they do, they would be ultra vires the Memorandum or the Act and will be null and void. For example, u/s 123, a company cannot pay the dividend except out of profits. Any provision in the articles contrary to this provisions of the Companies Act is void.

Compulsory to have Articles. U/s 5(1) and 7(1)(a) of 2013 Act, it is compulsory for every company to have its own articles and file the same with RoC for registration.

MODEL FORM OF ARTICLES

Schedule I to the Act gives various model forms of Memorandum of Association and Articles of Association for various types of companies. The schedule is divided into tables which serve as a model for various companies.

Articles of a public company limited by shares:

Section 5(7) provides that a company may adopt all or any of the regulations contained in the model articles applicable to such company.

Therefore, a company may either:—

(i) Formulate and register Articles of its won within the provisions of the Act and the memorandum of association; or

(ii) Adopt all or any of the regulations contained in the model articles (Table F); or

(iii) Partially adopt Table F and also have its own articles.

Articles of a private company:–

A private limited company must have articles of its own which must contain the restrictions as

1. Ashbury Railawy carriage & Iron Company Ltd. v. Riche (1875) L.R. 7 HL 653.

provided in section 2(68) of the Companies Act, 2013. Therefore, without following these restrictions in its articles it cannot have the status of a private company.

The company shall have a minimum paid up capital of ₹ 1,00,000 or such higher paid up capital as may be prescribed from time to time under the Companies Act, 2013.

It further–

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to 200:

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

Following shall not be included in the number of members :

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

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

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

With these restrictions the private limited companies are having liberty to adopt all or any of the regulations contained in Table 'F'.

Private limited company can adopt Table F with or without modification or exclusion of all or some of the provisions contained in Table F. Thus, a private company limited by shares has the following options available in preparing its articles of association for registration with the Registrar of Companies:

(a) Adopt the entire Table F as its articles of association;

(b) Adopt only some of the provisions of Table F and incorporate them in the articles;

(c) Adopt only some of the provisions of Table F, but instead of incorporating them in the articles, include in the beginning of the articles a suitable statement indicating their adoption;

(d) Adopt Table F but exclude some of its provisions by including a suitable statement to that effect in the articles of association of the company;

(e) Modify the provisions of Table F and incorporate them in the articles of association of the company; and not to adopt any of the provisions of Table F, but have independent articles.

Articles of Company limited by guarantee and unlimited companies

As per section 5(6) of the Act the articles of association of any company, not being a company limited by shares, shall be in such one of the Forms in Tables G, H, I and J in Schedule I as may be applicable, or in a Form as near thereto as circumstances admit.

The Articles of the above types of companies, which do not have share capital, may follow the pattern as prescribed in the Act as under:–

Table 'G' – Articles of association of a company limited by guarantee and having a share capital.

Table 'H' – Articles of association of a company limited by guarantee and not having share capital.

Table 'I' – Articles of association of an unlimited company and having a share capital.

Table 'J' – Articles of association of an unlimited company and not having share capital.

Printing and signing of articles [Section 7(1)(a)]. The articles must be printed and divided into paragraphs, numbered consecutively. The articles must be signed by each subscriber to the memorandum in the presence of at least one witness who will attest the signature and likewise add his address, description and occupation, if any. As in the case of memorandum no subscriber can attest the signature of another subscriber.

The Articles of Association printed on computer laser printers should be accepted by the Registrar for registration of a company provided they are neatly and legibly printed.

CONTENTS OF ARTICLES

The articles of a company may contain whatever rules the members decide should regulate the business of the company. The Act gives the members a free hand. Utmost care must be taken to prepare the articles of association of the proposed company. There are certain matters in respect of which powers can be exercised by the company only if its articles so provide and in the manner provided therein. At the same time, certain provisions of the Act are applicable to the company, notwithstanding anything to the contrary in the articles. Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later. Everything stated in the articles is subject to the Companies Act. The articles cannot authorise anything expressly or impliedly forbidden by the Act. Any clause which is contrary to the provisions of the Act is simply inoperative and void.

Example : The articles provided that no winding up petition could be presented without the consent of two directors or unless a resolution to wind up was passed at a general meeting or the petitioner held one-fifth of the share capital. None of these conditions was fulfilled. Held, the restrictions were invalid and the petition could be presented. **[Re Peveril Gold Mines Ltd. (1898) 1. Ch. 122 C.A.].**

The articles usually contain rules regarding following matters :

1. Adoption of preliminary contracts.	2. Number and value of shares.
3. Allotment of shares.	4. Calls on shares.
5. Lien on shares.	6. Transfer and transmission of shares.
7. Forfeiture of shares.	8. Alteration of capital.
9. Conversion of shares into stock.	10. Voting rights and proxies.
11. Meetings.	12. Directors, their appointment etc.
13. Borrowing powers.	14. Dividends and reserves.
15. Accounts and audit.	16. Winding up.

Provision for Entrenchment. The Companies Act 2013 has for the first time, made provision relating to entrenchment as part of articles, Section 5(3) of the Companies Act, 2013 provides that the articles may contain provision for entrenchment. What it signifies is that articles may provide that certain provisions of the articles will not be alterable simply by passing a special resolution. Rather, they will require a more detailed and elaborate procedure to be followed which may be prescribed.

The provision for entrenchment can be made either at the time of incorporation of a company or by an amendment in the articles agreed to by all the members in the case of a private company and by a special resolution in the case of a public company [Section 5(4)].

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

ALTERATION OF ARTICLES (SECTION 14)

A company has a statutory right to alter its articles of association. Any regulation or article purporting to deprive the company of this power would be invalid.[1] The company cannot contract itself out of its inherent statutory power to alter its articles and provide that any of its articles are to remain unaltered.[2] Thus, a provision in the articles that no alteration of articles shall be made without the consent of X is contrary to the provisions of Companies Act and is therefore ineffective or void.

A company can never replace its articles. It is only regulations contained therein which may be changed.

Procedure for alteration of articles of association

For effecting alteration to the articles of association, the following procedure is required to be followed : -

1. The proposal has to be approved by the Board of directors. The Board will fix the date and time of the general meeting. It will also approve the draft notice of the meeting, the special resolution and explanatory statement. The secretary, if any, will be authorised to convene the general body meeting.
2. The secretary shall convene the meeting on the appointed day. In the meeting the necessary special resolution amending the articles of association shall be passed.
3. Within 30 days of the passing of the resolution, a certified copy thereof shall be filed with the Registrar of Companies [*vide* section 117 of the Companies Act].
4. Where the alteration of the articles has the effect of converting a public company into a private company, the company shall seek the approval of the Tribunal which shall make such order as it may deem fit (*vide* section 14 of the Companies Act).
5. After getting the approval of the, printed copy of the articles, as altered, should be filed by the company with the Registrar of Companies within 15 days of the date of receipt of order of approval.
6. Six copies of the amendments (one of which shall be certified) should be sent to the stock exchange(s) on which the shares of the company are listed, as soon as they have been adopted by the company in the general meeting (*as per the Standard Listing Agreement]*
7. Alteration should be noted in every copy of the articles of association, and the articles issued after the date of alteration should be in accordance with the altered articles (section 15). A default in this regard shall invite penalty against the company as well as every officer in default. The penalty provided under the section is fine of ₹ 1000 for each copy so issued.

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1. Malleson v. National Insurance etc. Corporation (1894) 1 Ch. 200.
2. All India Railway Mens' Benefit Fund v. Jamadar Beheshwarnath (1945) N.187 (189).

Limitations On Power To Alter Articles

1. Must not be against the provisions of Act. The alteration must not authorise anything expressly or impliedly forbidden by the Companies Act. Thus, the articles cannot authorise a company to pay dividends out of capital. Where a resolution was pased expelling a member and authorising the directors to register the transfer of shares without an instrument of transfer the resolution was held to be invalid as being against the provisions of the Act.[1]

2. Must not be inconsistent to the Memorandum. The alteration must not extend or modify the memorandum. The memorandum of association is a superior document and the provisions of the articles cannot override it. What is prohibited by the memorandum cannot be authorised by altering the articles.

> **Example :** A resolution passed at a general meeting of a company altered the articles by inserting the power to issue new shares with preferential dividend. The memorandum contained no such power. The alternation was held to be inoperative [Hulton v. Scarborough Cliff Hotel Co. (1865) 62 ER 717.]

3. Must not sanction anything illegal. The alteration must not contain anything illegal. The company is the absolute master of its internal regulations and may alter those regulations provided such alteration is legal and is not prohibited by its memorandum. Such an alteration will be valid even if it alters the whole structure of the company.

4. Not be inconsistent with any alteration made by Tribunal [Sec. 242]. Where an order u/s 242 makes any alteration in MOA or AOA of a Company, then Company shall not have power to make any alteration which is inconsistent with its orders except with approval of Tribunal.

5. Approval of the Tribunal for conversion of public company into private company. No alteration can be made in the articles which has the effect of converting the public company into private company unless such alteration has been approved by the Tribunal. (Section 14)

Where an alteration has been approved by the Tribunal, a printed copy of the articles as altered must be filed by the company with the Registrar within one month of the date or receipt or order of the approval.

6. No increase in the liability of members. No alteration may be made in either the memorandum or the articles compelling a person who is a member at the date of the alteration to take or subscribe for more shares or increase his liability to the company unless he agrees in writing before or after the alteration is made.

7. Alteration by special resolution only. Alteration of articles will be made only by a special resolution as defined in the Act. Articles can never by altered by an ordinary resolution even if they provide for such a procedure. Even clerical errors in the articles should be set right by a special resolution.

8. Should not cause breach of contract. A company cannot by altering its articles escape liability for breach of a contract into which it has entered. It cannot plead its altered articles as a defence in an action for a breach of contract. The rights which have already accrued under the contract cannot be disturbed by the alteration.

> **Example :** An agreement provided that so long as X company should hold 5,000 shares in the Y company, it should have the right of nominating two directors on the Board of the Y company. A provision to the same effect was contained in the articles of the Y company. X company had nominated two persons as directors whom the Y company refused to accept. An attempt was made to alter the articles but an injunction was granted to restrain it as it would constitute a deliberate breach of contract with an outsider. **[British Murac Syndicate v. Alperton Rubber Co. Ltd. (1915) 2 Ch. 186].**

1. Madhav Ram Chandra Kamath v. Canara Banking Corporation AIR 1941 Mad. 354.

9. Must be for the benefit of the company. The power to alter the articles must be exercised bonafide for the benefit of the company as a whole. If the alteration is bonafide for the benefit of the company as a whole, the interests of the minority may be sacrificed. Companies enjoy wide powers as regards alteration of articles. But this power must be exercised not only in the manner required by laws but also bonafide for the benefit of the company as a whole. An alteration will not be restrained merely because it inflicts hardships on some members and not on others.

> **Example :** The articles gave the company lien on all shares 'not fully paid' for calls due to the company. A was the only shareholder holding fully paid shares. He also owed money to the company for calls due on other shares. A died. The company altered its articles by deleting the words 'not fully paid up' and thus gave itself the power to exercise lien on all of A's shares. It was held that the alteration was good as it was done bonafide for the benefit of the company as a whole.
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> **(Allen v. Gold Reefs West Africa Ltd. (1900) 1. Ch. 657).**

The expression for the benefit of the company as a whole' means for the benefit of the shareholders as a general body. Its effect should not be such as to discriminate between the majority shareholders and minority shareholders so as to give the former an advantage of which the latter are deprived.

10. Fraud on the minority. The alteration must not constitute a' fraud on the minority. The basic requirement is that the power of alteration must be exercised in good faith in the interests of the company.

In a case of Bwown vs. British Abrasive Wheel Co. [1919]1CH290 the majority which held 98% of shares passed a Special Resolution that upon request of holders of 9/10th of issued shares, a shareholder shall be bound to sell and transfer his share to the nominee of such holder at a fair value. Alternation was held to be invalid since it amounted to oppression of minority.

11. Retrospective alteration. Articles may be so altered as to have retrospective effect *e.g. the insertion of a lien clause so as to give the company a lien on shares of members for debts incurred both before and after the insertion of the clause. But alterations should not be such as to throw an increased liability on members more than they contracted for when they became members.*

But in case of Pyara Lal Sharma Managing Director, J & K Industries Ltd. [1989]3 Comp. L.J. (SL) 70, the Court held that the amended regulation in the articles of association cannot operate retrospectively, but only from the date of amendment.

12. Articles cannot be made unalterable. The alteration must not make the articles unlaterable as it is regarded bad in law.

13. Discrimination between two groups of Shareholders. The alterationshall not result in any discrimination between two groups of shareholders.

Thus, it may be noted that the power to alter articles is subject to a number of restrictions. It is rightly stated that 'the power of altering the articles is wide, yet it is subject to a large number of restrictions'.

MEMORANDUM AND ARTICLES DISTINGUISHED

Memorandum and articles are public documents. They are inter-linked and require to be registered for the formation of the company. Where there is any ambiguity or where the

memorandum is silent on any point, the articles may serve to explain or supplement the memorandum. Beyond this the two documents have nothing in common and differ from one another in the following respects.

Particulars	Memorandum of Association	Articles of Association
Meaning	Memorandum of Association defines the relation of the company with the outside world	Articles of Association deals with the rights of the members of the company *Inter se and also establishes the relationship of the company with the members.*
Scope	Memorandum of Association is the charter of the company and defines the *scope* of its activities.	Articles of Association of the company is a document which regulates the *internal management* of the company These are the rules made by the company for carrying out the objects of the company as set out in the memorandum.
Contents	Name Clause, Registered Office Clause, Objects Clause, Liability Clause, Capital Clause and Association Clause.	Contains Regulations for Company management and those that regulate relationship between members inter se.
Status	Memorandum is a supreme document of the company	Articles are subordinate to the memorandum. They cannot alter or control the Memorandum of Association.
Alteration	Can be altered only under certain situations and in the manner provided. Approval of Central Government is required, besides approval of Shareholders in a General Meeting by way of Ordinary or Special Resolution.	Can be altered by the members by passing a Special Resolution only.
Ultra vires	A company cannot depart from the provisions contained in its Memorandum, and if it does, it would be *ultra vires the company.*	Anything done against the provisions of Articles, but which is *intra vires the Memorandum, can be ratified.*

BINDING EFFECT OF MEMORANDUM AND ARTICLES

The memorandum and the articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member. According to section 10(1) of the Companies Act, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained convenants on its and his part to observe all the provisions of the memorandum and of the articles.

This section aims to impart contractual force to the memorandum and articles. The effect of these provisions is to constitute through the memorandum and the articles of association of a company a contract between each member and the company. The effect and the implications of this section may be appreciated by considering how far the memorandum and the articles bind—

(i) the members to the company,

(ii) the company to the members,

(iii) the member inter se,

(iv) the company to the outsiders.

(i) Members to the company. The memorandum and articles constitute a contract between the company and each member. Each member of the company is bound to observe the various provisions of the memorandum and articles of association as if he had actually signed the same. The company can therefore, enforce articles of association against any member.

Examples : The articles provided that the company shall have a first and paramount lien upon each share for debt due to the company by shareholders. One of the shareholders owing money to the company borrowed money from the bank on the security of shares. The bank gave notice of deposit of shares to the company. It was held that the shares deposited with the bank were bound by the articles just as if the shareholder had contracted with the company, and therefore, the lien which the company acquired under the articles on those shares precluded the bank from getting priority in respect of the debts incurred by a shareholder before the notice was given [Bradford Banking Corporation v. Briggs (1866) 12 AC 29].

But an alteration of the memorandum or articles which requires a member to take or subscribe for more shares or increases his liability to contribute to the share capital of the company shall not be binding on him unless he agrees in writing before or after the alteration.

(ii) Company to the members. The company is bound to the members by the various provisions contained in the memorandum and the articles of association in the same way as the members are bound to the company. The company can, therefore, exercise its rights as against any member only in pursuance of and in accordance with the articles and the memorandum. Every member is entitled to sue the company to prevent any breach of the articles which would affect his right as a member of the company. Thus, where a right is conferred by the articles on a shareholder to record his vote at a company meeting, the chairman of the meeting cannot deprive him of this right.

Similarly a shareholder can enforce his right to recover dividend which has been declared or receive notice of any general meeting in pursuance to the articles, if he is denied any of these rights by the company.

(iii) Members Inter se.. The articles and the memorandum do not constitute express agreement between the members of the company. Yet each member of the company is bound by the memorandum and articles on the basis of an implied contract to the other members. The articles regulate the rights of the members inter se but such right can be enforced only through the company or though the liquiator representing the company.

Example : 'The articles of association of the company provided that members wishing to transfer shares must inform the directors of their intention and the directors must "take the said shares equally between them at a fair value." The directors refused to take the shares and argued that the articles did not impose an enforceable liability on them. It was held that the directors were obliged to take the shares. The articles imposed an obligation on the directors in their capacity as members and as such this was a personal obligation enforceable by one member against another.

[Rayfield v. Hands (1960) Ch. 1].

When a member complains of a breach of the terms of articles by another member, the suit can be brought not by that member but by the company.

Example : The articles of a company provided that on the bankruptcy of a member he shall sell his shares to a particular person at a particular price which was fixed for all members alike and was not unfair. B became bankrupt and his trustee in bankruptcy claimed that he was not bound by the articles and could dispose of shares as he liked. It was held that the articles were a personal contract between B and the rest of the members and the trustee was bound by the articles.

[Borland's Trustee v. Steel Bros. and Co. Ltd. (1901) 1 Ch. 279].

(iv) Company to the outsiders. Articles do not constitute any contract between the company and an outsider. This is because an outsider is not a party to the contract, and therefore, cannot sue on it. An outsider is not entitled to enforce the articles against the company for any breach of right that is conferred on him by the articles.

Example : The articles of association of a company contained a clause to the effect that B should be director and should not be removable till after 1888. He was however removed earlier. B had brought an action to restrain the company from excluding him. Held there was no contract between B and the company **[Browne v. La. Trinidad (1887) 37 Ch. D 1].**

The term 'outsider' means a person who is not a member of the company. Even a member will be regarded as an outsider and he will not be in a position to enforce a right against the company if he enjoys the right in the capacity of a solicitor or a director and not in the capacity of a member.

Example : The articles of association of a company provided that E should be a solicitor of the company for life and should not be removed from his office except on account of misconduct. He was also a member of the company. E acted as a solicitor of the company for sometime but ultimately the company discontinued his services without any allegation of misconduct. He sued the company for damages for breach of the contract. It was held that the action was not maintainable because the right which he attempted to enforce was conferred upon him in a capacity other than that of a shareholder.

(Eley v. Positive. Government Life Assurance Company (1876) 1 Ex. D. 88 CA].

DOCTRINE OF CONSTRUCTIVE NOTICE

Section 399 provides that the Memorandum and Articles when registered with Registrar of Companies ' become public documents' and they can be inspected by any one by electronic means on payment of the prescribed fee. Again, Section 17 read along with Rule 34 of the Company (Incorporation) Rules, 2014 provides that a company shall on payment of the prescribed fee send a copy of each of the following documents to a member within seven days of the request being made by him-

1. the memorandum;
2. the articles, if any;
3. every agreement and every resolution referred to in sub-section (1) of section 117, if and so far as they have not been embodied in the memorandum and articles.

Failure to supply the copy (ies), as above, will make the company as well as every officer in default liable to a fine @ ₹ 1000 per day for each day of the default or ₹ 1,00,000, whichever is less.

Hence, to Summarise we can say that the Doctrine of Constructive Notice means :-

- The memorandum and articles of association of every company are required to be registered with the Registrar of Companies. The office of the Registrar is a public office and consequently the memorandum and the articles on registration become public documents. They are open and accessible to all.
- These documents are open for public inspection on payment.
- Every one dealing with the company, whether a shareholder or an outsider is presumed to have read the two documents. He will be presumed to know the contents of these documents. This deemed knowledge of the two documents and their contents is known as the contructive notice of memorandum and articles.
- The parties dealing with the company must be taken not only to have read these documents but also to have understood them according to their proper meaning.

- When a person deals with a company in a manner which is inconsistent with the provisions of the memorandum or articles, or enters into a transaction which is beyond the scope of the powers of the company, he must take the consequences in respect of such dealings.

Example : The articles of a company required that all deeds and other important documents should be signed by the managing director, the secretary and a working director on behalf of the company. The plaintiff accepted a deed of mortgage executed by the secretary and the working director only. It was held that the plaintiff could not claim under this deed as the bond was invalid. The court applied the doctrine of constructive notice in favour of the company.

[Kotla Venkataswamy v. Ram Murthi AIR 1934 Mad. 579].

DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management is an exception to the rule of constructive notice. A person dealing with a company is deemed to have knowledge of the memorandum and the articles of association of the company. So, if he enters into a transaction with the company which is *ultra vires of the memorandum or articles, he cannot treat the transaction as binding on the company. On the other hand, if the transaction appears to be proper one, when compared with the memorandum and articles, it would be grossly unfair if the company could escape liability under it by showing that there was some irregularity in the conduct of the company's affairs leading upto the transaction, when the other party did not know of the irregularity and had no means of discovering it.*

This rule has been described by Lord Hatherley as the 'Doctrine of Indoor management.' According to him, "Persons transacting business with the company are deemed to have notice of what they would have discovered by making a search at the office of the Registrar of Companies, and they would be stopped from asserting that they had not read the documents. But such persons are not deemed to have notice of, nor are they under a duty to inquire into the internal proceedings of a company[1]. So an outsider is presumed to know the constitution of a company, but not what may or may not have taken place within the doors that are closed to him.

Thus, where as the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

The doctrine had its origin in the leading case of *Royal British Bank v. Turquand*

Royal British Bank V. Turquand (1856) 6E & B. 327].

Point decided is

The outsiders dealings with the company are entitled to presume that as far as the internal management of the company is concerned, every thing has been regularly done.

Facts of the case are

- The articles of a company stated that the directors could borrow money on behalf of the company, if they are so authrised by a resolution passed by the shareholders in general meeting.
- The directors borrowed money from Mr. T without obtaining any authorisation from shareholders.

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1. Mahony v. East Holyford Mining Co. (1875) LR 7 H.L. 869.

- T had lent the money to the company assuming that the shareholders had authorised the directors to borrow money as per the requirement of the articles.
- It was held that borrowing of money by the directors without any authorisation from the shareholders amounted to a mere internal irregularity and further held that Mr. T could sue the company on the strength of the bond as he was entitled to assume that necessary resulution had been passed.

The lot of creditors of a company is not a particularly happy one; it would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf.

The doctrine is quite useful in the sense that it covers acts done on behalf of a company by directors who have never been appointed or who have exercised authority without proper quorum, or who having power to allot shares only with the consent of general meeting allotted them without any such consent.

Example : The articles of a company provided that the directors could allot shares only to the existing members and could not without the consent of the company in general meeting allot them to outsiders. They allotted certain shares to P without the consent of the company in general meeting. It was held that the applicant was entitled to assume that the sanction of the company in general meeting must have been obtained. The allotment was held valid.

[P.V. Damodara Reddi v. Indian National Agencies Ltd. AIR 1946 Mad. 35].

EXCEPTIONS

The doctrine is subject to the following exceptions :

1. Knowledge of irregularity. A person, who deals with company and who has knowledge of the irregularity in its internal management in connection with subject matter of his dealings, cannot claim the benefit of the rule in Turquand's case.

Examples : 1. Under the articles the directors were empowered to borrow upto 1,000 pounds on behalf of the company without the consent of the general meeting and to borrow further money with such consent. The directors themselves lent 3,500 pounds to the company and took debentures. No resolution of any general meeting was passed to authorise such borrowings. The company went into liquidation. It was held that the company was liable to the extent of 1,000 pounds and directors were not entitled to the further amount because they had knowledge of the irregularity.

[Howard v. Patent Ivory Manufacturing Co. [(1888) 38 Ch. D. 156.]

2. A transfer of shares was approved by two directors. The transferor knew that one of the directors was disqualified by reason of being the transferee himself and the other was never validly appointed. The transfer was held to be ineffective.

[Devi Ditta Mal v. The Standard Bank of India A.I.R (1927) Lah. 797].

2. Negligence. A person cannot claim the benefit of the rule in Turquand's case in circumstances under which he would have discovered the irregularity if he had made proper inquiries.

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Act to Override Memorandum, Articles, etc. (Sec. 6) Section 6 provides that the provisions of the Companies Act will prevail in case there is a conflict between the Act and the company's memorandum, articles, resolutions or agreement. As for example, the quorum at a Board meeting, according to section 174 of the Act, will be two directors, or one third of the total number of directors in office, whichever is higher. If the articles provide that the quorum will be minimum three, or one third, whichever is large, such provision will be ineffective.

- T had lent the money to the company assuming that the shareholders had authorised the directors to borrow money as per the requirement of the articles.
- It was held that borrowing of money by the directors without any authorisation from the shareholders amounted to a mere internal irregularity and further held that Mr. T could sue the company on the strength of the bond as he was entitled to assume that necessary resulution had been passed.

The lot of creditors of a company is not a particularly happy one; it would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf.

The doctrine is quite useful in the sense that it covers acts done on behalf of a company by directors who have never been appointed or who have exercised authority without proper quorum, or who having power to allot shares only with the consent of general meeting allotted them without any such consent.

Example : The articles of a company provided that the directors could allot shares only to the existing members and could not without the consent of the company in general meeting allot them to outsiders. They allotted certain shares to P without the consent of the company in general meeting. It was held that the applicant was entitled to assume that the sanction of the company in general meeting must have been obtained. The allotment was held valid.

[P.V. Damodara Reddi v. Indian National Agencies Ltd. AIR 1946 Mad. 35].

EXCEPTIONS

The doctrine is subject to the following exceptions :

1. Knowledge of irregularity. A person, who deals with company and who has knowledge of the irregularity in its internal management in connection with subject matter of his dealings, cannot claim the benefit of the rule in Turquand's case.

Examples : 1. Under the articles the directors were empowered to borrow upto 1,000 pounds on behalf of the company without the consent of the general meeting and to borrow further money with such consent. The directors themselves lent 3,500 pounds to the company and took debentures. No resolution of any general meeting was passed to authorise such borrowings. The company went into liquidation. It was held that the company was liable to the extent of 1,000 pounds and directors were not entitled to the further amount because they had knowledge of the irregularity.

[Howard v. Patent Ivory Manufacturing Co. [(1888) 38 Ch. D. 156.]

2. A transfer of shares was approved by two directors. The transferor knew that one of the directors was disqualified by reason of being the transferee himself and the other was never validly appointed. The transfer was held to be ineffective.

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Any provision contained in the memorandum, articles, agreement or resolution of the company is void to the extent to which it goes against the provisions of the Companies Act.

COMPANY SECRETARY'S DUTIES FOR ALTERATION OF AOA

Board meeting

The company secretary will convene meeting of the BOD to consider to approve the proposed alterations.

Even clerical errors in the articles should be submitted to the general meeting for amendment by way of special resolutions. *[Evans v. Chapman (1902) WN 78 : 18 TLR 506]*

Consent of members

Where the alteration involves an increase in pecuniary liability of a member, the member should agree in writing.

General meeting

Convene a general meeting and pass a special resolution altering the articles.

Validity of Ordinary Resolution

It is worth noting, an article providing for amendment of articles by ordinary resolution is invalid.

Special Resolution

It may be noted that except where a provision as covered by memorandum, any provision of articles may be amended by a special resolution. Therefore if a special resolution is not passed, the articles will not be validily altered.

Changes in Articles must be given in Explanatory Statement

Where a new set of articles is being adopted, it is necessary to give details of changes regarding important articles in the explanatory statement. Where majority of members reside at long distances from the registered office, it is not sufficient compliance if the notice merely specifies that copies of proposed articles are available for inspection at the registered office.

Alteration regarding Directors

where the alteration results of amendment of any provision relating to managing director/whole-time director or non-rotational director, file an application with the Central Government.

Conversion of Public Company into private Company

Where the alteration results in conversion of public company into private company, submit an application to the Registrar of Companies in the prescribed Form.

The documents that need to be attached with the application are :

(i) a copy of the current Memorandum and Articles of Association;

(ii) a copy of the new Articles of Association;

(iii) a copy of the latest balance sheet and profit and loss account;

(iv) a copy of the minutes of the meeting;

(v) a copy of the special resolution;

(vi) original treasury challan or demand draft.

(vii) names of shareholders who have voted for and against the conversion and their respective shareholdings. Also mention grounds to opposition to the proposal.

Copy of Articles

File a printed copy of the articles as altered with the Registrar within one month of the approval

Stock exchange

Besides sending three copies of notices to the stock exchange (where the shares are listed), send six copies of the amendment to the articles (at least one of which will be certified) and a copy of the proceedings of the general meeting to the stock exchange after adoption by the company in general meeting.

Noting of alteration

Note the alteration in every copy of the articles issued after the date of alteration.

SHORT ANSWER QUESTIONS

1. What is meant by 'articles of association' of a company.
2. Is it necessary for a private company to have its articles of association ?
3. Which companies must have their own articles ?
4. Why are the articles subsidiary to the memorandum ?
5. How can the articles of a company be altered ?
6. Can the articles be altered to go beyond the provisions of memo- randum ?
7. Articles of association cannot be made unalterable. Comment.
8. Can the articles of association be altered with retrospective effect ?
9. A company cannot by altering articles, justify a breach of contract. Comment.
10. What do you mean by constructive notice of memorandum and articles ?
11. State the rule in *Royal British Bank v. Turquand.*
12. What is the effect of doctrine of indoor management ?

TEST QUESTIONS

1. Define articles of association and give the contents thereof. Is it necessary for every company to have articles of association of its own ?
2. Discuss how and to what extent articles of association of a company can be altered ?
3. "The power of altering the articles is wide, yet it is subject to a large number of limitations." Explain.
4. Distinguish between memorandum and articles of association.
5. "The articles of association of a company constitute a contract between the members *inter se and between the company and the members 'qua members'. Elucidate.*
6. Discuss the effect of the memorandum and articles on their registration with the Registrar of Companies.

7. Explain the doctrine of indoor management and state the exceptions, if any, to the doctrine.
8. Explain the principle laid down in Royal British Bank v. Turquand. What are the exceptions to this principle ?
9. "The doctrine of indoor management is a silver lining to strangers dealing with the company." Comment.

PRACTICAL PROBLEMS

Q. 1. The articles of P Ltd. contained a clause that Q would be the legal adviser of the company and would not be removed except for misconduct. P Ltd. after some time removed Q. Has Q a legal right to be retained by the company ?

Ans. The articles are internal documents of the company. They do not constitute any binding contract as between the company and an outsider and as such no action shall be. Hence Q has no legal right to be retained by the company.

Q. 2. A company was in great need of further capital. The majority representing 98% of the share capital were willing to provide the capital if they could buy up the two percent minority. The majority passed a resolution altering the articles and enabling them to purchase the minority shares. Examine the legality of the alteration.

Ans. The alteration is not valid. In this case by virtue of this alteration the majority intends to drive out the minority by purchasing their shares. It in fact means a fraud by the majority on minority. So, it cannot be said to be a valid alteration and the minority can rightly challenge the resolution.

Q. 3. The majority of the shareholder of a company passed a special resolution to alter its articles and give the directors a power to require any shareholder who competed with the company's business to transfer his shares. The plaintiff who carried on a competiting business challenged the validity of the alteration. Give your decision on this point.

Ans. As the alteration is bonafide and for the benefit of the company, it is a valid alteration and the plaintiff is bound by alteration.

Q. 4. The articles of a company provided that S and four others should be permanent directors of company unless they should become disqualified by any of the six specified events. None of the six events had occurred. S on twenty two occasions failed to account for the company's money he had received. The articles were altered by adding a seventh disqualification to the effect that a director should resign his office on the request signed by his co-directors. S challenges the alteration of the Articles. Decide.

Ans. The alteration is valid because it is made in good faith and in the best interest of the company.

Q. 5. The articles provided for the reference of disputes between a member and company to arbitration H, a shareholder brought an action against the company in connection with a dispute between company and himself in his capacity as member. Can the company apply to the court to stay the proceedings ?

Ans. The company is entitled to have action stayed as the Articles amounted to a contract between the company and H.

Q. 6. The directors of the bank issued a bond to T. The articles provided that the directors had the power to issue bond if authorised by a proper resolution of the company. No such resolution was passed. T sued the company for recovery of money under the bonds. The suit was resisted on the ground that there was no general resolution of the company. Decide.

Ans. In this case X can sue the company as he is entitled to assume that all internal regulations have been complied with.

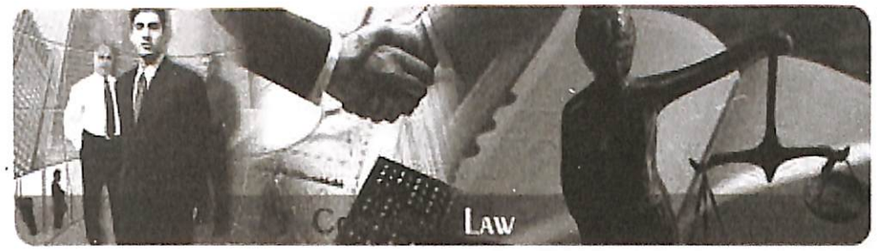
Q. 7. The articles of a company provided that the directors could allot shares only to the existing members of the company and could not without the consent of the company in general meeting allot them to outsiders. They allotted certain shares to P without the consent of the company in general meeting. Is the allotment valid ? Give reasons.

Ans. The articles of a company provided that the directors could allot the shares to the outsiders only with the consent in the general meeting. The outsiders were allotted shares without such consent. As such the allotment by the company to the outsiders of such shares is invalid.

Q. 8. Under the articles the directors were empowered to borrow upto ₹ 10,000 on behalf of the company without the consent of general meeting and to borrow further money with such consent. The directors themselves lent ₹ 35,000 to the company and took debentures. No resolution at the general meeting was passed to authorise the borrowings. Can the directors make the company liable for ₹ 35,000 ?

Ans. In the given case the directors knew that they have not taken consent of the general meeting. They cannot take the protection of doctrine of indoor management for non fulfillment of the internal regulations. Therefore the company is liable to pay only ₹ 10,000.

□□□



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PROSPECTUS

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	Public Offer	
Public Offer-Definition	"Public Offer" defined by the 2013 Act to include Initial Public Offer (IPO). Further Public Offer (FPO) and offer for sale of securities to public by an existing shareholder through issue of prospectus. "Private placement" which violates the provisions of Section 42 of the 2013 Act shall be deemed to be "public offer".	'Public offer' not defined by the 1956 Act.
	Prospectus	
Disclosures required in Prospectus	• Section 26 itself contains disclosure requirements. Further disclosure requirements are specified in Rules 3, 4, 5 and 6 of the Companies (Prospectus and Allotment of Securities) Rules, 2014. • No Schedule to the 2013 Act stipulating disclosures in a prospectus.	Disclosures were listed in Schedule II of the 1956 Act.
Disclosures regarding CFO and sources of promoter's contribution	• The 2013 Act requires disclosure in the prospectus of names and addresses of Chief Financial Officer (CFO), about sources of promoter's contribution among other things. [See Rule 3(b) of the Companies Prospectus and Allotment of Securities) Rules, 2014].	Such disclosures were not required by the 1956 Act.
Disclosures of related party transactions	• Related party transactions entered during the last 5 years to be disclosed in prospectus [Rule 5(6) of the Companies (Prospectus and Allotment of Securities) Rules, 2014]	No requirement in Schedule II to disclose related party transactions.

Variation in terms of con-tract or objects in prospectus	Special resolution required for such variation.	Only ordinary resolution required for variation.
Offer of sale of shares by certain members of a company	The 2013 Act contains provision regarding offer of part or whole of their holding of shares to public by certain members [Section 28 of the 2013 Act] [See rule 8 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.	No provisions in the 1956 Act regarding offer for sale of shares by members of the Company.
Companies for which it is compulsory to issue securities in demat form	Every company making a public offer (whether IPO or FPO or offer for sale) and other prescribed classes of public companies to issue the securities in demat form irrespective of size of the issue. [See rule 9 of the Companies (Prospectus and Allotment of Securities) Rules, 2014]	Every listed public company making IPO of any security for ` 10 crores or more required to issue the same in demat form.
Companies who can file Shelf prospectus	Any class or classes of companies prescribed by SEBI may file a shelf prospectus with the Registrar of Companies at the stage of the first offer of securities. [See rule 10 of the Companies (Prospectus and Allotment of Securities) Rules, 2014]	This facility was available only to any public financial institution, public sector bank or scheduled bank whose main object is financing.
Validity period of shelf prospectus	The 2013 Act stipulates maximum validity period of one year for shelf-prospectus.	No validity period stipulated by the 1956 Act.
Red-herring Prospectus	Section 32 of the 2013 Act only envisages filing of red-herring prospectus and final prospectus. The requirements of section 60B(5) to (8) of the 1956 Act have been omitted by the 2013 Act.	Section 60B of the 1956 Act envisaged filing of information memorandum (IM), red-herring prospectus and final prospectus.
Minimum subscription stated in prospectus	The minimum subscription requirement in the 1956 Act applied only to allotment of shares in public issue. The 2013 Act extends this requirement to public issues of all securities.	No allotment of shares in a public issue shall be made unless minimum subscription (as stated in the prospectus) is received by the company.
Minimum share – application money	• Minimum 5% of the nominal amount of the security or such other percentage or amount as specified by SEBI by regulations. • Made applicable to all securities. • Applicable to public offer which can be made only by public companies.	• Minimum 5% of nominal value payable with application under 1956 Act. • Applied only to shares. • Applicable to public and private companies.
Refund if the stated minimum amount not received	The 2013 Act provides for refunds if stated minimum subscription not received within 30 days from the date of issue of prospectus or such other period as may be specified by SEBI. [See rule 11 of the Companies (Prospectus and Allotment of Securities) Rules, 2014]	The 1956 Act provided for refund of application money if stated minimum amount (minimum subscription) not received within 120 days after the first issue of the prospectus).

Acceptance of Deposits by Companies

Definition of deposits	'Substance over form' rule made statutorily applicable in defining 'deposits' • 'Deposit' defined under Companies (Acceptance of Deposits) Rules, 2014 so as to prevent companies from camouflaging deposits accepted as advance against sale of goods or supply of services or sale of property. • 'Deposit' defined under Companies (Acceptance of Deposits) Rules, 2014 so as to prevent companies from camouflaging deposits accepted as share application money. • The following amounts received shall be treated as a deposit : (a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or kind, or completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or (b) any additional contri-butions, over and above the amount under item (a) above, made by the company as part of such promise or offer.	No 'substance over form' rule in defining deposits.
Prohibition of acceptance of deposits from public	• On and after the commencement of the 2013 Act, only the following companies may invite, accept or renew deposits from the public : (i) banking companies, (ii) NBFCs (non-banking financial company as defined in the Reserve Bank of India Act, 1934) (iii) notified companies (iv) public company having a net worth of not less than ` 100 crores or a turnover of not less than ` 500 crores. [See sections 73 and 76 of the 2013 Act ; Rule 2(1) (e) of the Companies (Acceptance of Deposits) Rules, 2014] • Companies other than those covered above shall not invite, accept or renew deposits from the public (*i.e.* persons other than members)	• No such prohibition – Section 58A of the 1956 Act empowered the Central Government to make rules prescribing limits up to which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members. • The provisions of section 58A of the 1956 Act and the rules thereunder were not applicable to banking companies and other companies as notified by the Central Government.
Acceptance of deposits from members	Any company may invite, accept or renew deposits from its members subject to certain specified stringent conditions [See section 73 ; Companies (Acceptance of Deposits) Rules, 2014]	No conditions stipulated by 1956 Act for acceptance of deposits from members.

INTRODUCTION

One great advantage of floating a company is the raising of capital required for business from the general public. This is done by issuing a document called 'prospectus'. In essence, prospectus sets out the prospects of the company and the purpose for which the capital is required. It intends to arouse the interest of the investors in the proposed company and induces them to invest in its shares or debentures. However, a private company is prohibited from inviting public to subscribe to its securities.

The Companies Act, 2013 provides the manner in which securities can be issued by both public and private companies. According to section 23(1) of the Companies Act, a public company may issue securities—

(a) to public through prospectus (herein referred to as "public offer") by complying with the provisions of Part I of Chapter III ; or

(b) through private placement by complying with the provisions of Part II of Chapter III; or

(c) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

A private company, according to section 23(2) of the Act, may issue securities :

(a) by way of rights issue or bonus issue; or

(b) through private placement by complying with the provisions of Part–II of Chapter III of the Companies Act.

DEFINITION

Section 2(70) of the Act defines a prospectus as

"any document described or issued as a prospectus and includes a red herring prospectus referred to Sec. 32 or shelf prospectus referred to in Sec. 31 or any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate."

The definition of prospectus now specifically provides that **"Red Herring** or **Shelf Prospectus"** will also be treated as prospectus. The scope of definition has been broadened to include securities instead of only shares or debentures.

In other words, a prospectus means any invitation issued to the public inviting it to deposit money with the company or to take shares or debentures of the company. Such invitation may be in the form of a document or a notice, circular, advertisement etc.

Any document to be called a prospectus must have the following ingredients :

(a) there must be a written invitation offering to the public ;

(b) the invitation must be made by or on behalf of the company or in relation to an intended company;

(c) the invitation must be to subscribe or purchase;

(d) the invitation must relate to shares or debentures.

- A prospectus is not an offer in itself but an invitation to make an offer, signifying thereby that on acceptance of such an invitation by any member of the public, no binding contract between him and the company comes into existence, it is rather a counter-offer by him to the company which, when accepted by it brings into existence a binding contract.
- Any advertisement offering to the public shares or debentures of the company for sale is prospectus.

DEEMED PROSPECTUS

Requirements of prospectus are very rigorous under the Companies Act. In order to avoid the issue of prospectus, one practice was to issue shares to another person. Such another person (often called Issue House), would then make further offer of sale of these shares to public by advertisements etc. In order to curb this tendency, section 25 provides that 'offer of sale' or advertisement of such 'Issue House' will be deemed to be the prospectus issued by the company. This is called ***'deemed prospectus'***. Provisions of responsibility of directors and promoters remain the same. In addition, Issuing House incurs its own liability regarding disclosures. They incur the same civil and criminal liability as the directors of the company will incur [section 25].

Section 25 of the Companies Act lays down that any document by which the offer or sale of securities to the public is made shall for all purposes be treated as prospectus.

A company is deemed (presumed) to have allotted or agreed to allot shares or debentures to Issue House for further sale if

(a) Such Issue House makes offer for sale of debentures or shares within 6 months after the shares/debentures were allotted to them or agreed to be allotted to them or

(b) On the date of offer of Issue House, whole consideration in respect of shares or debentures was not received by the company.

In short, the 'offer of sale' by issue house will not be considered as 'Prospectus' only when (a) Company receives full consideration in respect of shares/debentures and (b) The 'offer for sale' is made at least 6 months after the shares were allotted to it. [Section25(2)].

Offer of sale of shares by certain members of company : is also DEEMED PROSPECTUS

Section 28 is a new section and seeks to provide for that member or members of a company in consultation with Board of Directors, may offer the whole or a part of their holding of shares for sale to the public. The document by which the offer of sale to the public is made shall be treated as deemed prospectus issued by company. Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document referred to in section 25 is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be.

Provisions of section 28 are as under :

- Where certain members of a company propose, in consultation with the Board of Directors to offer part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed. [Section 28(1)].
- Any document by which the offer of sale to the public is made shall, for all purposes, **be deemed to be a prospectus** issued by the company, as if this is a prospectus issued by the company. [Section 28(2)].

- *The members, whether* individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company whose shares are offered for *sale to the public*, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter. [Section 28(3)].

The prospectus issued under section 28 shall disclose the name of the entity bearing the cost of making the offer for sale along with the reasons. (Companies Rules, 2013).

SHELF PROSPECTUS AND INFORMATION MEMORANDUM (SECTION 31)

Sometimes, securities are issued in stages spread over a period of time, particularly in respect of infrastructure projects where issue size is large as huge funds have to be collected. In such case, filing of prospectus each time will be very expensive. So, a provision of **'Shelf Prospectus'** has been made vide section 31 of the Companies Act, 2013. The advantage is that at each stage of offer of securities during validity of shelf prospectus, filing of prospectus is not required.

The term 'shelf prospectus' means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

The provisions of Section 31, in regard to Shelf Prospectus are as follows.

(i) A shelf prospectus may be issued by any class or classes of companies as the Securities and Exchange Board of India (SEBI) may provide by regulations in this behalf.

(ii) The shelf prospectus shall have a validity period not exceeding one year which shall commence from the date of opening of the first offer of securities under that prospectus.

(iii) The validity period not exceeding one year should be indicated in the shelf prospectus.

(iv) In respect of second/subsequent offer of securities during the validity period, no further prospectus shall be required.

(v) A company filing a shelf prospectus shall be required to file an information memorandum with the Registrar before making of any second or subsequent offer of securities under the shelf prospectus.

(vi) The information memorandum shall contain all material facts relating to :

- ♦ New charges created.
- ♦ Changes in financial position as have occurred between the first offer of securities and the succeeding offer of securities.
- ♦ Such other changes as may be prescribed.

(vii) Where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of suchchange, the company or other person shall intimate the changes to such applicants. If the applicants express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within 15 days thereof.

(viii) Where an information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

RED HERRING PROSPECTUS (SECTION 32)

With a view to explore the demand for securities and price at which securities may be offered to the public, a public company may before issuing prospectus, circulate information memorandum and **Red Herring Prospectus** to the public.

Provisions relating to Red Herring Prospectus are

- The term 'red herring prospectus' means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
- A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. [Section 32(1)].
- A company proposing to issue a red herring prospectus under sub-section (1) shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer. [Section 32(2)].
- A red herring prospectus shall carry the same obligations as are applicable to a prospectus
- Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus. [Section 32(3)].
- Upon the closing of the offer of securities under this section, the prospectus also stating therein (a) the total capital raised, whether by way of debt or share capital, and the closing price of the securities (c) any other details as are not included in the red herring prospectus.

Shall be filed with the Registrar and, in the case of a listed company, with the Registrar and the Securities and Exchange Board. [Section 32(4)].

ABRIDGED PROSPECTUS

Section 33 of the Companies Act provides that every form of application issued for the purchase of any securities of a company shall be accompanied by an abridged prospectus. **According to section 2(1) of the Companies Act, "abridged prospectus"** means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf.

If a company makes any default in complying with the provisions of section 33, it shall be liable to a penalty of fifty thousand rupees for each default. The definition of abridged prospectus remains the same as it was under the Companies Act, 1956. However, while it was the Central Government which was earlier authorised to specify the contents of abridged prospectus, now such power has been delegated to SEBI.

WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED (SEC. 26)

The issue of a prospectus by a company is not necessary in the following cases.

(1) When an offer is made in connection with a *bonafide* invitation to a person to enter into an underwriting agreement with respect to shares or debentures.

(2) When the shares or debentures are not offered to the public.

(3) Where the offer is made only to existing members or debenture holders of the company with or without a right to renounce. e.g. When shares are placed privately to less than 50 persons.

(4) Where the shares or debentures offered are in all respects uniform with shares or debentures previously issued and dealt in or quoted on a recognised stock exchange.

(5) Where invitation to the public for subscription to the shares or debentures of a company is made in the form of newspaper advertisement. [Sec. 30].

(6) A private company is not required to issue prospectus. [Sec. 2(35)]

LEGAL REQUIREMENTS IN RELATION TO A PROSPECTUS

(1) Dating of prospectus (Section 26)

A prospectus issued by a company must be dated. Section 26 further provides that the date on the prospectus shall, unless contrary is provide, be taken as the date of the publication of the prospectus. This ensures a *prima facie evidence of the date of its publication. However, this evidence may be rebutted by a contrary evidence.*

(2) Registration of prospectus (Section 27(7))

(i) Nature. A prospectus must not be issued unless a copy thereof has been delivered to the Registrar for registration.

(ii) Time Limit. Registration must be made on or before the publication of the prospectus.

(iii) Signatures. The copy sent for registration must be signed by every person who is named in the prospectus as a director or a proposed director of the company or by his agent duly authorised in writing.

(iv) Date of issue of prospectus. The date of issue of prospectus is the date on which the prospectus first appears as a newspaper advertisement.

(v) Contents. Prospectus should—

(a) State that a Copy thereof has been delivered to ROC for registration,

(b) Specify documents endorsed or attached to the copy so delivered, and

(c) Contain an endorsement that the consent of Experts has been obtained.

(vi) Enclosures.

(a) Consent of the Expert to the Issue of Prospectus, where it contains a Report by an Expert,

(b) Copy of every material contract appointing or fixing remuneration of a MD or Manager.

(c) Copy of every other material contract. However, the following need not be enclosed—

– Contract entered into in ordinary course of business, or

– Contract entered into more than 2 years before the date of Prospectus.

(d) Written statement from Auditors relating to the adjustments to figures of abridged Financial Statements along with reasons therefor.

(e) Consent of every person named therein as Auditor, Legal Adviser, Attorney, Solicitor, Banker or Broker of the Company/Intended Company to act in that capacity.

(vii) Registration. The prospectus must be issued within ninety days of its registration. If it is issued say 91 days after, it shall be deemed to be a prospectus a copy of which has not been delivered for registration.

(x) Penalty for non-registration of prospectus

If a prospectus is issued without a copy thereof being delivered to the Registrar for registration or without the required documents or consent attached thereto, the company and every person knowingly party to the issue of the prospectus, shall be punishable with fine which may extend to ₹ 50000 which may extend to rupees three lakhs.

(xi) Opening of subscription list. Where a prospectus has been issued, no allotment of any shares shall be made until—

(a) The beginning of the 5th day after prospectus is first issued ; or

(b) Such later time as may be specified in the prospectus ; or

(c) The beginning of the 5th day after public notice is given.

Such day is referred to as 'date of opening of subscription list'.

Disclosures to be made (Section 26)

Section 26 of the Companies Act requires every prospectus to disclose the matters specified in Schedule II of the Act. The Schedule is divided into three parts.

When Registrar can Refuse registration (Sec. 26)

The Registrar can refuse to register a prospectus if :

(a) it is not dated;

(b) it does not comply with the requirements of as to the matters and reports to be set out in it;

(c) it contains statements or reports of experts engaged or interested in the formation or promotion or management of the company;

(d) it includes a statement purported to be made by an expert without a statement that he has given and has not withdrawn his consent to the manner of its inclusion in the prospectus;

(e) it does not contain the consent in writing of directors and copy of the documents has not been filed or does not comply with the provisions with regard to the fact that a copy of it has been filed with the Registrar;

(f) it is not accompanied by the consent in writing of the auditor, legal adviser, solicitor, banker or broker of the company if named in the prospectus to act in that capacity.

CONTENTS OF PROSPECTUS

A prospectus is the most important document since the intending investors base their decisions on the facts and figures furnished in the prospectus. It is the window through which a prospective investor can look into the soundness of a company's venture. In order to protect the interests of the investing public against the frauds of the promoters, the Companies Act requires every company issuing a prospectus to observe a large number of regulations. Failure to observe them is made punishable with fine or imprisonment or both. Hence, utmost care should be taken in drafting a prospectus.

Section 26 of Companies Act, 2013 read with Rule-3 of Companies (Prospectus and Allotment of Securities) Rules, 2014

Under Section 26 and Rule 3, every prospectus shall be **dated** and **signed** and shall contain the following matters :

(A) MATTERS IN PROSPECTUS

(i) **names and addresses** of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed ;

(ii) **dates of the opening and closing** of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time ;

(iii) **a statement** by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner;

(iv) **details about underwriting** of the issue;

(v) **consent of the directors,** auditors, bankers to the issue, expert's opinion, if any, and of such other persons, as may be prescribed ;

(vi) **the authority for the issue** and the details of the resolution passed therefore;

(vii) **procedure and time** schedule for allotment and issue of securities;

(viii) **capital structure** of the company in the prescribed manner;

(ix) **main objects** of public offer, terms of the present issue and such other particulars as may be prescribed;

(x) **main objects and present business** of the company and its location, schedule of implementation of the project;

(xi) **particulars** relating to—

(a) management perception of risk factors specific to the project;
(b) gestation period of the project;
(c) extent of progress made in the project;
(d) deadlines for completion of the project; and
(e) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company;

(xii) **minimum subscription,** amount payable by way of premium, issue of shares otherwise than on cash;

(xiii) **details of directors** including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed ; and

(xiv) **disclosures** in such manner as may be prescribed about sources of promoter's contribution;

(B) REPORTS IN PROSPECTUS

The prospectus must set out the following reports for the purposes of the financial information, namely :

(i) **reports by the auditors** of the company with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed;

(ii) **reports relating to profits and losses** for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed;

- In case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out the reports relating to profits and losses for each of the financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries;

(iii) **reports made by the auditors upon the profits and losses of the business** of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus :

- In case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out the reports made by the auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of business on the last date before the issue of prospectus; and

(iv) **reports about the business or transaction** to which the proceeds of the securities are to be applied directly or indirectly;

(C) DECLARATION

The prospectus shall make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus in contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder.

The prospectus shall also state such other matters and set out such other reports, as may be prescribed.

(D) OTHER MATTERS

Prospectus shall also state such other matters and set out such other reports, as may be prescribed.

SOME IMPORTANT POINTS NOTE :

(1) U/S 26(2), the provisions of section 26(1) shall not apply to :

(a) to the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not in favour of any other person; or

(b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform which shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

(2) U/S 26(3) Date : The provisions of section 26(1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently. The date indicated in the prospectus shall be deemed to be the date of publication of prospectus.

(3) U/S 26 (4) Issue of Prospectus : No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney is being delivered to the Registrar for registration.

(4) U/S 26(5) Statement by expert : A prospectus issued shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company and has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration and a statement to that effect shall be included in the prospectus.

(5) U/S 26(6) Details : Every prospectus issued under section 26(1) shall, on the face of it, —

(a) state that a copy has been delivered for registration to the Registrar as required.

(b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

(6) U/S 26(7) Registration of Prospectus : The Registrar shall not register a prospectus unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

(7) U/S 28(8) Validity : No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar.

(8) U/S 26(9) Penalty for Contravention : If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable **with fine** with shall not be less **than fifty thousand rupees** but which may extend **to three lakh rupees** and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for **a term which may extend to three years** or with fine which shall not be less **than fifty thousand rupees** but which may extend to three lakh rupees, or **with both.**

LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS

Golden rule as to the framing of prospectus. A prospectus constitutes the basis of the contract between the company and the person who purchases securities. The persons who are behind the company have all the knowledge or means of knowledge as to the present position and future prospects of the enterprise and the investing public has none. It is but fair that the former should not only disclose all the matters within their knowledge relating to the enterprise, which might affect the investing mind but should state them accurately, correctly and unambiguously. A prospectus must, therefore, tell the truth, the whole truth and nothing but truth. Also it must not conceal any fact which ought to be disclosed. This is known as the 'golden rule' as to the framing of the prospectus and was laid down by Kindersley V.C. in *New Brunswick etc. Co. v. Muggeridge.*

"Those who issue a prospectus holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking and inviting them to take shares on the faith of the representations therein contained are bound to state everything with strict and scrupulous accuracy and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge the existence of which might in any degree affect the nature, or extent or quality of the privileges and advantages which the prospectus holds out as inducements to take shares. In a word, the true nature of the company's venture should be disclosed." [(1860) I. Dr. and Sm. 363].

What is an untrue statement/mis-statement ?

According to section 34(I) of the Act, a statement included in a prospectus shall be demand to be untrue :

(a) if the statement is misleading in the form or context in which it is included ; or

(b) where any inclusion or omission from a prospectus of any matter is likely to mislead.

Greenwood V. Leather Shod Wheel Co. (1900)

Point decided is

The mis-statement contained in the prospectus must be material.

Facts of the case are

A company manufacturing leather tyre wheels for trolleys issued a prospectus stating in large type, "Orders have already been received from the House of Commons, to be followed by large orders later." In fact the person who supplied refreshments to the House of Commons had one trolley with these wheels and no customer had yet expressed any intention to buy on a large scale. It was held that the prospectus was misleading.

A person subscribing for shares as a result of a prospectus is not bound to verify the accuracy of the statements contained in it and will be entitled to avoid the contract if they turn out to be untrue, even though he had the means of discovering the inaccuracy. In order to call a prospectus a 'misleading prospectus' there must be mis- representation of facts and not of law.

Liability for Mis-statements in Prospectus shall arise when :

(a) The aggrieved party proves that the person making the suggestion know that what he is stating in prospectus is not true or he did not believe it to be true or it is an active concealment of some material fact.

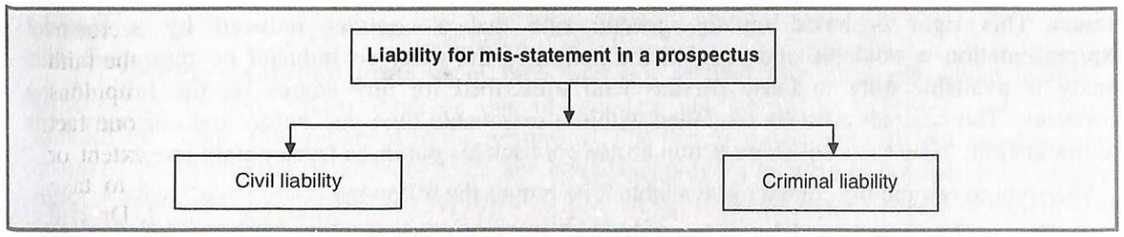
(b) The false representation must relate to some existing facts which are material (important) to the contract of purchasing shares.

(c) The aggrieved party must have taken the shares or securities or debentures directly from the company by being the allottees.

(d) A person who makes a mis-statement in the prospectus owes a duty of care to any who relied on that statement and took shares or debentures.

Who can be sued ?

Where a person has bought shares on the faith of a prospectus which is mis-leading because of a mis-statement in or an omission from the prospectus, he may have a legal remedy against all or any of the following :



(i) the company;

(ii) every director;
(iii) every person whose name appeared in the prospectus as a proposed director;
(iv) every promoter;
(v) every person who authorised the issue of the prospectus.
(vi) An expert referred u/s 26(5).

Onus of Proof

An allottee must prove that :
(i) the misrepresentation was of fact;
(ii) it was in respect of a material fact;
(iii) he acted on the misrepresentation; and
(iv) he has suffered damages in consequence.

Civil liability [Sec. 35(1)]

Section 35(1) of the Companies Act, 2013 provides that where

- a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who–
  (a) is a director of the company at the time of the issue of the prospectus ;
  (b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time :
  (c) is a promoter of the company ;
  (d) has authorised the issue of the prospectus; and
  (e) is an expert referred to in section 26(5).

shall, be liable to pay compensation to every person who has sustained such loss or damage.

Thus a person who has subscribed for securities on the faith of the misleading prospectus has remedies against—

(a) the company, and

(b) the directors, promoters, experts and every person who authorised the issue of prospectus

Remedies against the company. A person who has been induced to subscribe for shares may (1) rescind the contract to take the securities; (2) claim damages.

1. Rescission of the contract. Where a person has purchased the shares of a company on the faith of a prospectus which contained an untrue or misleading, statement he can seek rescission of the contract. This right is based on the general rule that a contract induced by a material misrepresentation is voidable and may, at the option of the party so induced be rescinded. This remedy is available only to those persons who subscribed for any shares on the faith of the prospectus. The contract must be rescinded within a reasonable time and before the company goes into liquidation. If he succeeds in his action he can get back his purchase money with interest.

The right to rescind the contract is available if he proves the following :

(i) Prospectus was issued by or on behalf of the company. It must be established that the

prospectus was issued by the company or by some one duly authorised by the company. If the prospectus was issued by the promoters and the Board of directors have ratified or adopted the issue, the company will be responsible for it.

(ii) Statement must be untrue. The prospectus must contain a false statement whether fraudulent or innocent. False representation takes place when there is positive misstatement or a concealment of matters of fact.

> **Example :** A prospectus of a company said that a company had paid a dividend every year between 1921 and 1927 years of depression, thus giving the impresion of a financially stable company. However, the company had in each of each of those years incurred considerable financial losses on trading account and was only able to pay a dividend out of reserves accumulated in previous years. This fact was suppressed. The court held that the prospectus was false in a material particular and conveyed a false impression. **[R. v. Kylsant (1932) 1 KB. 442]**

If the statement contained in the prospectus is true at the time it is made and becomes untrue before allotment of the shares, it would be a good ground for rescission. But where a statement in the prospectus though untrue when it was issued was true when the plaintiff applied for the shares, he would not be entitled to any relief against the company.

> **Example :** There was a statement in the prospectus to the effect that more than half of the shares had already been subscribed for and that the list would remain open only for a few days. This statement at the time of the issue of the prospectus was untrue but before the plaintiff had applied for shares the whole issue had been applied for. Nobody could say that the plaintiff had been deceived.
>
> **[Ship. v. Crosskill (1870) 10 Eq. 73].**

(iii) Statement must be a material misrepresentation. The false statement contained in the prospectus must be material to the contract to take shares or debentures. Whether a particular misrepresentation is material or not is a question of fact in each case. A statement will be material misrepresentation if it is likely to influence the decision of the person who is considering whether to purchase shares or not. Thus, where the prospectus falsely stated that X and Y, two businessmen of repute have agreed to become the directors of the company, it was a material misrepresentation.

> **Examples :** 1. A prospectus of a company stated that the directors and their friends have subscribed a large portion of the capital and they now offer to the public remaining shares. In reality the directors had subscribed only ten shares each. It was held that the subscriber could rescind the contract, because the prospectus contained a false statement. **[Henderson v. Lacon (1857) L.R. 5 Eq. 259].**

(iv) The misrepresentation must have induced the shareholder to take the securities and he must have relied on the statement in applying for securities. But it is not necessary that he should have verified it before relying upon it. Misrepresentation must have been at least one of the inducements for the contract to purchase the shares, only then the contract can be rescinded. Only original allotees can repudiate the allotment of shares on the ground of misrepresentation and not subsequent purchasers from them because the effect of a prospectus is exhausted as soon as allotment is made.

(v) Misrepresentation must be of facts and not of law. The statement which induced the shareholders to take shares must be one of fact and not merely an expression of opinion or expectation. Thus, the statement in the prospectus, that due to honest and efficient management the company is expected to progress by leaps and bounds, is only a statement of opinion and will give no right of rescission. Moreover, the representation must be of existing fact. Thus a calculation as to future profits cannot be taken as a statement of existing fact.

(vi) That he has taken action promptly to rescind the contract. The shareholder must start

(ii) every director;
(iii) every person whose name appeared in the prospectus as a proposed director;
(iv) every promoter;
(v) every person who authorised the issue of the prospectus.
(vi) An expert referred u/s 26(5).

Onus of Proof

An allottee must prove that :
(i) the misrepresentation was of fact;
(ii) it was in respect of a material fact;
(iii) he acted on the misrepresentation; and
(iv) he has suffered damages in consequence.

Civil liability [Sec. 35(1)]

Section 35(1) of the Companies Act, 2013 provides that where

- a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who–
  (a) is a director of the company at the time of the issue of the prospectus ;
  (b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time :
  (c) is a promoter of the company ;
  (d) has authorised the issue of the prospectus; and
  (e) is an expert referred to in section 26(5).

shall, be liable to pay compensation to every person who has sustained such loss or damage.

Thus a person who has subscribed for securities on the faith of the misleading prospectus has remedies against—

(a) the company, and

(b) the directors, promoters, experts and every person who authorised the issue of prospectus

Remedies against the company. A person who has been induced to subscribe for shares may (1) rescind the contract to take the securities; (2) claim damages.

1. Rescission of the contract. Where a person has purchased the shares of a company on the faith of a prospectus which contained an untrue or misleading, statement he can seek rescission of the contract. This right is based on the general rule that a contract induced by a material misrepresentation is voidable and may, at the option of the party so induced be rescinded. This remedy is available only to those persons who subscribed for any shares on the faith of the prospectus. The contract must be rescinded within a reasonable time and before the company goes into liquidation. If he succeeds in his action he can get back his purchase money with interest.

The right to rescind the contract is available if he proves the following :

(i) Prospectus was issued by or on behalf of the company. It must be established that the

prospectus was issued by the company or by some one duly authorised by the company. If the prospectus was issued by the promoters and the Board of directors have ratified or adopted the issue, the company will be responsible for it.

(ii) Statement must be untrue. The prospectus must contain a false statement whether fraudulent or innocent. False representation takes place when there is positive misstatement or a concealment of matters of fact.

> **Example :** A prospectus of a company said that a company had paid a dividend every year between 1921 and 1927 years of depression, thus giving the impresion of a financially stable company. However, the company had in each of each of those years incurred considerable financial losses on trading account and was only able to pay a dividend out of reserves accumulated in previous years. This fact was suppressed. The court held that the prospectus was false in a material particular and conveyed a false impression. **[R. v. Kylsant (1932) 1 KB. 442]**

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(iv) The misrepresentation must have induced the shareholder to take the securities and he must have relied on the statement in applying for securities. But it is not necessary that he should have verified it before relying upon it. Misrepresentation must have been at least one of the inducements for the contract to purchase the shares, only then the contract can be rescinded. Only original allotees can repudiate the allotment of shares on the ground of misrepresentation and not subsequent purchasers from them because the effect of a prospectus is exhausted as soon as allotment is made.

(v) Misrepresentation must be of facts and not of law. The statement which induced the shareholders to take shares must be one of fact and not merely an expression of opinion or expectation. Thus, the statement in the prospectus, that due to honest and efficient management the company is expected to progress by leaps and bounds, is only a statement of opinion and will give no right of rescission. Moreover, the representation must be of existing fact. Thus a calculation as to future profits cannot be taken as a statement of existing fact.

(vi) That he has taken action promptly to rescind the contract. The shareholder must start

proceedings for rescission within a reasonable time and before the company goes into liquidation. But the investor need not act on rumour. He is entitled to wait until he has sufficient knowledge.

Loss of right to rescind the contract

The subscriber loses his right to rescind the contract in the following cases:

(a) **Unreasonable delay.** The right to rescind is lost if the shareholder fails to take any action within a reasonable time after he has come to know the misrepresentation in the prospectus. In one case even a lapse of fifteen days after the shareholder became fully aware of the circumstances entitling him to apply for rescission was held to deprive him of his right to rescind the contract [Re Scottish Petroleum Co. 23 Ch. D. 413].

> **Example :** An allottee became fully aware of misrepresentation in the company's prospectus in the month of July. However he moved to have his name removed from the register of members in December. It was held that the un-explained delay of five months precluded him from obtaining relief.
>
> **[Re Christineville Rubber Estates Ltd. (1911) 81 L.J. Ch. 63].**

(b) Affirmation. If the shareholder, with full knowledge of misrepresentation in the prospectus, affirms his contract for purchase of shares; he cannot rescind the contract afterwards. However, affirmation may be express or implied. Implied affirmation will be deemed to have taken place in the following cases :

(i) where he endeavours to sell shares.

(ii) where he attends and votes at general meetings in person or by proxy.

(iii) where he receives dividend or pays calls.

(iv) where he executes a transfer.

(c) Commencement of winding up. The right of rescission is lost if the shareholder does not exercise the right until after the commencement of winding up. Accordingly, if a shareholder having a right to rescind the contract for shares is on the register of members at the commencement of the winding up, he cannot escape liability as a contributory unless he has commenced legal proceedings to enforce rescission before the date of the winding up. But, however, where a contract is cancelled for misrepresentation, it is rescinded ab initio and hence, in winding up, a shareholder cannot be placed on the list of contributories even as a past member.

2. Right of action for damages for deceit. In cases where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in section 35(1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus. [Section 35(3)].

Defences available to avoid civil liability. Section 35(2) of the Companies Act provides that no person shall be liable for civil action under section 35(1) if he proves—

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(b) That the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

Criminal Liability

Section 34 of the Companies Act, 2013 provides for criminal liability for mis-statements in prospectus. It provides that where a prospectus, issued, circulated or distributed under this Chapter, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who athorises the issue of such prospectus shall be liable under section 447.

In addition to penal provisions for untrue statement in prospectus, now in case of prospectus containing statements which are misleading in form or context or where any inclusion or omission of any matter is likely to mislead, the persons who have **authorised the issue of the said prospectus shall also be criminally liable.** Further the punishment has been increased and in case of default, the persons responsible, shall be liable for punishment for fraud under section 447 of the Act and will be subject to stringent penalties.

U/s 34 where prospectus contains any untrue statement, every person who has authorized the issue of the prospectus shall be punishable under section 447 of the Act, which provides punishment for fraud as follows :

(a) imprisonment for a term which may not be less than six months but which may extend to 10 years ; or

(b) fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud ; or

(c) both imprisonment and fine.

The accused person, however, may not be liable if he proves—

(a) that the statement was immaterial, or

(b) that he had reasonable ground to believe and did believe upto the time of the issue of the prospectus that the statement was true.

The punishment for issuing an application for shares or debentures which is not accompanied by a prospectus is a fine.

Penalty for fraudulently inducing persons to invest money (Section 36). Any person who makes an untrue, deceptive, or misleading statement in a prospectus with a view to inducing persons to invest money shall be liable for imprisonment for six months which may extend to ten years or fine equivalent to three times the amount of fraud or both. This section attempts at preventing fraud in connection with obtaining capital from public. This penalty is imposed as stated u/s 447 of the Act.

Action by affected persons

Section 37 of Companies Act, provides that any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus may file a suit or initiate any other action under section 34, 35 or 36 of the Companies Act, 2013.

There was no provision for class action under the Companies Act, 1956. Section 37 of the Companies Act, 2013 provides that action may be taken against guilty persons under Section 34 or 35 or 36 of the 2013 Act by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Issue and allotment of shares in fictitious names [Sec. 38]

Benami shareholding and shareholding in the name of fictitious or non existing persons are common. The object is to avoid tax. Section 38 makes it an offence to make applications for shares in the name of, or to induce the allotment or transfer of shares to fictitious persons. The punishment in such cases is imposed u/s 447 (improvement for 6 months which may extend to 10 years or five equivalent to three times the amount of fraud).

BOOK BUILDING

Book Building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memorandum or other document.

Thus, in case of a public issue through the process of book-building, though the total size of the issue is known, the number of shares is not known. It is because the price at which shares will be allotted is not known, it's determined through the process of book-building only. The prospectus only mentions the price band [*i.e.* the lowest (floor price)] and the highest (maximum price). As per SEBI Regulations, 2009 the maximum price cannot be more than 20% of the floor price. At part of the process, bids are invited from the prospective investors and final price determined (that is, the price at which the issue is likely to be fully subscribed). By dividing the total issue size by the price so determined, the number of shares to be issued is arrived at.

As per SEBI Regulations, 2009, an issuer company may make an issue of securities to the public through a prospectus by making 100% of the net offer to the public through book-building process.

Advantages of Book-building : Advantages of book-building include :

(i) The demand for security proposed to be issued by a body corporate may be created and build-up.

(ii) The quantum of security to be issued may be determined with a certain degree of accuracy.

SEBI has allowed book building as an alternative to firm allotment. Under the process of book building prospective buyer make offers to purchase specified number of shares at a particular price. SEBI Regulations, 2009 define 'book building' to mean a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be. In case the issuer chooses to issue securities through book building, it must follow the SEBI Regulations in this regard explained below:

Offer to Public through Book Building Process (SEBI Regulations)

1. An issuer company may, subject to the requirements specified hereunder, make an issue of securities to the public through a prospectus by making 100% of the net offer to the public through book building process.
2. **Not permitted to offer capital on reservation bases.** Book Building shall be for the portion other than the promoters contribution and the allocation made to:
   (i) permanent employees of the issuer company and in the case of new company the permanent employees of the promoting companies (upto the percentage specified by SEBI); and

(ii) shareholders of the listed promoting companies in the case of a new company and shareholders of listed group companies in the case of an existing company (upto the percentage specified by SEBI) on a 'competitive basis'.

In other words, an issuer company opting for the Book Building facility shall not be permitted to offer capital on a 'reservation' basis to categories other than the categories mentioned above.

3. **Appointment of Merchant Banker(s).** The issuer company shall appoint an eligible Merchant Banker(s) as book runner(s) and their name(s) shall be mentioned in the draft prospectus submitted to SEBI. The Lead Merchant Banker shall act as the Lead Book Runner and the other eligible Merchant Banker(s), so appointed by the issuer, shall be termed as Co-Book Runner(s). In case the issuer company appoints more than one book runner, the names of the book runners who have submitted the due diligence certificate to SEBI, may be mentioned on the front cover page of the prospectus.
4. **Agreement with Stock Exchange(s).** The issuer company what enter into an agreement with one or more of the Stock Exchange(s) which have the requisite system of online offer of securities. The agreement shall specify, *inter alia,* the rights, duties, responsibilities and obligations of the company and stock exchange(s) *inter se.* The agreement may also provide for a dispute resolution merchanism between the company and the stock exchange. The company may apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the online system.
5. **Filing Drat Prospectus.** The draft prospectus shall be filed with SEBI by the Lea Merchant Banker as per the SEBI Regulations containing all the disclosures except that of price and the number of securities to be offered to the public. However, the total size of the issue shall be mentioned in the draft prospectus.
6. **Provisions of Brokers.**
   (i) The Book Runner(s)/syndicate members shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting bids, applications and placing orders with the company and ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors, if any.
   (ii) The brokers so appointed, accepting applications and application monies, shall be considered as 'bidding/collection centers.'
   (iii) The broker(s) so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client/investor fails to pay for shares allocated as per the Regulations, the broker shall pay such amount.
   (iv) The company shall pay to the broker(s) a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients/investors in lieu of his services.
   (v) The Red herring prospectus shall disclose, either the floor price of the securities offered through it or a price band along with the range within which the price can move, if any.
7. **Advertisement.** The issuer company shall after receiving the final observations, if any, on the offer document from SEBI make an advertisement in an English National daily with

wide circulation, one Hindi National newspaper and Regional language newspaper with wide circulation at the place where the registered office of the Issuer company is situated. The advertisement so issued shall contain the salient features of the final offer document as specified in Form 2A circulated along with the application form. The advertisement in addition to other required information, shall also contain the following:

(i) the date of opening and closing of the issue

(ii) the method and process of application and allotment

(iii) the names, addresses and the telephone numbers of the stock brokers and centres for bidding.

Further, the issuer company shall circulate the application forms to the brokers.

8. **Determination of Issue Price.**

- The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the 'syndicate members' and 'Self Certified Syndicate Banks'. On determination of the price the number of securities to be offered shall be determined (issue size divided by the price which has been determined).
- Once the final price (cut-off price) is determined, all those bidders whose bids have been found to be successful (*i.e.,* at and above the final price or cut- off price) shall become entitled for allotment of securities.
- No incentive, whether in cash or kind, shall be paid to the investors, who have become entitled for allotment of securities.

9. **Additional Discloures:** Apart from meeting the disclosure requirements as, specified in these Regulations, the following disclosures shall be suitably made in the offer document:

(i) The particulars of syndicate members, brokers, registrars, bankers to the issue, etc.

(ii) The following statement shall be given under the 'basis for issue price':

"The issue price has been determined by the Issuer in consultation with the Book Runner(s), on the basis of assessment of market demand for the offered securities by way of book-building."

(iii) The following accounting ratios shall be given under the basis for issuer price for each of the accounting periods for which the financial information is given:

- EPS, pre-issue, for the last three years (as adjusted for changes in capital).
- P/E pre-issue
- Average return on networth in the last three years.
- Net-asset value per share based on last balance sheet.
- Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (*i.e.* companies of comparable size in the same industry.) (Indicate the source from which industry average and accounting ratios of the peer group has been taken).
- The accounting ratios disclosed in the offer document shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital shall be exercised.

10. **Formalities after disclosures.**

- The final prospectus containing all disclosures as per SEBI Guidelines including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.
- Arrangement shall be made by the Issuer for collection of the applications by appointing mandatory collection centers.
- The online, real time graphical display of demand and bid prices at the bidding terminals, shall be made.
- The Book Running Lead Manager shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids on a real time basis.
- The investors who had not participated in the bidding process or have not received intimation of entitlement of securities may also make an application.

GLOBAL DEPOSITORY RECEIPT (GDR'S)

Definition

"Global Depository Receipt" means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorized by a company making an issue of such depository receipt.

U/S 2(44) of the Companies Act, 2013 Companies (Issue of Global Depository Receipts) Rules, 2014

In exercise of the powers conferred by section 41 read with section 469 of the Companies Act, 2013, the Central Government hereby makes the following rules, namely :-

Rule 1. Short title and commencement.

(1) These Rules may be called Companies (Issue of Global Depository Receipts) Rules, 2014.

(2) They shall come into force on the date of publication of this notification in the Official Gazette.

Rule 2. Definitions.

(1) In these Rules, unless the context otherwise requires, -

(a) "Act" means the Companies Act. 2013 (18 of 2013);

(b) "Section" means section of the Act;

(c) "Scheme" means the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or any modification or reenactment thereof;

(2) Words and expressions occurring in these rules shall bear the same meaning as in the Act and the Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993 or any modification or re-enactment thereof.

Rule 3. Eligibility to issue depository receipts.

A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

Rule 4. Conditions for issue of depository receipts

(1) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorizing the company to do so.

(2) The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting :

Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

(3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

(5) The company shall appoint a merchant banker or a practicing chartered accountant or a practicing cost accountant or a practicing company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practicing chartered accountant or practicing cost accountant or practicing company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorized by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts:

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

Rule 5. Manner and form of depository receipts.

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Rule 6. Voting rights.

(1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Rule 7. Proceeds of issue.

The proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may

be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Rule 8. Depository receipts prior to commencement.

(1) A company which has issued depository receipts prior to commencement of these rules shall comply with the requirements under this rule within six months of such commencement.

(2) Any issue of depository receipts after six months of commencement of these rules shall be in accordance with the requirements of these rules.

Rule 9. Non-applicability of certain provisions of the Act.

(1) The provisions of the Act and any rules issued thereunder insofar as relate to public issue of shares or debentures shall not apply of depository receipts abroad.

(2) The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 of the Act, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.

INDIAN DEPOSITORY RECEIPTS (IDR)

[As per Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014]

Issue of Indian Depository Receipts (IDRs).

(1) For the purposes of section 390, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India (hereinafter in this rule called 'issuing company') shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

Explanation – For the purposes of this rule, the term "Indian Depository Receipt" (here-in-after referred to as 'IDR') means any instrument in the form of a depository receipt created by a Domestic Depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

(2) The issuing company shall not issue IDRs unless –

(a) its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US$ 100 million;

(b) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;

(c) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;

(d) it fulfils such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

The procedure for the issue of IDR's has to followed as prescribed under Rule 13 of the Companies (Registration of Foreign Companies Rules, 2014.

ACCEPTANCE OF DEPOSITS BY COMPANIES [SEC. 73 & 74]

U/s 2(31), Deposits includes any receipt of money by way of deposit or loan in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with Reserve Bank of India.

Companies in India accept deposits from the public at a high rate of interest. In many cases deposits so taken by the companies have not been refunded on the due dates. In many such cases either the companies have gone into liquidation or the funds are depleted to such an extent that the companies are not in a position to refund the deposits. It is therefore necessary to control the companies inviting deposits from the public. The new section 73 & 74 were inserted dealing with the control and regulation of public deposits by the companies. The main purpose of regulating acceptance of deposits by non-banking and non-financial companies is to keep the magnitude of these deposits within limits and to control and regulate deposits outside the banking system in the interest of public and depositors. Various provisions relating to acceptance of deposits by the companies are as under:

Deposit and Loan. According to section 2(31) and the Companies (Acceptance of Deposits) Rules, 2014, the term 'deposit' includes loan *i.e.* any amount borrowed by a company. But a number of judicial decisions have brought out a distinction between a loan and a deposit. Deposit, in a sense, is a loan but with the difference that deposit is repayed on the maturity date while loan becomes payable instantly or on notice. In the case of deposits there is no immediate obligation to repay. The provisions of Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014 can be discussed under two heads :

(1) Acceptance of deposits from members.

(2) Acceptance of deposits from public.

Acceptance of deposits from members —

1. Limits and conditions of deposits. The Central Government is empowered to make rules in consultation with the Reserve Bank of India to prescribe the limits upto which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members.

2. Deposits to be in accordance with rules framed by the Central Government. No company shall invite or allow any other person to invite, any deposit unless :

(a) such deposit is invited or is caused to be invited in accordance with the rules made by the Central Government in this behalf;

(b) an advertisement, including therein a statement showing the financial position of the company, in such form and in such manner as may be prescribed. and

(c) the company is not in default in the re-payment of any deposit or part there of and any interest thereupon in accordance with the terms and conditions of such deposits.

Any company shall accept deposits from its members subject to the fulfillment of the following conditions :

(a) **issuance of a circular** to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed ;

(b) **filing a copy of the circular** along with such statement with the **Registrar** within thirty days before the date of issue of the circular ;

(c) **depositing such sum which shall not be less than fifteen per cent** of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;

(d) **providing such deposit insurance** in such manner and to such extent as may be prescribed;

(e) **certifying that the company has not committed and default** in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and

(f) **providing security,** if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company :

- In case where a company does not secure the deposits or secures such deposits partially, then the deposits shall be termed as "unsecured deposits" and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

3. Past deposits. Every deposit accepted by a company before the commencement of the Companies (Amendment) Act, 1974, in accordance with the directions made by the Reserve Bank of India, shall be repaid in accordance with the terms and conditions of such deposit unless it is renewed. But no such deposit shall be renewed after the expiry of the term thereof, unless the deposit is such that it could have been accepted by the company if the rule made by the Central Government were in force at the time when the deposit was initially accepted by the company.

4. Return of deposits unless renewed. Every deposit accepted by a company after the commencement of the Companies (Amendment) Act, 1988, shall unless renewed in accordance with the rules, be repaid in accordance with the terms and conditions of such deposit.

5. Deposits accepted before commencement. Any Deposits received before the commencement of the Companies Act and such amount is unpaid then the company shall file within 3 months with ROC a statement for all such deposits.

6. Omission or failure to refund deposits. Where there has been an omission or failure to refund any deposit in accordance with the provisions mentioned above, a fine shall be imposed on the company for such contravention. Out of the fine realised, an amount equal to the amount of the deposit which has not been refunded will be paid by the court trying the offence to the depositor. On such payment to the depositor the liability of the company shall stand discharged. Further every officer of the company, who is knowingly guilty of the omission or failure or who authorised such omission or failure shall be punishable with imprisonment upto five years and shall also be liable to fine.

7. Penalty for contravention. Where a company accepts, or invites any deposits in excess of the prescribed limit or in contravention of the manner orconditions prescribed under the rules, or without making proper advertisement :

(a) the company shall be punishable :

(i) where the contravention relates to the acceptance of any deposit, with fine upto an amount equal to the amount of the deposit so accepted;

(ii) where the contravention relates to the invitation of any deposit, with fine which may extend to ten crore rupees but shall not be less than one crore rupees ;

(b) every officer who is in default shall be punishable with imprisonment upto seven years and shall also be liable to fine not less than 25 lakhs which can extend upto 2 crore rupees.

8. Exceptions. These provisions of section 73 & 74 shall not apply to :

(i) a banking company, non banking company ;

(ii) such other company as the Central Government may after consultation with the Reserve Bank of India specify in this behalf ;

(iii) a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987.

9. Repayment of deposits. Where a company has failed to repay any deposit or part thereof, in accordance with the terms and conditions of such deposits, the Tribunal, may, if it is satisfied, either on its own motion or on the application of the depositor, that it is necessary so to do to safeguard the interests of the company, the depositors or in the public interest, direct by order, the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order.

The Tribunal, may before making any order give a reasonable opportunity of being heard to the company and other persons interested in the matter.

10. Nomination. A depositor may, at any time make a nomination and the provisions shall, as far as may be, apply to the nominations made under this subsection.

Acceptance of Deposits from Public (Section 76)

Section 73(1) of the Companies Act, 2013 provides that on and after the commencement of Act, no company shall invite, accept or renew deposits under this Act from the public except as provided under this Act. However, this provision shall not apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

Section 76 and the Companies (Acceptance of Deposits) Rules, 2014 allow a public company, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees, to accept deposits from persons other than its members, Such a company is described as an 'eligible company'. An eligible company may accept deposits from the public provided the following requirements are satisfied–

1. Special Resolution. The company shall pass a special resolution regarding the acceptance of deposits from the public in the general meeting of the company.

2. Filing with the Registrar. The company shall file a copy of the special resolution with the Registrar before accepting deposits from the public.

3. Rating. Such a company is required to obtain the rating (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public

the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety. The rating shall be obtained for every year during the tenure of deposits.

4. Charge on the assets. The company shall, within thirty days of acceptance of deposits, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders.

5. Duration of deposits. The company shall not accept or renew any deposit of less than six months or more than thirty six months from the date of acceptance or renewal of such deposits.

6. Ceiling on Deposits. No eligible company shall accept or renew :

(a) any **deposit from its members,** if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members **exceeds ten per cent** of the aggregate of the paid-up share capital and free reserves of the company ;

(b) **any other deposit,** if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in clause (a), outstanding on the date of acceptance or renewal **exceeds twenty-five per cent** of aggregate of the paid-up share capital and free reserves of the company.

7. Circular/Advertisement. For inviting deposits, the company must issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper and in vernacular language in one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated. It must also upload a copy of the circular on its website, if any.

8. Filing a copy of the circular or advertisement. At least thirty days before the date of such issue, there must have been delivered to the Registrar for registration a copy of the aforesaid circular/advertisement signed by a majority of the directors or their agents, duly authorized by them in writing.

9. Validity. The **circular/advertisement issued shall be valid until the expiry of six months** from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

10. Deposit Insurance. Every company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be. The requirement of mandatory deposit insurance has been postponed for the lime being as per Government notification.

11. Nomination. A depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death.

12. Receipt of Deposit. Receipt of the deposit must be given to the depositor or his agent within a period of twenty one days from the date of receipt of money or realisation of cheque or date of renewal.

13. Register of Deposits. Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, which there shall be entered separately in the case of each depositor the described particulars.

14. Return of deposits to be filed with the Registrar. Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.

15. Penal rate of interest. Every company shall pay a penal rate of interest of eighteen per cent, per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

Repayment of Deposits accepted before commencement of this Act (Section 74). Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall–

(a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment; and

(b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Damages for Fraud (Section 75)

Where a company fails to repay the deposit or a part thereof or any interest within the time specified and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

A class action suit can also be filed against such company. [Section 75(2)].

Penalty (76A). A new section 76A has been incorporated by the Companies (Amendment) Act, 2014. The provisions of this section are as under :

Where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73 :

(a) the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one core rupees but which may extend to ten core rupees; and

(b) every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five rupees but which may extend to two crore rupees, or with both. However if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

Underwriting commission (Section 40)

When a company offers its securities to public, it often wants that the whole issue should be taken up. Consequently, a company is usually willing to pay a small commission on all the shares offered to the public to any one who undertakes to take all the shares, if the public do not take. This is known as 'underwriting'. It consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriters a commission on all shares, whether taken by the public or by the underwriters. It is, thus in the nature of an insurance against the possibility of inadequate subscription. It is usual to underwrite even when a company is sound and the shares are popular, since changes in the international situation or financial state of the country can affect an issue adversely.

A company may pay a commission to any person in consideration of his subscribing or agreeing to subscribe for securities, or procuring or agreeing to procure subscriptions for any securities in the company.

Minimum Subscription

When a company invites the public to subscribe for its securities, it cannot allot those securities until the minimum amount stated in the prospectus has been subscribed. This amount stated in the prospectus is known as the 'minimum subscription'.

Section 39 of the Companies Act, 2013 prohibits allotment of securities where the minimum amount has not been subscribed. The amount so received shall be refunded to all the applicants within a given time frame**. [Section 39(1)].**

The amount payable on application on every security shall not be less than five percent, of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf **[Section 39(2)].**

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of 30 days from the date of issue of prospectus or such other period as may be specified by the Securities and Exchange Board, the amount received under section 39(1) shall be returned within such time and manner as may be prescribed.

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed. [Section 39(4)].

In case of any default under sub-section(3) or sub-section(4), the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less. [Section 39(5)].

PAYMENT OF COMMISSION

RULE-13 of Companies (Prospectus and Allotment of Securities) Rules, 2014

A company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely :

(a) the payment of such commission shall be authorized in the company's articles of association ;

(b) the commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five per cent of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent of the price at which the debentures are issued, or as specified in the company's articles, whichever is less ;

(d) the prospectus of the company shall disclose :

(i) the name of the underwriters;

(ii) the rate and amount of the commission payable to the underwriter; and

(iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

(e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription ;

(f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Brokerage

Brokerage is a remuneration paid to a middlemen for services performed under a contract in procuring subscription of the public issue of shares and debentures. However, the term 'brokerage' is not defined in the Companies Act.

Brokerage may be paid at the rate prevailing in the market at a particular point of time.

The following conditions should be kept in view :

1. There must be an authority in the articles to pay brokerage ;
2. The prospectus or a statement in lieu of prospectus relating to the issue should disclose the rate of brokerage ;
3. A contract relating to such brokerage should be filed with the Registrar of Companies along with the prospectus or a statement in lieu of prospectus.

It may be noted that brokerage is payable only to a person who is carrying on the business as a broker and not to all persons who procure subscriptions to the shares or debentures of the company.

The distinction between an underwriter and a broker must also be noted

Underwriters	Brokers
1. An underwriter is a person who agrees to take specified number of shares or debentures, or a specified amount of debenture stock in the case of under-subscription.	A broker gives no such undertaking to take up shares or debentures in the event of under-subscription.
2. An underwriter gets underwriting commission for his work.	A broker gets brokerage for his work. But he is not entitled to any brokerage in respect of shares not placed.
3. An underwriter is entitled to under-writing commission at a rate not exceeding 5% of the issue price of shares and 2.5% of the issue price of debentures.	A broker is entitled to get such brokerage which has been lawful for companies to pay.
4. The name, address, and occupation of each underwriter will have to be disclosed in the prospectus.	There is no such requirement in case of brokers.

SHORT ANSWER QUESTIONS

1. What is prospectus ?
2. What is the importance of a prospectus ?
3. What constitutes public issue of prospectus ?
4. When should a statement in lieu of prospectus be issued ?
5. Is it compulsory on the part of the company issue a prospectus ?
6. When should the prospectus of a company be delivered to the Registrar for registration ?
7. Should a prospectus be necessarily dated ?
8. What is the meaning of deemed prospectus ?
9. What are the particulars that a prospectus must contain ?
10. What is 'the golden rule as to framing a prospectus' ?
11. What amounts to a mis-statement in a prospectus ?
12. Who are liable for mis-statement in a prospectus ?
13. What are the remedies open to an allottee of shares who had applied for them on the faith of a false and misleading prospectus ?
14. Can the directors avoid liability for a false statement in the prospectus ?
15. Under what circumstances can the opinion of an expert be incorporated in the prospectus ?
16. What is the measures of damages awarded to a subscriber of shares on the faith of a fraudulent prospectus ?
17. When does an allottee of shares on the faith of a fraudulent misleading prospectus lose his right of rescission ?
18. What are the legal requirement if a company wants to invite deposits from the public ?
19. What are the particulars to be included in an advertisement inviting deposits by a company ?
20. What is meant by minimum subscription ?
21. What is the effect of allotting shares without minimum subscription having been subscribed ?

TEST QUESTIONS

1. What is a prospectus ? Is the issue of a prospectus compulsory on the part of a company ?
2. Explain the meaning and importance of prospectus. What constitutes public issue of prospectus ?
3. Explain the legal provisions relating to issue and registration of a prospectus.
4. What is a prospectus ? When should a statement in lieu of prospectus be issued ? Do you notice any substantial differences between a prospectus and a statement in lieu of prospectus ?
5. What is a prospectus ? Who are liable for mis-statements in a prospectus? Explain the extent of civil and criminal liability for such mis-statements.
6. What are the remedies open to an allottee of shares who had applied for them on the faith of a false and misleading prospectus and what are the defences available to the directors of the company who have issued such a prospectus ?
7. Who is deemed to be an expert in relation to the prospectus of a company ? What conditions must be satisfied before a report by an expert can be published therein ? Is there any remedy available to the allottee of the shares who has been induced to take shares on the faith of an untrue statement of an expert in the prospectus ?

8. A prospectus was issued on the basis of the report of an expert who examined the property purchased by the company. If such report contained false statements of facts which were relied upon by a shareholder, what will be his remedy ?
9. (*a*) Who are the different categories of persons liable for misrepresenta-tions in the prospectus ?
10. (*b*) What are the defences available to such persons to escape their liability ?
11. "Prospectus is the window through which company is displayed without distortions." Comment. Distinguish a prospectus from statement in lieu of prospectus.
12. A person has purchased shares from an existing shareholder. Is the purchaser entitled to relief, if any, if there are untrue statements in the prospectus ?
13. What is prospectus by implication ?
14. State the provisions of Companies Act, 2013 regarding payment of commission and brokerage on public issues of shares.
15. Explain the term 'minimum subscription'. What is the effect of allotting shares without minimum subscription having been subscribed ?

PRACTICAL PROBLEMS

Q. 1. A deceitful prospectus containing an untrue statement was issued by the defendant on behalf of a company. The plaintiff received a copy of it but did not take any shares originally in the company. The allotment was completed and several months afterwards the plaintiff bought 200 shares in open market. The plaintiff sues the defendant for rescission on the ground of untrue statement in the prospectus. Decide stating reasons.

Ans. The plaintiff cannot sue the defendant for rescission of the contract. The plaintiff can succeed only if he is an allottee and he must have relied upon the statement in the prospectus. If a person purchases shares in the open market, he has no rights against the company. Refer to the case of *Peek Vs. Gurney.*

Q. 2. In a prospectus issued by the managing director of a company it was stated that the company had paid a dividend every year during 2001-07 (years of depression), thus implying that the company had been prospering. As a matter of fact the company has sustained loss during the relevant period and had paid the dividends only out of reserves accumulated in the past. Can this observation be constructed as a mis-statement so as to render the maker criminally liable, and if so, on what ground ? If not, why not ?

Ans. The statements made by the managing director and included in the prospectus are literally true. But, the managing director has concealed a material fact. Section 65 of the Companies Act provides that in case the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed , in respect of such omission, to be a prospectus in which untrue statement is included.

Q. 3. X Co. Ltd. intended to buy a rubber estate in Peru. Its prospectus contained extracts from an expert's report giving the number of rubber trees in the estate. The report was inaccurate. Will any shareholder buying shares of the company on the basis of the above representation have any remedy against the company ? Can the persons authorising the issue of the prospectus escape from their liability ?

Ans. The shareholder, who has bought shares of the company on the basis of such a representation in the prospectus, shall have the right to claim compensation from the company for any loss that he might have sustained in terms of the value of shares. But, his claim against those responsible for issue of prospectus shall not succeed since they made the statement on the basis of report of an expert whom they believed to be competent. However, expert can be proceeded against.

Q. 4. A company issued a prospectus advertising that the company has a great potential 'turnover' of a million bags of cement in a year. It is discovered later that while the company did have the

installed capacity of one million bags it had never produced more than six lacs bags of cement in a year. Buyers of the shares seek remedy against the misleading statement. Will they succeed ?

Ans. The buyers cannot succeed because the statement is only an opinion.

Q. 5. A applies for some shares on the basis of a prospectus which contains a mis-statement and the shares are allotted to A, who thereafter transfers them to B. Can B bring an action for rescission on the ground of mis-statement ?

Ans. No, B cannot bring an action for rescission on the ground of mis-statement. A person who has purchased shares in the open market cannot sue. Refer to *Peek Vs. Gurney.*

Q. 6. A applied for certain shares of a company on the basis of a prospectus containing the names of the directors. Some of the directors retired before the shares could be allotted. Can A set aside the contract ?

Ans. Yes, A can set aside the contract. A subscriber to the shares of a company on the basis of a misleading prospectus has a right to rescind the contract to take shares.

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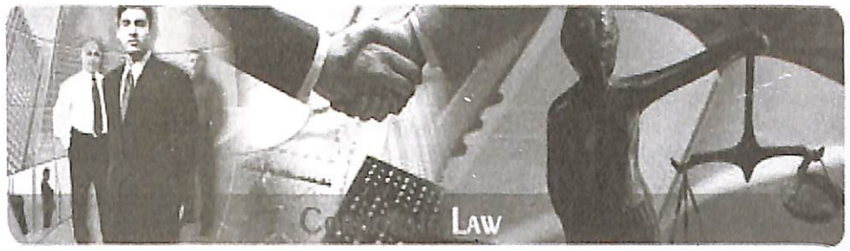

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SHARES

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	ALLOTMENT OF SECURITIES	
Minimum subscription stated in prospectus	The minimum subscription requirement in the 1956 Act applied only to allotment of shares in public issue. The 2013 Act extends this requirement to public issues of all securities.	No allotment of shares in a public issue shall be made unless minimum subscription (as stated in the prospectus) is received by the company.
Minimum share-application money	• Minimum 5% of the nominal amount of the security or such other percentage or amount as specified by SEBI by regulations. • Made applicable to all securities. • Applicable to public offer which can be made only by public companies.	• Minimum 5% of nominal value payable with application under 1956 Act. • Applied only to shares. • Applicable to public and private companies.
Refund if the stated minimum amount not received	The 2013 Act provides for refunds if stated minimum subscription not received **within 30 days** from the date of issue of prospectus or such other period as may be specified by SEBI. [See rule 11 of the Companies (Prospectus and Allotment of Securities) Rules, 2014]	The 1956 Act provided for refund of application money if stated minimum amount (minimum subscription) not received within **120 days** after the first issue of the prospectus.
Keeping application moneys in Scheduled Bank	The 2013 Act omits the provisions of section 69(4) of the 1956 Act.	Section 69(4) provided that all moneys received on application of shares in public issue shall be kept deposited and kept deposited in a Schedule Bank— (a) until the certificate to commence business is obtained, or (b) where such certificate has already been obtained, until the entire amount payable on applications for shares in respect of the minimum

		subscription has been received by the company.
Securities to be dealt in stock exchanges	The 2013 Act requires that listing permission be obtained from one or more recognised stock exchanges before making public offer. Merely making applications before making public offer not enough as was the case in 1956 Act.	The 1956 Act only required application for listing be made to one or more recognized stock exchanges before offering shares or debentures to public for subscription. The 1956 Act did not require that listing permission be obtained before making the public offer.
Application of premium received on issue of shares	Section 52(3) of the 2013 Act intends to eliminate conflict with Accounting Standards by providing that such class of companies as may be prescribed whose financial statements comply with Accounting Standards prescribed for such class of companies, cannot utilize securities premium account for writing off preliminary expenses or for writing off the expenses or the commission paid or discount allowed on the issue of preference shares or debentures of the company for providing premium payable on redemption of preference share or debentures.	Section 78(2) of the 1956 Act permitted all companies to utilise securities premium account *inter alia* for writing off preliminary expenses or for writing off the expenses of or the commission paid or discount allowed on any issue of shares or debentures of the company for providing premium payable on redemption of preference shares or debentures.
Prohibition on issue of shares at discount	The 2013 Act has prohibited issue of shares (other than sweat equity shares) at a discount. Under the 2013 Act, only sweat equity shares can be issued at a discount.	Section 79 of the 1956 Act permitted issue of shares at a discount subject to certain conditions.
Issue of sweat equity shares	Section 54 of the 2013 Act has no application to issue of sweat equity shares by foreign/ overseas subsidiary of an Indian company. [See rule 8 of the Companies (Share Capital and Debentures) Rules, 2014]	Section 79A of the 1956 Act also applied to issue of sweat equity shares by foreign company/overseas subsidiary of an Indian company.
Issue of redeemable preference shares **redeemable after 20 years from the date of their issue**	A company may issue preference shares for a period exceeding 20 years but not exceeding 30 years for infrastructure projects [Schedule VI to the 2013 Act], subject to the redemption of minimum 10% of such preference shares from the 21st year onwards or earlier, on proportionate basis, on an annual basis, at the option of such preferential shareholders – [Rule 10 of the Companies (Share Capital and Debentures) Rules, 2014.	Not allowed

DEFINITION OF SHARE

A 'share' in a company denotes rights and obligations. It is the interest of a shareholder in a definite portion of the capital. It expresses a proprietary relationship between the company and the shareholder. A shareholder is the proportionate owner of the company but he does not own the company's assets which belong to the company as a separate legal entity. According to section 2(84) a share means, **"A share in the share capital of a company and includes stock."** An exhaustive definition of share has been given by Farwell J. in *Borland's Trustee v. Steel Bros*1, in the following words :

"A share is the interest of a shareholder in the company, measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se in accordance with the Companies Act."*

The Supreme Court of India has approved the above definition of share in the *Commissioner of Income-tax v. Standard Vacuum Oil Company*2 wherein it has observed, **"By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holder by the articles of the company which constitute a contract between him and the company." Thus, a share (i)** ***measures the right of a shareholder to receive a certain proportion of the profits of the company when it is a going concern and to contribute to assets of the company when it is being wound up; and (ii) forms the basis of the mutual covenants contained in the articles binding the shareholders inter se.***

A share is a personal estate capable of being transferred in the manner laid down in the articles of association. It is a movable property which can either be mortgaged or pledged. Share is included in the definition of 'goods' under the provisions of the Sale of Goods Act, 1930.

On the basis of above discussion, the nature of share can be summed up as under.

1. Share gives some rights and liabilities to the holder.
2. Shareholder is not a part owner of the company or property of the company.
3. The share is a movable property. The movable property of a person can be a 'chose in action' or chose in possession. Share is chose in action.
4. Share is 'goods'.

According to section 45, every share issued by a company must be numbered so that one share may be distinguished from another share. However this provision will not apply to the shares held with a depository. A certificate of shares issued by a company under its common seal specifies the shares held by any member.

STOCK AND SHARES

Stock. Stock is a different concept When shares are fully paid up, they may be converted into stock. Stock is simply a set of shares put together in a bundle. Stock is expressed in terms of money and not as so many shares. It is the aggregate of fully paid shares legally consolidated. The aggregate can be split up into fractions of any amount without regard to the original nominal value of shares. The issue of partly paid up stock is invalid.

A company limited by shares, may, if so authorised by its articles, convert all or some of the fully paid-up shares into stock or reconvert its stock into fully paid up shares of any denomination. A company cannot issue stock directly but can only convert fully paid-up shares into stock. Stock certificates, similar to share certificates, must be issued.

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1. (1901) 1 Ch. 279.
2. (1966) 1. Comp. L.J. 187 (S.C.)

Stock is transferable like share. The Board may, however, fix the minimum amount of stock transferable. The holders of the stock have according to the amount of stock held by them the same rights, privileges and advantages as regards dividends, voting at the meetings of the company and other matters as if they held the shares from which the stock arose.

Stock and shares distinguished. The main points of distinction between the two are as under.

1. A share is one of a number of individual units into which the capital of a company is divided. Stock is the capital in the form of a fund which may be divided into any desired amount. Thus, shares are in units, whereas stock is in lump holding.
2. Shares may be partly or fully paid-up, but stock must be fully paid.
3. Shares can be issued directly but stock cannot be issued directly.
4. Share has a nominal value, whereas stock has none.
5. Shares must bear distinctive numbers[1], while stock is never numbered.
6. Shares are of equal denomination while stock may be split into unequal amounts.
7. Shares cannot be transferred in fractional amount; stock can be transferred in any fraction although the articles may provide the minimum fractional amount of stock which can be transferred.

TYPES OF SHARES

Under Section 43 of Companies Act, 2013. The share capital of a company limited by shares shall be of two kinds, namely, equity and preference. But equity shares have been subdivided into two categories, namely, shares with equal rights and shares with differential rights.

(a) equity shares—

(i) with voting rights ; or

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

(b) preference shares.

Preference shares. A preference share must satisfy the following two conditions:

(i) It shall carry a preferential right as to the payment of dividend at a fixed rate; and

(ii) In the event of winding up, there must be a preferential right to the payment of the paid up capital.

These are two dominant characteristics of preference shares. A preference share may or may not carry such other rights as—

(a) a preferential right to any arrears of dividend ;

(b) a right to share in surplus profits by way of additional dividend :

(c) a right to be paid a fixed premium specified in the memorandum ; and

(d) a right to share in surplus assets in the event of a winding up, after all kinds of capital have been repaid.

Before there can be preference shares there must be at least two kinds of shares in which one

1. This does not apply to shares held in a depository mode.

class is given preferential treatment over the other. Where there is only one class of shares, there is no question of preferential treatment of one class of shareholders over another in the matter of dividends.

Equity shares. All shares which are not preference shares are equity shares. Equity shareholders have the residual right of the company. They may get higher dividend than preference shareholders if the company is prosperous or get nothing if the business of the company flops. It is pertinent to note that Section 43 of the Act empowers companies to issue equity shares without voting rights subject to the rules and terms and conditions that may be prescribed.

With respect to issue of shares with differential voting rights, Ministry of Corporate Affairs has notified Companies (Share capital and debentures) Rules, 2014.

These rules provide :

(i) Shares with differential voting rights, including non-voting shares, shall be allowed to the extent of 26 percent of the total issued share capital.

(ii) The Company must have distributable profits, as per section 205, in the three years preceding such issue.

(iii) Equity capital with regular voting rights will not be allowed to be converted into shares with differential voting rights and vice-versa.

(iv) Issue of such shares shall have to be approved by the shareholders through resolution in a general meeting. A listed company may obtain the shareholders approval through postal ballot.

(v) The notice of the general meeting must give the prescribed details by way of explanatory statement.

(vi) A company which has defaulted in filing annual returns during the preceding three years or has failed to repay its deposits or interest thereon on due date or redeem debentures on due date or pay dividend shall not be eligible to issue shares with differential rights.

(vii) A company should not have defaulted in addressing investors' grievances.

(viii) The issue of such shares should be permissible under the Articles of association of the company.

(ix) The company should not have been convicted of any offence under :

(a) Securities and Exchange Board of India Act, 1992 ;

(b) Securities Contracts (Regulation) Act ; 1956 ; and

(c) Foreign Exchange Management Act, 1999.

(x) Members holding equity shares with differential rights shall be entitled to bonus and rights issue of the same class.

Kinds of preference shares. Following are the various kinds of preference shares :

1. Cumulative and non-cumulative preference shares. With regard to the payment of dividend, preference shares may be cumulative or non-cumulative. In the case of cumulative preference shares, if the profits of the company in any year are not sufficient to pay the fixed dividend on the preference shares, the deficiency must be made up out of the profits of subsequent years. The accumulated arrears of dividend must be paid before anything is paid out of the profits to the holders of any other class of shares. In the case of non-cumulative preference share, the dividend is only payable out of the net profits of each year. If there are no profits in any year, the arrears of dividend cannot be claimed

in the subsequent year. Preference shares are presumed to be cumulative unless expressly described as non-cumulative.

2. Participating and *non-participating* preference shares. Participating preference shares are those shares which are entitled, in addition to preference dividend at a fixed rate, to participate in the balance of profits with the equity shareholders after they get a fixed rate of dividend on their shares. The participating preference shares may also have the right to share in the surplus assets of the company on its winding up. Such a right must be expressly provided in the memorandum or the articles of association of the company.

Non-participating preference shares are entitled only to a fixed rate of dividend and do not share in the surplus profits. The preference shares are presumed to be non-participating unless expressly provided in the memorandum or the articles or the terms of issue.

3. Convertible and non-convertible preference shares. Convertible preference shares are those shares which can be converted into equity shares within a certain period. Those shares, which do not carry the right of conversion into equity shares, are called non-convertible preference shares.

4. Redeemable preference shares. According to section 55(2), a company limited by shares, if so authorised by its articles, may issue redeemable preference shares. Such shares may be redeemed within a period not exceeding 20 years from the date of their issue. In the case of irredeemable shares, the capital is to be returned on the winding up of the company.

The redeemable preference shares can be redeemed, only subject to the following conditions :

(i) Such shares must be fully paid.

(ii) Such shares shall be redeemed out of distributable profits or out of the proceeds of a fresh issue made for the purposes of redemption.

(iii) Any premium to be paid on redemption of such shares must be paid out of profits or out of the securities 1 premium account.

(iv) Where shares are so redeemed out of profits, a sum equal to the nominal value of the shares redeemed must be transferred to the 'Capital Redemption Reserve Account'. This amount shall be treated as capital of the company and the provisions as regards reduction of capital shall apply.

No company limited by shares shall, issue irredeemable preference shares or redeemable preference shares which are redeemable after 20 years of its issue. [Section 55(1) and (2)]

Where a company fails to comply with these provisions, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 1000 for each day during which such default continues or ₹ 5 lacs, which ever is less.

Redemption of redeemable preference shares shall be notified to the Registrar within one month of redemption. Where redeemable preference shares have been issued, the balance sheet must contain a statement specifying what part of the capital consists of such shares and the earliest date on which the company has power to redeem the shares.

Preference Shares compared with Equity Shares

Basis	Preference Shares	Equity Shares
Definition	Shares that carry a Preferential Right as to payment of—(a) Dividend and (b) Repayment of Capital.	Shares that are not Preference Shares are called Equity Shares.

Subsituted for 'share' by the Companies (Amendment) Act 1999, with retrospective effect from 31-10-1998.

Return	Preference shares are more like debentures than like equity shares. Preference shares are entitled to a fixed rate of dividend as debentures carry a fixed rate of interest.	The rate of dividend on equity shares depends upon the amount of profits available.
Priority	Dividend on the preference shares is paid in priority to the equity shares.	The dividend on equity shares is paid only after the preference dividend has been paid.
Repayment of Capital	The preference shares must be fully repaid first.	The equity shares rank behind the preference shares for repayment of capital on winding up.
Arrears of Dividend	Generally accumulates unless specifically said to be non-cumulative.	No accumulation of Unpaid Dividend. No Profits means no Dividend payable to equity shareholders.
Voting Rights	The voting rights of preference shareholders are usually restricted.	An equity shareholder can vote on all matters affecting the company. However, Section 43 of the Companies Act empowers companies to issue equity shares without voting rights.
Bonus Shares or Right Shares	Bonus shares or Right shares are usually not allowed to the preference shareholders.	A company may issue bonus shares or rights shares to the company's existing equity shareholders.
Redemption	Redeemable preference shares are redeemed by the company on the expiry of the stipulated period.	But equity shares cannot be redeemed. But now buy back is permitted u/s 68.
Control and Management	No right to take part in management.	Equity Shareholders are the real owners, hence have a right to control the management of Company.

Nomination of shares (Section 72)

Sec. 72 the Companies Act, 2013, confers a right on the shareholders of a company to nominate at any time in the prescribed manner a person to whom his securities in the company shall vest in the event of his death.

As per the provisions of Sec. 72(1), a holder of securities of a company may nominate a person to whom his securities shall vest in the event of his death. It appears that there can be maximum one nominee and the nominee can either be an individual or a Company. Even a minor can be a nominee.

Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, a person to whom all the rights in the shares or debentures of the company shall vest in the event of death of all the joint holders. [Section 72(2)].

Any person who becomes a nominee by virtue of the provisions of Section 72 A can call on the company to register himself (or herself) as holder of the shares in the event of the death of the person who had nominated him (her) on the production of such evidence as many be required by the company—such as death certificate etc. The nominee shall have all the rights and entitlement of the original shareholder(s). [Section 72(3)]

Under the Companies (Share Capital & Debentures Rules, 2014), the Ministry of Corporate Affairs has issued the "Nomination Form No. SH. 13" which will have to be filled in by the Securityholders at the time of making nominations.

APPLICATION AND ALLOTMENT OF SHARES

A prospectus 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. 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 a company of a certain number of shares to a person. Till such allotment is made, shares as such do not exist.

Provisions relating to allotment are discussed under the following heads :

1. General provisions regarding allotment.
2. Statutory provisions regarding allotment.

General principles regarding allotment. The ordinary law of contracts applies to agreements to take shares in a company. Thus, the allotment to be valid must be made in accordance with the principles of the law of Contract relating to offer and its acceptance. An offer to take share must be made in writing which may be accepted by the company by alloting the shares to the applicants. These principles are as under :

1. *Proper authority.* Allotment must be made by the directors at a properly constituted Board meeting or by a committee of the Board where the directors have power to delegate their powers to such a committee. Where the directors delegate their powers to make allotment to the general manager of the company and there is no such provision in the articles the allotment made by the general manager is void.

2. *Absolute and unconditional.* The allotment must be absolute and unconditional. If an application for shares is made subject to a condition, such a condition becomes the part of the offer and an allotment disregarding the condition may be repudiated by the allottee.

Example : S wrote to a hotel company offering to take 300 shares if the contract for renovation of the hotel was given to him. The company accepted his offer and the shares were allotted to him. The contract for renovation was not given to S. The hotel company before entering into the contract with S went into liquidation. It was held that S was not liable as a contributory as his offer was conditional [Simpson's case (1969) 4 Ch. 184].

3. *Within reasonable time.* An application for shares must be accepted within a reasonable time. If there is undue delay in the allotment the offer lapses.

Example : X applied for shares on June 28. Shares were allotted on Nov. 23. X refused to take them. It was held that the offer had lapsed and X was not liable to pay for them. [Rams gate Victoria Hotel Co. v. Montefiore (1886) L.R.I. Ex. Ch. 109].

However, if there is unreasonable delay in allotment of shares but shares are accepted by the applicant and are not repudiated, he cannot plead that his offer had lapsed because of delay.

4. *Must be communicated.* Allotment by itself does not constitute acceptance of offer for shares. It must be communicated to the applicant. Notice of allotment may be given by post and in such a case the contract is complete when the letter is posted even though it is never received.

Example : G applied for some shares in a company. He sent the application by post. A letter of allotment was despatched by the company soon after. But the letter never reached G. It was held that G was liable as a shareholder in the company. [Household Fire Insurance Co. Ltd. v. Grant (1879) 4 Ex. 216].

5. *Revocation of the offer.* An application for shares can be revoked at any time before acceptance is communicated.

Example : H applied for shares in a company. Shares were allotted to him. The letter of allotment was sent to the company's agent to deliver by hand to H. Before the letter was delivered. H withdrew his application. It was held that there was no allotment. [Re National Savings Bank Association (1867) L. R. Eq. 9].

The above rule is now subject to an exception. Where an application is made in response to a prospectus issued generally, the application cannot be withdrawn until after the expiration of the fifth day after the time of the opening of the subscription list. This has been provided to lessen the inconvenience caused to companies by 'stags' who withdraw their application before allotment when they feel that the issue has not been successful.

Over subscription. If the applications are more than the shares issued, allotment has to be done on *pro rata* basis as per guidelines of SEBI, if it is a public issue. In case of private issue, allotment is at the discretion of Board.

Effect of Non-compliance of 'general provisions'.

The allotment will be null and void if general provisions are not complied with.

Statutory provisions

As far as private companies are concerned the Companies Act does not prescribe any restrictions on them as to the allotment of shares and debentures. However, the Companies Act prescribes certain restrictions regarding the allotment of shares and debentures by public companies.

Such restrictions may be discussed under the following two heads :

(*i*) When no public offer is made.

(*ii*) When public offer is made.

(*i*) ***When no public offer is made.*** **(Private allotment of shares)** A company can also raise capital by placing the securities privately and without inviting the public for subscription of its securities. In this kind of arrangement, Section 42 of the Companies Act, 2013 has introduced a new provision regarding private placement of securities. **Private placement** means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42.

The offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty [raised to two hundred (200)] or such higher number as may be prescribed, [excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of section 62(1), in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

The company shall not issue any prospectus for such offer or invitation and such offer or invitation shall be made through a private placement offer letter.

If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons under clause (a), whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same

shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of section 23(a). Private placement under section 42 is carried out through offer latter as compared to public issue through prospectus under section 26.

Securities offered under private placement shall be allotted within 60 days. There is no restriction as regards minimum subscription.

Both private and public companies can issue securities (e.g. equity or preference shares, debentures, convertible instruments) in private placement mode.

Private Placement Process

A company can issue securities in the private placement mode by issuing *private placement offer letter* in Form 3.4. It is permitted to invite or make offer to maximum 50 persons in financial year [Draft Rule 3.12(2)(b) proposes a higher number of 200]. The Central Government is empowered to increase the numbers. A private company has to essentially issue securities in the private placement route in compliance with the requirements of section 42 as it cannot invite public to subscribe any securities. A public company can opt for both public offer and private placement routes.

Why Private Placement ?

The cost of public issue of debentures is quite high and time consuming. Many companies prefer to issue debentures on private placement basis as this will bring in funds quickly.

No company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

Whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

The Central Government may make rules in relation to offer or invitation of securities to be made by the companies under section 42.

If a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty. [Section 42(11)].

(ii) When public offer is made.

1. First allotment of shares

The Companies Act, 2013, prescribes the following restrictions which must be complied with before a public company proceeds to make allotment of shares.

(i) Registration of prospectus. The company must deliver a copy of the propectus to the Registrar on or before the date of its publication. The prospectus must be signed by every person who is named therein as a director or proposed director of the company. [Sec. 26].

(ii) Minimum subscription. No securities which are offered to the public for subscription can be

allotted until the minimum subscription stated in the prospectus has been subscribed and the amount payable on application has been received by the company by cheque or other instrument (section 3).

As per Section 39 read with SEBI guidelines, a company making any rights or public issue of shares, debentures etc. must receive a minimum subscription as prescribed [90% against the entire issue] in the prospectus against the entire issue before making an allotment of shares or debentures to the public. If minimum amount is not received within 30 days from the date of issue of prospectus, the entire amount collected with applications shall be refunded within 15 days from date of closure of issue to the applicants at the end of stipulated period. If there is a delay in refund of such amount by more than 15 days the company will pay interest @ 15% p.a. for the delayed period. The penalty for default in not making refund within specified time is a fine of 1000 rupees per day of default or 1lakh rupees which ever is less. [Sec. 39(5)].

(iii) Application money. The money payable on application for each security shall not be less than 5 per cent of the nominal value of the securities or such other percentage as specified by SEBI (Sec. 39). For example, if share of nominal value of ₹ 10 is issued, at least 50 paise per share should be received alongwith application. However, company may prescribe higher amount.

Companies issuing securities to public have to follow SEBI guidelines. As per SEBI guidelines, application money cannot be less than ₹ 2,000. All moneys received from applicants for shares must be deposited and kept deposited in a scheduled bank until the entire amount payable on application for securities in respect of the minimum subscription has been received. A condition requiring an applicant for shares to waive a breach of the above requirements is void.

In respect of applications for value of ₹ 1,00,000 or more, the applicant or in case of applications in joint names, each of the applicant, shall mention his/her permanent account number (PAN) and income tax circle, ward, district or the fact of non-allotment of PAN, as the case may be and applications not complying with the provisions are liable to be rejected.

(iv) Opening and closing of the subscription list. Where shares are offered by a prospectus no allotment shall be made until the beginning of the fifth day after the day on which prsopectus is first issued or on such later day as may be specified in the prospectus. This date is known as the 'opening of the subscription list'. The object of this is to give time for consideration before submission of applications. Where after the issue of the prospectus a public notice is given by some responsible person, disclaming his responsibility for the issue of the prospectus, no allotment shall be made until the beginning of the fifth day after that on which such public notice is first given. The prospectus shall be construed to have been issued generally from the date it is first issued as a newspaper advertisement or if it has not been so issued from the date on which it is first issued in any manner.

The object of these provisions is to give applicants for shares sufficient time to study the prospectus and to withdraw their applications if they are not satisfied with the prospectus.

A company may proceed to allot shares soon after the opening of the subscription list. In case of listed shares, however, the subscription list must be kept open for at least 3 days under the rules of recognised stock exchanges. The prospectus generally states the time when the subscription lists will be closed.

The allotment of shares in contravention of these provisions is valid. But the company and every officer who is in default shall be liable to a fine upto 1000 rupees for each day or one lakh rupees whichever is less.

An application for shares shall not be revocable until after the expiry of the fifth day after the opening of the subscription list.

(v) Securities to be dealt on a stock exchange : Listing (Sec. 40). It is usual for companies to state prominently on the face of the prospectus that an application has been made or will be made to a stock exchange for quotation of the securities offered for subscription. The object underlying this statement is to give an assurance to the intending investor that the shares become marketable and to induce him to subscribe for them on that basis. Although there is no guarantee that the application for quotation will be granted by the stock exchange authorities, the public assumes that the permission is likely to be granted and is thereby encouraged to subscribe. In many cases inspite of this statement contained in the prospectus the necessary permission is not sought or sought only after considerable delay.

To remove this lacunae the Companies Act was amended in 1988 to provide for compulsory listing of public issues. The provisions of section 40 are as under :

Every company issuing securities to the public by issue of prospectus, shall before such issue, make an application to one or more recognised stock exchanges for permission for enlistment of its securities. [Sec. 40(1)].

Where a prospectus states that an application under section 40(1) has been made for permission for the securities offered thereby to be dealt in on one or more recognised stock exchanges, such prospectus shall state the name of the stock exchanges.

Return of excess money where permission granted. Where permission has been granted by the recognised stock exchange or stock exchanges for dealing in any securities, in such stock exchange or each such stock exchange, and the moneys received from applicants for securities are in excess of the aggregate of the application moneys relating to the securities in respect of which allotments have been made, the company shall repay the money to the extent of such excess. If such money is not repaid the company becomes liable to pay it, the company and every director of the company who is an officer in default shall be jointly and severally liable to repay that money with interest, for the period of delay.

If **default is made in complying** with this provision, the company and every officer in default shall be punishable with fine upto ₹ five lakh which may extend upto 50 lakhs.

(vi) All money to be kept in a scheduled bank

If prospectus states that application has been or will be made for permission to deal in the shares on a recognised stock exchange, the money received from applicants must be paid into a separate bank account maintained with a scheduled bank. The object of this provision is to provide protection to persons who pay the money on the faith of a promise.

If default is made in complying with this provision, the company shall be punishable with fine which may extend to ₹ five lakhs which may extend upto ₹ 50 lakhs [Sec. 40(3)].

Utilisation of moneys kept in the separate account. Money standing to the credit of the separate bank account cannot be utilised for any purposes other than—

(a) for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus, or

(b) for the repayment of monies within the time specified by the SEBI, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

(vii) Initial offer of securities to be in dematerialised form

Section 29 of the Companies Act, 2013 provides that :

(a) every company making public offer; and

(b) such other class or classes of public companies as may be prescribed,

shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996.

Any other company, may convert its securities into dematerialized form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialized form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Allotment Procedure. On receipt of all the share applications by the company, the directors shall proceed with the allotment of shares. If the issue is fully described, then there is no difficulty in allotment of shares. If, however, the issue is subscribed, the directors make allotment in consultation with the stock exchange.

The letters of allotment are issued to the successful applicants and to others the application money is refunded.

After the allotment of shares, a return of allotment in the prescribed form shall be filed with the Registrar of Companies.[Sec. 39(4)

2. Subsequent allotment of shares

In case of subsequent allotment of shares all the 'statutory provisions' regarding 'first allotment of shares' apply equally except :

(1) minimum subscription

(2) application money must be deposited in a scheduled bank.

3. Allotment of debentures

In case of issue of debentures all the 'statutory provisions' regarding 'first allotment of shares' apply equally, except :

(a) minimum subscription,

(b) the amount payable on application,

(c) application money must be deposited in a scheduled bank.

IRREGULAR ALLOTMENT

Meaning. If allotment of shares is made in contravention of the provisions of the Section 39, then the allotment is termed as irregular.

Thus, an allotment will be considered irregular in the following cases as may be applicable :

(a) Where minimum subscription has not been received.

(b) Where a copy of the prospectus has not been filed with the Registrar.

(c) Where a copy of the statement in lieu of prospectus has not been delivered to the Registrar.

(d) Where subscription list is opened before the beginning of the 5th day from the date of issue of prospectus.

(e) Where a minimum of 5% of the nominal value of shares has not been received by way of application money.

(f) Where the application money has not been kept in a scheduled bank.

(g) Where stock exchange has either not listed shares within 10 weeks or has refused permission.

Consequences of irregular allotment. Consequences of irregular allotment depend upon the nature of irregularity involved. The allotment may be valid, voidable or void.

In the following cases, though allotment is irregular, yet it will be valid. However the company and officers who are in default can be penalised.

(a) Copy of prospectus is not delivered to the Registrar of Companies before issue.

(b) Allotment is made before the beginning of 5th day from the date of issue of prospectus.

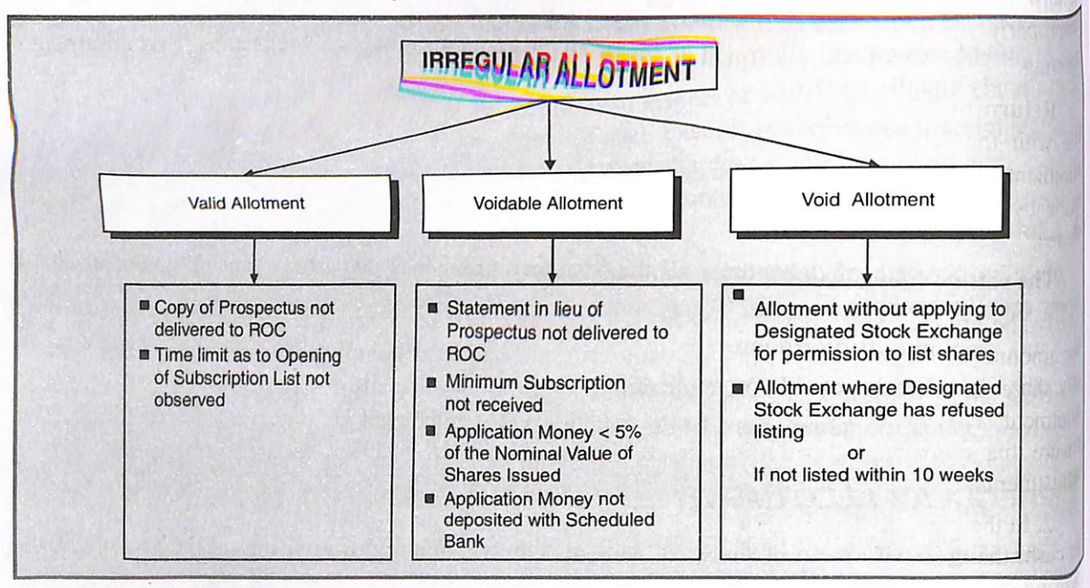
Voidable allotment. The allotment is voidable in the following cases —

(*a*) Where the company has issued a prospectus—

(i) without receiving the minimum subscription.

(ii) without collecting application money which shall not be less than 5 per cent of the nominal value of shares ; and

(iii) without keeping the money so received in a scheduled bank.



(*b*) Where the company has failed to deliver a copy of statement in lieu of prospectus atleast three days before the first allotment of shares.

In the above cases, allotment can be avoided by the aggrieved party.

Time limit for avoiding allotment

The allottee of shares can avoid the allotment—

(a) within 2 months of the holding of statutory meeting ; or ;

(b) where the company is not required to hold a statutory meeting or where the allotment is made after the statutory meeting, within two months after the date of allotment and not later.

It is enough for the allottee to give a notice to the company of his intention to avoid the allotment within the time specified above although the actual legal proceedings may start later. However, legal proceedings should be reasonably prompt thereafter if they are to be brought.

If the allotee of shares does not make any objection, the allotment is valid.

Void allotment. If even one of the stock exchanges specified in the propectus refuses to grant listing of shares, the allotment becomes void. Entire money received along with application becomes refundable.

Distinction between void and voidable (irregular) allotment. A voidable allotment is valid unless it is avoided. A void allotment is *void ab initio.* Such alloted shares cannot be retained by shareholder even if he wants to.

LIABILITY OF DIRECTORS

Where the directors knowingly contravene the provisions as to allotment, they are liable to compensate the company and the allottee for any loss or damage suffered thereby. Proceedings against the directors must be commenced within two years of allotment. However, an allotment improperly made by the directors can be subsequently ratified by the shareholders in a general meeting.

Return as to allotment. Section 39(4) of the Act requires a company having a share capital to file with the Registrar return of allotment of the allotment, whenever the company makes any allotment of shares. However, the Registrar can extend the period for filing the return on application made by the company. The object of the section is to require full disclosures of the allotment of shares.

The return must contain the following particulars :

1. The number, nominal amount of shares, names, addresses and occupations of the allottees and the amount paid in cash or due and payable on each share. The company shall not show in such return any shares as having been allotted for cash if cash has not actually been received in respect of such allotment. This provision seeks to impose a duty on the promoters and directors of the companies to ensure that share capital reflects cash and other valuable assets and is not supported by merely book adjustments.

2. In the case of shares (other than bonus shares) allotted as fully or partly paid-up, otherwise than in cash, the company must produce for the inspection and examination of the Registrar a contract in writing constituting the title of the allottee together with any contract of sale or for services or other consideration for the allotment. Copies of such contracts and a return showing the number and the nominal amount of shares so allotted and the extent to which they are treated as paid-up and the consideration for which they have been allotted, should be filed.

3. Where bonus shares have been issued, the return shall state the number of shares, nominal amount, the names addresses and occupations of the allottees and the copy of the resolution authorising the issue of such shares shall be filed.

4. In the case of shares issued at a discount, a copy of the resolution along with a copy of the

order of the Tribunal sanctioning the issue and where the maximum rate of discount exceeds 10 per cent a copy of the permission granted by the Central Government shall be filed.

There is no need to file a return of the issue and allotment of shares forfeited for non-payment of calls.

On default every officer of the company shall be liable to a fine upto ₹ five thousand for every day during which the default continues. However, where it is shown in the return that shares have been allotted for cash, when such is not the case, every promoter and the company who is guilty of the contravention shall be punishable with fine which may extend to ₹ fifty thousand.

A return of allotment must be duly dated and signed by a director or the secretary.

SECRETARIAL DUTIES INVOLVED IN ALLOTMENT OF SHARES / PROCEDURE FOR ALLOTMENT OF SHARES

1. Allotment should not be in respect of any shares offered to public before beginning of 5th day after the prospectus is so issued or any later time as specified in the Prospectus.
2. (i) No allotment shall be made of any share capital offered by the Company unless the amount mentioned in the prospectus as minimum Subscription has been received either in cash or by cheque or any other instrument. The amount payable on application should not be less then 5% of the nominal value of the share.

   (ii) If Minimum Subscription is not received within 30 days of closure of issue all the money received from the applicants for the shares shall be repaid within 15 days from the closure of the issue, and for delay beyond 15 days, interest @ 15% p.a. shall be payable.
3. An allotment made without obtaining Certificate of Commencement of Business or receiving Minimum Subscription is irregular & is voidable at the option of the applicant.
4. All money received from the applicants for shares should be deposited in a separate account maintained in a Scheduled Bank untill permission by Stock Exchange is granted.
5. Every company intending to offer any shares to public for subscription by issuing a prospectus shall make application to one or more recognised stock exchanges.
6. A list of applicants should be prepared showing details of name, address, money received along with each application distinctive number etc.
7. After receiving these lists of applicants the basis of allotment is decided. If the issue is fully subscribed or under subscribed deciding the basis of allotment is no problem.

   (a) Pro-rata Method. Under this method, shares are alloted on Pro-rata basis *i.e. by alloting shares to each applicant in proportion to the number of shares applied for. Thus every applicant gets some shares. At present, this system is applicable.*
8. In case of private companies basis of allotment shall be decided by Board of Directors.
   - However in case public companies the basis has to approved by stock exchange and in accordance with SEBI Guidelines & it should be advertised in the newspapers.
   - In the case of public issue, the Executive Director/Managing Director of the Regional Stock Exchange along with the post-issue Lead Merchant Banker and the Registrar to the issue shall be responsible to ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the SEBI Guidelines.

- The applications shall be categorised according to the number of shares applied for.
- The total number of shares to be allotted to each category as a whole shall be arrived at on a proportionate basis i.e. total number of shares applied for in that category multiplied by the reverse of the subscription ratio.

Total no. of applications in category 100	1,500
Total number of shares applied for	1,50,000
No. of times over subscribed	3
Proportional allotment	$1,50,000 \times \frac{1}{3} = 50,000$

Number of shares to be allotted to each allottee shall be arrived at as follows :

No. of shares applied for	100
No. of times over subscribed	3
Proportional allotment	$100 \times \frac{1}{3} = 33$

(to be rounded off to 100)

Where the proportional allotment works out to be less than 100 shares per applicant, the allotment shall be made as follows :

Each applicant shall be allotted minimum 100 shares and the applicants shall be determined by drawing of lots so that the number of shares does not exceed the total number of shares eligible to that category.

Where the proportional allotment works out to be more than 50 but not a multiple of 100, it shall be rounded off to the nearest 100 shares.

In the process of rounding off, actual allotment may be higher than the shares offered.

9. The company secretary convenes BOD meeting to allot shares to the applicants in accordance with the approved basis.

   Board Resolution should be passed for allotment of shares and authorising the issue of letter of allotment/share certificates.
10. In the case of a listed company, intimation regarding allotment of shares should be made by way of fax or telegram to the stock exchange immediately after the Board Meeting.
11. Every Applicant to issue should either be sent allotment letters or refund orders. A person shall acquire a status of shareholder only when shares are alloted to him & communication of allotment is made to him.
12. Any Company intending allotment of shares to NRI, should seek prior permission from Reserve Bank of India.
13. As per Rule 12 of Companies (Prospectus & Allotment of Securities) Rules, 2014 of the Act every company making allotment of shares should within 30 days of allotment file a return in Form PAS-3 with Registrar of Companies.

    Return shall contain details as to the number & nominal value of shares alloted, name, address, occupation of allottees, amount payable or due from each share.

    In the case of shares allotted for consideration other than cash, the contract constituting the

title of the allottee to the allotment together with the contract for sale or service or other consideration in respect of which the allotment is made should be produced to the Registrar for inspection and verification.

If the contract is not reduced to writing, a memorandum containing a return in Form PAS-3 should be filed with the Registrar within 30 days of the allotment. The return should be stamped with appropriate stamp duty as if it is a contract reduced to writing & verified.

14. If Default is made incomplying the above requirements Secretary or any officer responsible will be punishable with fine upto ₹ 5000 for everyday for which default continues.

15. There is no need to file return of allotment in case allotment of forfeited shares.

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, an 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 time during the life time of the company or the 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 articles is a debt due from him to the company. But he is not bound to pay unless a call has been made.

Requisites of valid call. Following are the requisites of a valid call.

1. According to the provisions of the Act. The call must be made in accordance with the provisions of the Companies Act and the articles of the company. Provisions Contained in regulation 13 to 18 of Para II of Table F of Schedule–I of the Companies Act, 2013 regarding calls on shares must be followed.

2. Resolution of the Board. A call must be made under a resolution of the Board of directors. Such directors must be duly appointed and qualified. The meeeting of the directors must be duly convened and proper quorum must be present. The resolution making the call must be duly passed. A proper entry must be made in the minutes. However, a small irregularity will not make a call invalid. [Sec. 179(3)(9)]

3. Amount, place and time of payment. The resolution making the call must be passed. It must specify the amount of the call, the time and place of payment and to whom the call is to be paid. Thus, where the directors of a company resolved to make a call but failed to specify the date and amount of payment and the blanks were subsequently filled by the secretary, the call was held to be invalid.[1]

The amount of call and the time when that amount should be paid, however, must always be specified in the resolution for call independently of the provisions of the articles, for a call imposes a liability upon a shareholder to pay the amount specified in the resolution and that liability commences only from the time when he becomes liable to pay that amount.

4. Notice of Call. A call must be made by serving upon members a notice of payment in

1. E & W Insurance Co. Ltd. v. Mrs. Kamala Mehta AIR 1956 Bombay 357.

accordance with the provisions of the Companies Act. It should be a formal notice and not mere request for payment. The notice must specify the exact amount and the time and place of payment.

5. Bona fide and for the benefit of the company. The power to make a call is in the nature of a trust to be exercised for the benefit of the company. If it is exercised malafide i.e. for the benefit of directors the call may be prevented by an injunction or the directors may be compelled to hand over the benefit or the advantage gained by them. Thus, where the directors deliberately postponed the date on which a call was deemed to be made, with the intention of disposing their shares in the mean time, in order to avoid the payment of the call, the notice of call will be invalid.[1] Similarly, where the directors paid into the company's account the amount due on their shares and immediately thereafter withdrew it as their fee, it was held that payment was not in good faith for the benefit of the company and they remained liable to pay.

Example : The directors of the company paid nothing on their own shares although all other shareholders were required to pay 3 s 6 d on each share, partly on allotment and partly by a call. The directors did not tell the other shareholders of the difference. It was held that, it was a breach of trust and the directors must pay to the company 3s 6d on each of their shares. [Alexander v. Automatic Telephone Co. (1900) 2 Ch. 56]

6. Uniform basis. The call must be made on a uniform basis. A call cannot be made on some of the members only. [Section 49]. It is essential that the call be made equally on all the shareholders of the same class unless the terms of issue and the articles otherwise provide.

Shares of the nominal value on which different amounts have been paid up shall not be deemed to fall under the same class.

If a call is made on some shareholders but not on others or a call of a greater amount is made on some shareholders than on others, the call is void.

Example : G, a shareholder paid the first two calls after a great delay and neglected to pay the third call. The directors got annoyed and called upon him to pay whole amount on his shares without making a similar call on other shareholders. It was held that the call was invalid as it did not require all the members to pay the full amount due to their shares. [Galloway v. Halley Concerts Society (1915) 2 Ch. 233.]

7. Time within which shares are to be made fully paid-up. Any company offering shares to the public shall ensure that the shares are made fully paid-up within twelve months of the date of allotment, if the size of the issue is upto ₹ 500 crores. If the size of the issue is upto ₹ 500 crores. If the size of the issue is more than ₹ 500 crores, the amount to be called up on application, allotment and on various calls should not in each case exceed 25% of the total amount of issue.

8. SEBI Guidelines. Where the shares of a company are listed on a stock exchange SEBI guidelines as regards making of call should be followed.

Calls in advance. Section 50 provides that a company, if authorised by its articles, can accept advance payment from any shareholder in respect of the shares held by him. For such payment he becomes a creditor of the company and is entitled to interest. Such interest must be paid out of capital if there are no profits. But because of such payment the shareholder cannot claim any extra voting rights.

The power of the directors to accept calls in advance must be exercised bonafide.

Call may not be made until the company becomes entitled to commence business.

1. Re National and Provincial Marine Insurance Co. Gilberts Case.

Calls must be paid in cash. The articles may provide that interest shall accrue on calls not paid.

If a person fails to pay money on a call for six months, he will be disqualified from holding the office of a director. (Section 164).

A call may be made payable in instalment even though there is no express provision in articles.

The directors may make calls after the commencement of voluntary winding up with the approval of the general meeting or of the liquidators.

Calls which remain unpaid on the date of the bankruptcy of a shareholder may be proved in bankruptcy.

So long as the company is a going concern, the shareholder may set off call due by the company to him. If the company is, however, wound up, debts cannot be set off against calls made by the liquidators. The shareholder must pay his call and prove in the winding up for the debt due to him.

SHARE CERTIFICATE (SECTION 46)

A share certificate is a document issued by a company stating that the person named therein is the registered holder of a specified number of shares of a certain class and that they are fully paid up or paid up to a stated amount.

Every person whose name is entered as a member in the register of members shall be entitled to receive one certificate for all his shares without payment.

In respect of any share or shares held jointly by several persons, the company shall not be bound to issue more than one certificate, and delivery of certificate for shares to one of the several joint holders shall be sufficient delivery to all such holders.

Notwithstanding 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.

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.

A share certificate has to be issued whether, the shares are partly paid up or fully paid up. The share certificate enables the share holder to deal more easily in the market. The 2013 Act imposes a duty on the company to deliver the share certificate within the time specified in section 56.

Delivery of Shares Certificate [U/S 56(4)]

Every company (unless prohibited by provision of any law, by order of Court or Tribunal) shall deliver the share certificates :

(a) Within 2 months from the date of incorporation–in case of subscribers to Memorandum of Association.

(b) Within 2 months from the date of allotment of any shares.

(c) Within 1 month from the date of receipt of instrument of transfer or intimation of transmission–in case of transfer and transmission.

(d) Within 6 months from the date of allotment–in case of allotment of debentures.

The Central Government has been empowered under section 56 to extend the period of delivery of certificate of debentures or debenture stock in appropriate cases for a further period not exceeding

nine months. It may be noted that the Central Government has no power to extend the time in respect of delay in delivering the share certificates.

The provisions of Section 56 which prescribe time limits for the issue of share certificates are not applicable where the securities are dealt in a depository. In such a case, the company is required to intimate the details of allotment of securities to depository immediately on allotment of securities.

A person aggrieved by the refusal of the company to issue the certificate may give notice to the company to make good the default.

If the company fails to comply with the notice within 10 days after the service of the notice, the Central Government may on the application of such person order the company and every other officer thereof to make good the default. The Central Government may order the company or any other officer of the company responsible for the default to pay the costs of the application. Besides, the company and every other officer of the company who is in default shall be punishable with fine which may extend to ₹ 500 for every day of default. The section applies in relation to debentures and debenture stock as well.

The share certificate must be under the common seal of the company and specify the shares to which it relates and the amount paid thereon and the name and address of the holder of the shares. It must be signed by at least two directors and the secretary.

Effect of a share certificate (Section 46). A share certificate under the common seal (if any) of the company, specifying the shares held by any member shall be prima facie but not conclusive evidence of the title of the member to such shares. "The certificate... is a statement that the company asserts that the person to whom it is granted is the registered shareholder entitled to the shares included in the certificate and... that the amount certified to be paid has been paid."

The company may, therefore, be estopped from—

(a) disputing the title of the registered holder or

(b) alleging that the amount stated as being paid on the shares has not been paid.

1. *Estoppel as to title.* If a company authorises the issue of a certificate stating that A is the registered holder of certain shares, it cannot afterwards allege that A is not entitled to those shares. A company that issues a share certificate makes a representation to the person named in the certificate and to person with whom he may be expected to deal that the person named therein is entitled to the shares as at the date of the certificate.

2. *Estoppel as to payment.* When an estoppel is raised against the company it relates to all the facts asserted in the certificate. This includes not only the assertion as to title but also the assertion as to the amount paid up on the shares.

Thus, if the certificate states that the shares are fully paid, the company cannot afterwards allege that they are not fully paid. But such a statement in the certificate would not help a person who knew that the shares were not paid for full in cash.

Issue of duplicate share certificate. According to Section 46(2) of the Act, a certificate may be renewed or a duplicate of a certificate may be issued if such certificate is :

(a) proved to have been lost or destroyed ; or

(b) having been defaced or mutilated or torn is surrendered to the company.

A small fee is charged on the **renewal of a share certificate** or on the issue of a duplicate share certificate. However, a company listed on a stock exchange is not permitted to charge fees for issue of

duplicate shares. It may be noted that a share holder shall give the company an indemnity bond, in case any liability should fall on the company.

- The manner of issue of a duplicate certificate of shares 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.
- 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.
- Without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447.

A company can **issue duplicate share** certificate only to registered shareholder.

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 warrants are negotiable instruments. A public company limited by shares so authorised by its articles, may with the previous approval of the Central Government, with respect to any fully paid-up shares, issue under its common seal a warrant stating that the bearer of the warrant is entitled to the shares therein specified.

Conditions for issue of share warrants

1. The shares shall be fully paid up.
2. The articles shall authorise the issue of share warrants
3. Prior approval of the Central Government shall be obtained.
4. The share warrants shall be issued under the common seal of the company.
5. An application should be made to RBI for issue of share warrant.

Share warrants should contain the number of shares in respect of which they have been issued. Such a warrant must state that the bearer of it is entitled to the shares specified therein. The company may provide by coupons or otherwise, for the payment of future dividends on the shares specified in the warrant.

When the share warrant is issued, the name of the member is struck off the register of members, and are entered in that register the following particulars—

(a) the fact of the issue of the warrant ;

(b) a statement of the shares specified in the warrant distinguishing each share by its number ; and

(c) the date of the issue of the warrant.

The bearer of a share warrant will, subject to the articles of the company, be entitled on surrendering the warrant to have his name entered as a member in the register of members. He shall

have to pay such fee to the company as the Board of directors may from time to time determine. On the surrender of the warrant the date of surrender shall be entered in the register where the fact of issue of such warrant was entered.

When share warrants are issued the annual return must show—

(i) the total amount of shares for which share warrants are outstanding at the date of the return;

(ii) the total amount of share warrants issued and surrendered since the last return; and

(iii) the number of shares comprised in each warrant.

The bearer of a share warrant is not a member of the company.

But, if the company's articles of association so provide, he may be treated as a member of the company for any purpose defined in the articles. Thus, the articles may provide that the bearer of a share warrant shall be allowed to exercise the rights of a member, such as attending meetings, approving annual accounts etc.

If default is made in complying with any of the requirements of this section, company and every other officer of the company who is in default, shall be punishable with fine which may extend to ₹ 500 for every day during which the default continues.

When directors are required by the articles to hold qualification shares, the holding of a share warrant will not satisfy the requirement.

Share warrants cannot be issued by a private company, since such a company must impose restrictions on the transfer of its shares in its articles.

Distinction between share warrant and share certificate

1. A share warrant can be issued only when the shares are fully paid up whereas a share certificate can be issued at any stage without the shares being fully paid up.
2. A share warrant is a negotiable instrument but a share certificate is not. In other words, a share warrant can be transferred by mere delivery, but a share certificate cannot be so transferred.
3. A share certificate is a document showing *prima facie title to the shares represented thereby but a share warrant is the share security itself capable of easy transfer.*
4. A holder of a share certificate is a member of the company but the holder of a share warrant is not, unless the articles otherwise provide.
5. A share certificate can be issued both by a public and a private company but a share warrant is issued only by a public company.
6. Coupons for dividends may be attached to the share warrant and dividend is paid to the bearer of the coupons. But no such coupons are attached to the share certificates.
7. Holding a share warrant is not enough where the articles require a director to hold a specified share qualification. But the shares specified in the share certificate are counted for this purpose.
8. The issue of a share certificate does not require the approval of the Central Government. A share warrant can be issued only if the articles authorise its issue and the Central Government has accorded its previous approval.
9. The holder of a share certificate can present a petition for winding up, but the holder of a share warrant cannot do so.

10. No stamp duty is payable on the transfer of a share warrant. Whereas stamp duty is payable on the transfer of shares specified in a shares certificate.

Penalty for personation of shareholder

A person who deceitfully personates an owner of any share, share warrant or coupon and thereby obtains or attempts to obtain it shall be liable to imprisonment for a term which may extend to three years and a fine.

LIEN ON SHARES

A lien is the right to retain possession of a thing until a claim is satisfied. In the case of a company lien on shares means that the member would not be permitted to transfer his shares unless he pays his debt to the company. A lien on shares is a contractual lien originating from the contract contained in the memorandum and articles of association. A company's lien on shares is both a contractual lien and possessory lien, though the share certificate issued by the company is with the shareholder.

The Companies Act gives no statutory right of lien to the company. The articles generally provide that the company shall have a first and paramount lien on the shares of each member for his debts and liabilities to the company. The right of lien is not inherent but must be clearly provided for in the articles.1 The articles may give the right of lien over shares either for unpaid calls or for any other debt due by the member to the company. The company may have lien on fully paid-up shares. The lien also extends to the dividends payable on the shares.

The death of a shareholder does not destroy the lien. The right of lien can be exercised even though the claim has become barred by law of limitation. Where the liability of the shareholder towards the company is disputed by him, it does not deprive the company of its right of lien on the shares.

Priority of lien. If a shareholder mortgages his shares, and the mortgage gives notice to the company, and then the shareholder incurs a liability to the company, the mortgage has priority over the lien of the company. Thus, a company will not be able to exercise its right of lien where the shareholder has mortgaged his shares before he has incurred any liability to the company and the company has notice of it.

A company may sell in such manner as the Board thinks fit any share on which the company has lien provided that no sale shall be made—

(a) unless a sum in respect of which the lien exists is presently payable; or

(b) until the expiration of fourteen days after a notice in writing stating and demanding payment of such part of the amount in respect of which the lien exists as is presently payable has been given to the registered holder of the shares of the person entitled thereto by reason of his death or insolvency.

SURRENDER OF SHARES

The Companies Act 2013does not provide for surrender of shares. Shares are said to be surrendered when they are voluntarily given up.

Canara Bank Ltd. v. Tribhuvan Das, AIR 1957 Trab. Co. 183.

A company can accept surrender of shares only under following circumstances :

(i) the articles of the company provide for it ;

(ii) it is done to relieve the company from going through the formality of forfeiture of shares ;

(iii) in exchange of new shares of the same face value.

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.

Every surrender of shares, whether fully paid up or not, involves a reduction of capital which is unlawful except when sanctioned by the Tribunal. But, fully paid shares can be surrendered without leave of the court provided the surrender does not involve the reduction of capital, i.e. in exchange for other shares of the same nominal value.

A person ceases to be a member of the company on a valid surrender of shares. But he shall be liable as a contributory as a past member of the company if it is wound up within twelve months of his surrendering his shares. Shares which have been validly surrendered can be reissued in the same way as forfeited shares.

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 articles often provide 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 :

1. Conform to the provisions of Articles of Association. A company has no inherent power to forfeit shares. The power to forfeit shares must be contained in the articles. Where a shareholder fails to pay the amount due on any call, the directors may, if so authorised by the articles, forfeit his shares.

Shares cannot be forfeited unless there is a clear power to that effect in the articles.

The right to forfeit shares must be pursued with the greatest exactness. Forfeiture being in the nature of a penal proceedings, the provisions of the articles must be strictly followed. Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void.

The articles cannot authorise the forfeiture of shares for the non-payment of sums due otherwise than in payment for the calls on shares and for such a forfeiture would amount to an unlawful reduction of capital. A company may, however, by its articles lawfully provide for grounds of forfeiture other than non-payment of calls, subject to the qualification that the articles relating to forfeiture do not offend against the general law of the land and in particular the Companies Act and public policy. Further the forfeiture contemplated should not entail or effect a reduction of capital or amount to purchase by the company of its own shares nor does it amount to trafficking in its own shares.[1]

1. Naresh Chander Sanyal v. Calcutta Stock Exchange Ltd. (1971) Comp. Cas. 51 (S.C.).

2. Notice prior to forfeiture. Before the shares are forfeited the shareholder—

(i) must be served with a notice requiring him to pay the money due on the call together with interest ; and

(ii) the notice shall specify a date, not being earlier than the expiry of 14 days from the date of service of notice, on or before which the payment is to be made and must also state that in the event of non payment within that date will make the shares liable for forfeiture.

A proper notice is condition precedent to the forfeiture and even the slightest defect in the notice will invalidate the forfeiture. The object of the notice is to give the shareholder an opportunity for payment of the all money, interest and expenses. It must, therefore, disclose sufficient in formation with particulars of the amounts due.

3. Resolution of the board. If the member does not comply with the notice, the board of directors will pass a formal resolution of forfeiture and a notice of the same will be served on the defaulting shareholder. But it must be exercised by properly appointed directors at their meeting with requisite quorum. A small or insignificant irregularity will make the forfeiture void.

4. Good faith. The power of forfeiture is a power of trust and the board must exercise the same bonafide for the good of the company, and not to give some personal advantage to a director or shareholder. Thus where the shares are declared forfeited for the purpose of relieving a friend from liability, the forfeiture may be set aside.

> Example : H & G were given certain shares. They paid nothing on the shares. The company was not doing well and H & G asked the company to forfeit their shares. This was done. The forfeiture of shares was set aside, because it was found to have been carried out at the request of a shareholder to relieve him of liability. [Re Esparto Trading Co. (1897) 12 Ch. D. 191]

An invalid forfeiture can be restrained by injuction. An invalid forfeiture cannot be validated by the lapse of time or acquiescence.

Permission of Court/CLB not required for forfeiture. Forfeiture of shares does not amount to reduction in capital, and hence permission of Court or CLB is not necessary. This is because forfeiture does not vest the property in respect of forfeited shares in the company.

Liability of person whose shares are forfeited

A person, whose shares have been forfeited, ceases to be a member of the company. But he shall remain liable to pay to the company all moneys which at the date of forfeiture were payable by him to the company in respect of shares. The liability of such a person shall cease as and when the company receives payment in full in respect of the shares.

It may further be noted, if a company is wound up more than one year after the forfeiture, the members whose shares have been forfeited cannot be made liable as a contributory.1 And if the company is wound up within one year of forfeiture, the defaulting member may be put on the B list of contributories in the winding up.

REISSUE OF FORFEITED SHARES

Forfeited shares become the property of the company. To that extent it involves a reduction of the capital of the company. This is one of the instances in which share capital is reduced without

1. Ladies Dress Association Ltd. v. Pulbrook (1900) 2 Q.B. 376.

following the procedure laid down in sections 100 to 104 of the Act. The company may sell the forfeited shares for any price they fetch, *i.e.* the shares may be issued at a discount. But it must be noted, that such an issue does not amount to allotment. Further, the discount must not exceed the amount forfeited.

In a nut shell, the amount already paid upon the shares and the amount being received from the new purchaser must be at least equal to the issue value of the shares. Forfeited shares can be sold at a premium.

As per listing agreement with stock exchange, company should issue forfeited shares to existing equity shareholders on pro rata basis, unless stock exchange agrees otherwise or unless shareholders in general meeting decide otherwise. If notice of forfeiture is sent, intimation should be given to stock exchange.

No Return of Allotment need be Filed

Since the issue of forfeited shares is treated as sale, therefore, no return of allotment of such shares need be filed with the Registrar.

Particulars of Forfeited Shares in Annual Return

The company shall specify the total number of shares forfeited in every annual return submitted to the Registrar.

Whether Annulment of Forfeiture is Possible

If the defaulting ex-shareholder makes a request for the cancellation of forfeiture, the Board may accede to his request provided the forfeited shares are still not-re-issued. For the annulment of forfeiture, the directors must act bonafide and pass a suitable resolution to that effect. And after the defaulting ex-shareholder has made payment of all calls due with interest, his name will be restored in the register of members.

BUY BACK OF SHARES

The Indian corporate sector, in its attempt to be at par with international practices, had been demanding during the recent past few years for legislation permitting buy back of shares. The Companies (Amendment) Act, 1999 has introduced the concept of buy back of shares and allowed the companies to purchase their own shares.

Buyback of shares means a company buying its own shares. The rationale for buy back of shares is that when a company has excess capital, it should be allowed to boost its earnings per share by chapping off the dead wood. It is a company sponsored initiative and has several positive benefits. As a result of buyback there is a smaller capital base and hence earning per share increases. This leads to an increase in the share price of the company. Dividend per share also increases.

Major reasons for buy back may be one or more of the following :-

(a) to return surplus cash to shareholders ;

(b) to increase the underlying share value ;

(c) to support share price during periods of temporary weakness ;

(d) to achieve or maintain a target capital structure ;

(e) to prevent or inhibit unwelcome take-over bids, i.e. to allow promoters to get a better hold on the company.

The buy back provisions are contained in Section 68, 69, 70 and are discussed as under.

Power of Company to Purchase its Own Securities (Section 68)

According to Section 68, a company may purchase its own shares or other specified securities out of—

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of an earlier issue other than fresh issue made specifically for buyback purposes.

It is to be noted that all types of Companies, whether listed or unlisted, are included for the purposes of this section. Specified securities includes employees' stock option or other securities as may be notified by Central Government from time to time.

CONDITIONS FOR BUY-BACK

Section 68 has allowed companies to buy their own shars with certain conditions.

(1) No company shall purchase its own shares or other specified securities unless :—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back;

(c) the buy-back is less than twenty-five per cent of the total paid-up capital and free reserves of the company. However, the buy-back of equity shares in any financial year shall not exceed twenty-five per cent, of its total paid-up equity capital in that financial year;

(d) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy- back.

In other words, the debt equity ratio should not be more than 2 : 1 after the buy-back. However, the Central Goverment may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies;

(e) all the shares or other specified securities for buy- back are fully paid-up.

(f) The buy-back of the shares or other specified securities, if listed in a stock exchange, shall be carried out inaccordance with the regulations framed by the Securities and Exchanges Board of India. In the case of securities of other companies, the buy- back shall be done as per rules framed by the government.

(2) The gap between two offers of buy-back shall be at least one year.

(3) According to Section 68(3), the notice of the meeting, at which special resolution is proposed to be passed, shall be accompanied by an explanatory statement stating the following viz ;

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back; and

(e) the time limit for completion of buy-back.

(4) Every buy back shall be completed within a period of one year from the date of passing the special resolution. [Section 68(4)].

(5) The buy-back may be :—

(a) from the existing security-holders on a proportionate basis; or

(b) from the open market; or

(c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. [Section 68(5)].

(6) Declaration of solvency. Where a company has passed a special resolution to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any

However, no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. [Section 68(6)].

(7) Physical destruction of securities. Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buyback. [Section 68(7)].

(8) Further issues after buy-back. Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of the same kind of shares including by way of right shares or other specified securities within a period of six months1 except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. [Section 68(8)].

(9) Register of bought back securities. Where a company buys-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed. [Section 68(9)].

(10) Return of buy-back. A company shall, after the completion of the buyback under this section, file with the Registrar and The Securities and Exchange Board of India, a return containing such particulars relating to the buyback within thirty days of such completion, as may be prescribed.

Moreover, no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. [Section 68(10)].

Penalty. If a company makes default in complying with the provisions of this section or any rules made thereunder, or any regulations made under clause (f) of sub-section (2), the company or any

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The Companies (Amendment) Act, 2001 has reduced the period from twenty four months to six months.

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 may extend to one lakh rupees which may extend to 3 lakhs rupees or with both. [Section 68(11)].

Transfer of Certain Sums to Capital Redemption Reserve Account (Section 69)

Section 69 which lays down that where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve. Details of such transfer are required to be disclosed in the balance sheet.

Prohibition for Buyback in certain Circumstances [Sec. 70]

No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable there onto any financial institution or bank, is subsisting. [Section 70(1)].

No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of sections 92, 123, 127 and 129. [Section 70(2)].

ISSUE OF SHARES AT A PREMIUM [SECTION 52]

A company is free to sell its shares at a premium i.e. at a price higher than their nominal value. The power to issue shares at a premium need not be taken in the articles. The premium received on issue of shares, whether in cash or kind, must be transferred to a separate account called 'Securities Premium Account'. The provisions of the Act relating to the reduction of the share capital will apply as if the securities premium account were paid-up share capital of the company.

The premium can, however, be used for the following purposes :

(a) for issuing to the members as fully paid bonus shares, the unissued shares of the company ;

(b) for writing off preliminary expenses of the company ;

(c) for writing off expenses, commission or discount on the issue of shares or debentures of the company ;

(d) for providing for the payment of premium payable on redemption of redeemable preference shares or debentures.

(e) For the purchase of its own shares or other securites.

When a company issues shares at a premium, even though the consideration may be other than cash, a sum equal to the amount of premium must be transferred to the securities premium account.

Prohibition on issue of shares at discount : (Sec. 53)

- Under Section 53 of Companies Act, 2013, a company cannot issue shares at a discount, except for sweat equity shares.

Subsitituted for 'share' by the Companies (Amendment) Act, 1999, with retrospective effect from 31-10-1998.

- Any share issued by a company at a discounted price shall be void.
- For contravention of provisions of section 53, a fine not less than one lakh rupees (which may extend to 5 lakh rupees) shall be imposed. Every officer who is in default shall be punishable with imprisonment for a term which may extend to 6 months or fine not less than ₹ 1 lakh but which may extend to ₹ 5 lacs or with both.

ISSUE OF SWEAT EQUITY SHARES (SECTION 54)

An employee or a director works best when he has a feeling that he is a part of the organisation. He will perform best if he is adequately rewarded. One way of rewarding him is by offering him shares of the company where he is working. The offer of equity shares also encourages employees to join a new and unknown company. The modern trend is to offer equity at low prices to employees and directors.

The expression 'sweat equity shares' means such equity shares as are issued by the company to employees or directors at a discount or for consideration other than cash for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. [Section 2 (88)]

According to section 54, a company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled, namely:

1. It should be of a class of shares already issued.
2. The issue of sweat equity shares is authorised by an ordinary resolution passed by the company in the general meeting.
3. The resolution specifies the number of shares, their value and the class or classes of directors or employees to whom such equity shares are to be issued.
4. There must be a gap of at least one year since the date on which the company was entitled to commence business.
5. In the case of listed companies, the issue of sweat equity shares should be as per SEBI guidelines.
6. In other companies the sweat equity shares will be issued in accordance with the guidelines as may be prescribed.
7. A company may issue sweat equity shares at less than nominal value and there is no need to comply with the provisions of section 54.

ISSUE OF BONUS SHARES

A company may, instead of paying dividends, capitalise its profits if the articles so permit. Section 123 which provides for payment of dividend in cash does not prohibit the capitalisation of profits or reserves of a company. The profit so capitalised is used for issuing new fully paid shares to the existing shareholders in proportion to their existing holding. The company is thus enabled to increase its capital and the shareholders at the same time receive their capital bonus in

the shape of fully paid shares which are called bonus shares. Thus, issue of bonus shares implies the payment of dividend in the form of shares instead of cash. Such a course is adopted by the company in those cases where it intends to distribute large reserves accumulated out of profits unrepresented by liquid assets.

It may be recalled that the capital redemption reserve fund arising from the redemption of redeemable preference shares under Section 55 and the 'share premium account' under Section 52 can also be applied towards the issue of bonus shares.

A bonus issued in the form of fully paid shares is not income but capital gain for income tax purposes. Further, bonus shares cannot be issued as a gift.

The 'right issue' and bonus issue are two different things. In the case of bonus issue no payment is made by the shareholders but instead the company applies its profits and reserves towards the payment of shares, whereas in case of right issue the shareholders have to pay in cash.

Bonus shares can be issued only when the following conditions are satisfied :

(A) Articles should permit such an issue

There should be provisions in the articles of association of the company enabling the company to capitalise its profits. If no such provision exists, the company should provide for it in the articles of association by passing a resolution at its general meeting. Regulations 96 and 97 of Table A to Schedule I of the Act provide as under :

Regulation 96

1. The company in general meeting may upon the recommendation of Board resolve :
   (a) that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts, or to the credit of the profit and loss account, or otherwise available for distribution; and
   (b) that such sum be accordingly set-free for distribution in the manner specified in clause (2) amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.
2. The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (3) either in or towards ;
   (i) paying up any amount for the time being unpaid on any shares held by such members respectively; or
   (ii) paying up in full unissued shares of the company to be allotted and distributed, credited as fully paid up, to and amongst such members in the proportions aforesaid ; or
   (iii) partly in the way specified in sub-clause *(i) and partly as specified in sub-clause (ii).*
3. A share premium account and a capital redemption reserve account, may, for the purposes of this regulation, only be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares.
4. The Board shall give effect to the resolution passed by the company in pursuance of the regulation.

Regulation 97

1. Whenever such a resolution aforesaid shall have been passed, the Board shall :
   (a) make all appropriations and applications of the undivided profits resolved to be capitalisd thereby and all allotments and issues of fully paid shares if any; and
   (b) generally do all acts and things required to give effect thereto.

2. The Board shall have full power.
   (a) to make such provision, by the issue of fractional certificates or by payment in cash or otherwise, as it thinks fit, in the case of shares or debentures becoming distributable in fractions and ; also.
   (b) to authorise any person to enter, on behalf of all the members entitled thereto, into an agreement with the company providing for allotment to them respectively, credited as fully paid up, of any further shares to whcih they may be entitled upon such capitalisation or (as the case may require) for the payment by the company on their behalf, by the application thereto, of their respective proportions of the profits resolved to be capitalised, of the amounts or any part of the amounts remaining unpaid on their existing shares.

3. Any agreement made under such authority shall be effective and binding on all such members.

(B) Approval by the Board of directors and shareholders

A resolution for capitalising the profits must have been passed by the Board of directors and then such resolution of the Board of directors must be approved by the shareholder in general meeting.

Under clause 22 of the listing agreement the company should immediately after the meeting of the Board of directors has been held, intimate to the stock exchange by letter or by telegram short particulars of any increase of capital whether by issue of bonus shares or by way or right shares or in any other way.

FILING OF RETURN OF ALLOTMENT

Within 30 days of the allotment of bonus shares a return of allotment has to be filed with the Registrar of Companies under Section 39 of the Act stating the number and nominal amount of bonus shares issued together with the names, addresses and occupations of the allotees and a copy of the resolution authorising the issue be attached.

EMPLOYEES STOCK OPTION SCHEME [ESOS]

'Employees stock option' means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company/(ies)which gives such directors, officers or employees the benefit or right to purchase or subscribe for the shares of the company at a future date at a pre-determined Price [Section 2(37) of the Companies Act, 2013]. Companies are allowed to offer stock option scheme to their employees, etc. subject to SEBI Guidelines, 1999.

SEBI Guidelines, in this regard, *inter alia,* provide as follows :

1. No ESOS shall be offered unless the disclosures, as specified in Schedule IV, are made by the company to the prospective option grantees and the company constitutes a Compensation Committee for administration and superintendence of the ESOS.

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 may extend to one lakh rupees which may extend to 3 lakhs rupees or with both. [Section 68(11)].

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1. It should be of a class of shares already issued.
2. The issue of sweat equity shares is authorised by an ordinary resolution passed by the company in the general meeting.
3. The resolution specifies the number of shares, their value and the class or classes of directors or employees to whom such equity shares are to be issued.
4. There must be a gap of at least one year since the date on which the company was entitled to commence business.
5. In the case of listed companies, the issue of sweat equity shares should be as per SEBI guidelines.
6. In other companies the sweat equity shares will be issued in accordance with the guidelines as may be prescribed.
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   (b) that such sum be accordingly set-free for distribution in the manner specified in clause (2) amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.
2. The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (3) either in or towards ;
   (i) paying up any amount for the time being unpaid on any shares held by such members respectively; or
   (ii) paying up in full unissued shares of the company to be allotted and distributed, credited as fully paid up, to and amongst such members in the proportions aforesaid ; or
   (iii) partly in the way specified in sub-clause *(i) and partly as specified in sub-clause (ii).*
3. A share premium account and a capital redemption reserve account, may, for the purposes of this regulation, only be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares.
4. The Board shall give effect to the resolution passed by the company in pursuance of the regulation.

Regulation 97

1. Whenever such a resolution aforesaid shall have been passed, the Board shall :
   (a) make all appropriations and applications of the undivided profits resolved to be capitalisd thereby and all allotments and issues of fully paid shares if any; and
   (b) generally do all acts and things required to give effect thereto.

2. The Board shall have full power.
   (a) to make such provision, by the issue of fractional certificates or by payment in cash or otherwise, as it thinks fit, in the case of shares or debentures becoming distributable in fractions and ; also.
   (b) to authorise any person to enter, on behalf of all the members entitled thereto, into an agreement with the company providing for allotment to them respectively, credited as fully paid up, of any further shares to whcih they may be entitled upon such capitalisation or (as the case may require) for the payment by the company on their behalf, by the application thereto, of their respective proportions of the profits resolved to be capitalised, of the amounts or any part of the amounts remaining unpaid on their existing shares.

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'Employees stock option' means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company/(ies)which gives such directors, officers or employees the benefit or right to purchase or subscribe for the shares of the company at a future date at a pre-determined Price [Section 2(37) of the Companies Act, 2013]. Companies are allowed to offer stock option scheme to their employees, etc. subject to SEBI Guidelines, 1999.

SEBI Guidelines, in this regard, *inter alia,* provide as follows :

1. No ESOS shall be offered unless the disclosures, as specified in Schedule IV, are made by the company to the prospective option grantees and the company constitutes a Compensation Committee for administration and superintendence of the ESOS.

Compensation Committee shall be a committee of the Board of directors consisting of a majority of independent directors.

2. Issue of stock options at a discount to the market price would be regarded as another form of employee compensation and would be treated as such n the financial statements of the company regardless of the quantum of discount on the exercise rice of the options.
3. Subject to the aforesaid financial treatment ESOS would not be covered by the pricing provisions of SEBIs preferential allotment regulations.
4. The issue of ESOS would be subject to approval by shareholders through a special resolution.
5. There would be no restriction on the maximum number of shares to be issued to a single employee. However, separate resolution in general meeting shall be obtained in case of: (*a*) employees being offered equal to or more than 1% shares during any one year; (*b*) grant of option to employees of subsidiary or holding company.
6. A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company. Company may specific a lock-in-period.

   The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefit of a shareholder in respect of option granted to him, till shares are issued on exercise of option.
7. The operation of ESOS scheme would have to be under the superintendence and directions of a Compensation Committee.
8. ESOS would be open to all permanent employees (whether working in India a abroad) and to the directors (whole-time or part-time) of the company *but not to : (i)* employees who is a promoter or belongs to the promoter group : (*ii*) a director who either by himself or through his relatives or through any body corporate holds more than 10% of the outstanding equity shares of the company. With the specific approval of the shareholders, the Scheme would be allowed to cover the employees of a subsidiary or a holding company.
9. Directors report shall contain the following disclosures :
   (i) the total number of shares covered by the ESOS as approved by the shareholders;
   (ii) the pricing formula;
   (iii) options granted, option vested, options exercised, options forfeited, extinguishments or modification of options, money realised by exercise of options, total number of options in force, employee- wise details of options granted to senior managerial personnel and to any other employee who receive a grant in any one year of options amounting to 50% or more of options granted during that year.
   (iv) fully diluted earning per share (EPS) computed in accordance with international accounting standards.
10. Company may vary the terms of ESOS by passing a special resolution provided variation :
    (i) Relates to options not yet exercised;
    (ii) Is not prejudicial to the interests of option holders.

Again, a company may reprice the options which are exercised is ESOSs where rendered unattractive due to fall in the price of the shares in the market. However, the company must ensure that such repricing shall not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such repricing.

11. Option granted to an employee shall not be transferable to any person.
12. Option granted cannot be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
13. In the event of death, options granted to an employee shall vest in the legal successor/nominee.
14. In case of permanent incapacity, all options granted shall vest in him a the date in incapacitation.
15. Auditor to certify that the scheme has been implemented as per guide Certificate of the auditor to be placed at AGM.

SHORT ANSWER QUESTIONS

1. What is a share ?
2. Distinguish between share and stock.
3. How can a company convert shares into stock ?
4. Can stock be issued in case of partly paid shares ?
5. 'A company can issue only two types of shares.' What are these ?
6. What is a preference share ?
7. What are participating preference shares ?
8. What are redeemable preference shares ?
9. What is meant by allotment of shares ?
10. What is meant by return as to allotment ?
11. Can a new company issue shares at a discount ?

TEST QUESTIONS

1. (a) Define share. What are the different kinds of shares which a company may issue?

   (b) Explain the procedure for the conversion of shares into stock. Distinguish between stock and share.
2. (a) What is preference share capital ? When can a company issue redeemable preference shares ? What are the restrictions on the powers of a company to redeem shares ?

   (b) Some preference shareholders want dividend to be increased from 7-1/2 per cent to 10 per cent on preference shares. Advise them
3. What is meant by allotment of shares ? Discuss the rules relating to the allotment of shares.
4. Explain what do you understand by allotment of shares. State in brief the provisions of the Companies Act, 2013 on prohibition of allotment of shares and the effect of irregular allotment.
5. What are the general principles and statutory restrictions on the allotment of shares in a public limited company ? State the consequences of irregular allotment of shares.
6. Define a call and state the usual conditions observed in connection with the making of a call.
7. What is a share warrant ? How does it differ from a share certificate ? Is the holder of share warrant a member of the company ?

8. What are the circumstances under which a duplicate share certificate can be issued and subject to what conditions ?
9. Briefly explain the requirements of the Companies Act, 2013 relating to :
   (a) Issue of share certificates.
   (b) Sealing and signing of share certificates
   (c) Issue of share warrants.
10. Discuss in detail the law and practice regarding the forfeiture of shares and the reissue of forfeited shares.
11. What do you understand by the forfeiture of shares ? State the liabilities of a shareholder after forfeiture ?
12. Distinguish between forfeiture and surrender of shares.
13. "A company limited by shares has no power to buy its own shares," Comment.
14. "The purchase of its own shares by a company involves a reduction of capital." Discuss the statement with special reference to the restrictions, if any, on the powers of the company to deal with its own shares.
15. Can a company issue shares for consideration other than cash ?
16. State the purposes for which the premium on shares can be utilized.
17. Has a company power to issue shares at a discount. If so, when and under that conditions ?
18. What are requisites for dematerialisation of shares. Also explain its process.
19. Write a detailed note on ASBA.

PRACTICAL PROBLEMS

Q. 1. In the prospectus for issue of shares of Raj Steels Ltd., it had been mentioned that application to two stock exchanges would be made for permission for the shares to be dealt in these two stock exchanges. While one stock exchange gave permission, the other did not give it. Decide.

Ans. Where a prospectus states that application has been made for permission for listing of shares or debentures, then the allotment shall be void if the permission has not been granted by the stock exchange or each such stock exchange, as the case may be before the expiry of ten weeks from date of the closing of the subscription lists. So, allotment in this case is void.

Q. 2. The directors of B Ltd. made a call on the shareholders but the resolution making the call was defective in as much as it did not mention the amount of the call and the time and place for its payment. On the failure of M, a shareholders to pay the call, the directors purported to forfeit his shares. The directors subsequently discovered their mistake and rescinded their previous resolution as to forfeiture. They then made a fresh call on the shareholder and on M's failure to pay the call money, filed a suit against him to recover the amount due. M contended that his shares have been already forfeited, he had ceased to be a shareholder and was therefore, not liable on the call made. How would you decide the suit?

Ans. M cannot deny his liability for the payment of call money.

Q. 3. A company made a call in respect of certain partly paid shares, standing in the name of X who failed to pay the amount of the call within the stipulated period. Shortly thereafter the company went into liquidation and the liquidator renewed the call. X there upon moved the court for rectification of the share register to remove his name as contributory on the plea that he was only a nominal holder of the shares. Will X succeed ?

Ans. No, X cannot succeed. A call can be made by the liquidator in the course of winding up of the company. X will be liable as a contributory.

Q. 4. The articles of a company empowered the directors to forfeit shares of a shareholder on payment of the full market value of his shares, in case he commences or threatens an action against the company, or its directors. A shareholder lodges a false and frivolous complaint against the directors. The directors thereupon forfeited his shares and sent to him a cheque covering the full market value of the forfeited shares. State giving reasons whether the forfeiture is valid.

Ans. In the above case the forfeiture by the company is valid because articles of the company contain express provision and the shareholder has done something which the articles forbid.

Q. 5. A public company limited by shares forfeited 50 equity shares held by a defaulting member and issued them making a profit of ₹ 1,000. But no return of allotment was made, as against 50 shares reissued. Has the company contravened any of the provisions of the Companies Act ?

Ans. The company has not contravened any provisions of the Companies Act. There is no need to file a return of allotment in case of re- issue of forfeited shares.

Q. 6. The secretary of a company issued a share certificate in favour of B which apparently complied with the company's articles as it purported to be signed by two directors and the secretary and it had the company's seal affixed to it. In fact, the secretary had forged the signatures of the directors and affixed the seal without authority. Is the certificate binding on the company ?

Ans. No, the certificate is not binding on the company. Since it is case of forgery, it is a nullity and non-existent in the eyes of law.

□□□

8

SHARE CAPITAL

COMPARITIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
Redemption of unredeemed preference shares by issue of further preference shares.	Section 55(3) of the 2013 Act provides for redemption of unredeemed preference shares by issue of further preference shares with consent of holders of 75% in value of such preference shares and with the approval of the NCLT.	The 1956 Act did not contain any enabling provisions in this regard. Compromise and arrangement route will have to be taken under section 391 of 1956 Act for this purpose.
Premium payable on redemption of preference shares or debentures.	Such class of companies as may be prescribed whose financial statements comply with Acco-unting Standards prescribed for such class of companies cannot utilize securities premium account for providing premium payable on redemption of preference shares or debentures.	The 1956 Act allowed all companies to set off premium payable on redemption against securities premium account.
Filing fees relief (ROC filing fees) and stamp duty relief for reissue	No such relief allowed.	Allowed under section 80(4) of the 1956 Act.
Applicability of rights issue provisions	Section 62 of the 2013 Act applies to all companies – public as well as private.	Section 81 of the 1956 Act applied only to public companies.
Period for which rights shares offer should be open	Minimum 15 days maximum 30 days.	Minimum 15 days no maximum period.
Despatch of notice of rights offer through electronic mode	Expressly allowed by 2013 Act.	No provisions like this in the 1956 Act.
Offer of further shares to others (other than existing equity shareholders)	Special resolution required. Alternative of ordinary resolution and Central Govt. approval omitted by 2013 Act. [See rule 13 of the Companies (Share Capital and Debentures) Rules, 2014]	Special resolution required. Alternatively ordinary resolution and Central Government approval.

Bar on reduction of capital if deposits in arrears	Section 66 of the 2013 Act bars reduction of capital if deposits/interest thereon are in arrears. This is a new provision.	No such bar.
Applicability of reduction of capital provisions to buy back	The provisions for reduction of capital shall not apply to buy-back of its own securities by a company. The intention seems to be that if buyback is made in strict compliance with section 68 of the 2013 Act, provisions of section 66 of the 2013 Act regarding reduction of capital are not applicable to such buy-back. If buy back does not comply with section 68 of the 2013 Act, it is a reduction of capital requiring Tribunal's Confirmation [Section 66(6) of the 2013 Act].	No provisions in this regard.
Prohibition of buyback in certain circumstances	Prohibition on buy back to continue for till 3 years after specified default(s) remedied.	Prohibition to buyback ceased immediately when specified default(s) ceased to subsist.

INTRODUCTION

In order to finance its activities the company needs to have capital. The words 'capital' and 'share capital' are synonymous in the case of a company. Share capital means the capital raised by a company by the 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 the 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.

The memorandum of associaiton of every limited company must state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount. An unlimited company and a company limited by guarantee may not have a share capital.

KINDS OF SHARE CAPITAL

The word 'capital' has several different meanings. It may mean the nominal, issued, paid-up or reserve share capital of the company.

1. Nominal, Registered or Authorised Capital. The nominal or authorised capital is the amount of share capital which a company is authorised to issue. The amount is set out in the memorandum in the case of companies limited by shares or companies limited by guarantee and having a share capital. This is the maximum amount which a company is authorised to raise by the issue of shares and upon which it pays stamp duty and registration fees. Nominal capital is divided into shares of a fixed amount. The amount of the company's nominal capital depends on its business requirements. Nominal capital can be increased or reduced by following the prescribed procedure.

The whole of the nominal capital may be issued and subscribed and sometimes paid up, or only a portion of its nominal capital may be applied for and allotted.

2. Issued Capital. It is that part of the nominal capital which is actually issued by the company for public subscription. A company is not obliged to issue all its nominal capital at once. It may have

unallotted residue to be alloted in the near future as and when the company needs further capital. The difference between the nominal and the issued capital is known as the 'unissued capital'.

The issued capital can never be more than the nominal capital. It can at the most be equal to the nominal capital; it can so happen when all the shares have been issued to the public.

3. Subscribed Capital. It is the total amount of the nominal value of shares which have been actually taken up, i.e., subscribed for by the public. It is that type of the nominal capital which has actually been taken up by shareholders who have agreed to give consideration in cash or kind for the shares issued to them. The subscribed capital is thus a reality. Where the shares issued for subscription are wholly subscribed for, issued capital would mean the same thing as 'subscribed capital'.

4. Called-up Capital. According to section 2(15) of the Companies Act, 2013, 'called up capital' means such part of the capital, which has been called for payment.

5. Paid-up Capital. The paid-up capital is that part of the issued capital which has been paid up by the shareholders. The money received on each share as a result of calls is said to be paid-up and the total amount that has been paid upon the company's shares is the paid-up capital which can never exceed the issued capital.

6. Uncalled capital. This is the amount which remains uncalled on shares. The company may, at any time, call upon the shareholders to pay the uncalled capital in accordance with the provisions of the articles. When shares are fully paid there is no uncalled capital.

To illustrate the above different classes of share capital, suppose a company is to be registered with a capital of ₹ 1,00,00,000 (₹ one crore). The Nominal Capital of the company is ₹ 1,00,00,000 divided into 10,00,000 equity shares of ₹ 10 each. The company may decide to issue for public subscription, for the time being, 8,00,000 equity shares of ₹ 10 each. Thus ₹ 80,00,000 will be its Issued Capital. Now if the company has received applications from the public only for 6,00,000 shares the Subscribed Capital of the company will be ₹ 60,00,000. If the company decides to call up ₹ 5 per share, its called up Capital will be ₹ 30,00,000. If all the shareholders have paid the application money, the paid up capital of the company would be ₹ 30,00,000. The Uncalled Capital of the company would be ₹ 30,00,000.

7. Reserve Capital. A company may resolve by special resolution that part or the whole of the uncalled capital shall not be called upon except in the event of winding up. This amount is called 'the reserve capital' or 'the reserve liability.' Section 99 of the Companies Act deals with the question of reserve capital. Reserve capital cannot be turned into ordinary capital without leave of the court and it cannot be dealt with or charged by the directors. Thus, where a company issued debentures charging its undertaking including the uncalled capital, the charge will not be operative on the reserve capital. It can not also be cancelled by a reduction of capital. It is available only for the creditors on the winding up of the company and is thus a kind of guarantee for them.

Reserve capital should be distinguished from a reserve or Reserve fund'. The latter expressions are applied to undistributed profits. Such reserves can be spent, charged or divided among share-holders at the company's discretion.

Publication of Authorised, subscribed and Paid up capital

Any notice, advertisement, official publication, business letter, bill head or letter paper which mentions the authorised capital of the company must also mention in equal prominence the subscribed and paid-up capital of the company. On a default being made, the company shall be

punishable with fine which may extend to ten thousand rupees and every officer shall liable to pay a penalty of five thousand rupees for each default.(Sec. 60).

The provision is incorporated so that the company may not mislead the public by showing an impressive figure as authorised capital but having very little paid-up capital.

CLASSES OF CAPITAL

Section 43 as amended by the Companies Amendment Act, 2000 provides that the share capital of a company limited by shares shall be of two kinds only, namely :-

(*a*) equity share capital—

(*i*) with voting rights ; or

(*ii*) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

(*b*) preference share capital.

While a company may issue equity share capital with differential rights as to dividend, voting or otherwise, no preference capital with any such differential rights could be issued.

Preference share capital. It is the sum total of preference shares. These shares carry the following preferential rights over equilty shares.

(i) as regards dividends, to be paid a fixed amount or an amount calculated at a fixed rate ;

(ii) on winding up of the company, repayment of capital paidup. [Section 43]

Equity share capital. It means all share capital which is not preference share capital. It may be noted that while a company can have only equity share capital, but it cannot have only preference share capital. As per the definition of 'preference share capital' in Section 43, preference shareholders have certain preferential rights over the equity shareholders. Thus in the absence of equity share capital, there cannot be preference share capital.

Section 86 does not apply to a private company unless it is a subsidiary of a public company. It means that such a private company may issue share capital of such other kinds as it may think fit.

ALTERATION OF CAPITAL

Under Section 61 a company limited by shares may in general meeting, if so authorised by its articles, alter the conditions of its memorandum relating to share capital in order to :

(a) increase its share capital by issuing new shares ;

(b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares. However, consolidation or 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.

(c) convert all or any of its fully paid-up shares into stock and reconvert that stock into fully paid-up shares of any denomination ;

(d) sub-divide its shares into shares of smaller amount than is fixed by the memorandum, provided the paid-up amount will remain at the same proportion to the unpaid amount of the shares;

(e) cancel shares which have not been taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

Within 30 days of passing the resolution for alteration of share captial, notice must be given to the Registrar who shall thereupon make necessary changes in the company's memorandum or articles or both. On failure to give notice to the Registrar, the company and every officer in default shall be liable to a fine which may extend up to ₹ one thousand for every day during which the default continues or ₹ 5 lacs which ever is less. (Sec. 64).

A notice to the Registrar shall also be given by a company when redeemable preference shares have been redeemed or where its share capital has been increased beyond the authorised capital. A company having no share capital shall inform by similar notice any increase in its membership (Sec. 64).

The power of alteration must be exercised bona fide in the interests of the company and not for benefitting any group.

REDUCTION OF CAPITAL (SEC. 66)

The share capital of a company is the only security on which the creditors rely. Any reduction of capital, therefore, reduces the fund out of which they are to be paid. Reduction of capital means reduction of issued, subscribed and paid up capital of a company. The capital of a company cannot be reduced unless all the formalities as laid down in section 66 of the Companies Act are complied with.

A company may wish to reduce its capital for a number of reasons, namely—

1. The capital of the company may be more than enough for its needs, and so, it may return the surplus capital to the shareholders.
2. The paid-up capital of the company is sufficient and it may refrain from calling up the unpaid portion of share money.
3. Some of the capital may in fact have been lost or diminished *e.g., share of ₹ 100 may represent assets worth ₹ 50. The company may wish to write off the lost capital.*

Reduction under item (1) or (2) above will reduce the funds available to the creditors. Reduction under item (3) affects the rights of different classes of shareholders as well as the interest of the members of the public who may be induced to take shares in the company.

Reduction of capital may be effected in several ways which may be classified under two heads.

1. Reduction without the consent of the Tribunal[1]. There are a number of cases where a company may reduce its capital without the sanction of the Tribunal[2].

(a) Where redeemable preference shares are redeemed in accordance with the provisions of Section 55.

(b) Where unissued shares are cancelled.

(c) Where any shares are forfeited for non-payment of calls.

(d) Where there is a surrender of shares or a gift is made to the company of its own shares.

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1. Substituted by the Companies (Second Amendment) Act, 2002.

2. Ibid

(e) The company may purchase its own shares under section 68 of the Companies Act.

(f) The Tribunal may, under section 241 or 242, order the purchase of the shares or interest of any members of the company by the company.

In all these cases the procedure laid down under Section 66 of the Companies Act is not required to be followed.

2. Reduction with the consent of the Tribunal. Section 66 gives a company limited by shares or a company limited by guarantee and having a share capital the power to reduce its share capital in any way. The Act has not prescribed the manner in which the reduction is to be carried out, nor has it prohibited any method of effecting that object.

The reduction of capital can only be made—

(i) by passing a special resolution,

(ii) which is confirmed by the Tribunal.

Section 66(1) mentions the following three modes in particular, without in any way affecting the various other ways by which a company may reduce its share capital :—

(1) By extingushing or reducing the liability of members for unpaid capital,

(2) By writing off lost or unwanted capital. This is the most common method of reduction of capital.

(3) By paying off paid up share capital which is in excess of the wants of the company with or without reducing members' liability (i.e. by refunding a portion of the paid up capital).

No reduction shall be made if the company is in arrears in repayment of any deposits/interests thereon.

Illustrations of the third mode of reduction of share capital are—

(1) Payment of dividend out of paid up share capital.

(2) Purchase by the company of its own shares.

PROCEDURE FOR REDUCING SHARE CAPITAL (SEC. 66)

The procedure for reducing the share capital of a company is as follows:

1. Special resolution. A company shall pass a special resolution for reduction of share capital. [Sec. 66(1)]

However, no such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon contain any provision for reduction of capital, the articles must first be altered so as to give the power and then the resolution for reducing the capital must be passed.

2. *Application to the Tribunal*[1]. After having passed the special resolution for reducing the share capital, sanction of the National Company Law Tribunal shall be obtained by the company for an order confirming the reduction. [Sec. 66(1)]

The Tribunal shall give notice of every application made to it to the Central Government, Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that

1. Substituted by the Companies (Second Amendment) Act, 2002.

Government, Registrar, the Securities and Exchange Board and the creditors within a period of the three months from the date of receipt of the notice.

The object of requiring this sanction is three-fold: (1) To protect persons dealing with the company so that the funds available for satisfying their claim shall not be diminished except by ordinary business risks. (2) To ensure that the reduction is equitable as between the shareholders of the company. (3) To protect the interest of the public.

Interests of the creditors. The primary duty of the Tribunal is to look after the interests of creditors. Creditors are entitled to object if the reduction of share capital involves (a) reduction of liability in respect of uncalled capital, (b) payment to any share holder of any paid-up capital and (c) in any other case if the Tribunal so directs.

However, it may be noted that only such creditors are entitled to object to whom the company owes a debt which would have been provable in the winding up of the company. The creditors have, however, no right to object to the proposed reduction of capital where no asset out of which their claims could be satisfied is being given up or returned to the shareholders.

The Tribunal shall settle a list of creditors who may object to such reduction. The Tribunal may publish notices fixing a day or days within which the creditors not entered on the list or to claim to be so entered or are to be excluded from the right of objecting to the reduction.

Under special circumstances, the Tribunal may sanction such reduction without settling the list of creditors or without securing the debt of any creditor.

Where the Tribunal is satisfied that the interests of the creditors have been secured, it may confirm the reduction on such terms and conditions as it may think fit.

No application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 and a certificate to that effect by the company's auditor has been filed with the Tribunal. [Section 66(3)]

The order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be published by the company in such manner as the Tribunal may direct. [Section 66(4)].

Interests of the shareholders. The second duty of the Tribunal is to protect the interests of the shareholders. The proposed scheme of reduction must be reasonable and fair between all the classes of shareholders in the company.

If the scheme of reduction is unfair and would work injustice between the different classes of shareholders, it will not be sanctioned by the Tribunal. Thus, where under a scheme of reduction the whole burden of the loss was thrown upon the ordinary shareholders and as such was not fair between the ordinary shareholders and the preference shareholders, the Tribunal refused to sanction the scheme.

The question of reducing the capital is a domestic affair to be decided by the majority, but this power must be exercised in fair and equitable manner.

Example : A company reduced its capital by paying back the preference stock. The power to pay of the preferential stock was in the articles. Yet the reduction was opposed by some preference stock-holders on the ground that it deprived them of the advantage of their investment. It was held that the proposed reduction was not unfair because even without it the preference stock holders would not be entitled to anything more than the return of their paid-up capital. [Scottish Insurance Co. v. WIlson and Clyde Coal Co. (1949) AC 462].

3. Registration of the order of Tribunal with Registrar. The company shall deliver to the Registrar a certified copy of the Tribunal order and a minute approved by the Tribunal showing the following details for registration—

(a) the amount of the share capital ;

(b) the number of shares into which it is to be divided ;

(c) the amount of each share; and

(d) the amount, if any, at the date of registration deemed to be paid-up on each share.

The Registrar will, thereupon register the order and the minute. On such registration, the resolution for reducing the capital takes effect. Notice of the registration shall be published in such manner as may be directed by the Tribunal. The Registrar shall certify the registration of the order and the minute under his hand. Such certificate shall be conclusive evidence that all the requirements of the Act have been complied with.

The reduction takes effect as from the date of registration by the Registrar. The minute when registered is deemed to be substituted for the corresponding part of the memorandum of association and is deemed to be an alteration of the memorandum of association and such alteration shall be noted on every copy of the memorandum issued after the date of registration.

If any officer of the company knowingly conceals the name of any creditor entitled to object, or knowingly misrepresents the amount or nature of his claim or debt or is party to such concealment or misrepresentation, he will be liable to imprisonment upto one year or fine or both.

Liability of members on reduction. On reduction of capital, the members of a company whether present or past are not liable beyond a certain limit. The liability of the members is limited to the difference, if any, between the amount of the share as fixed by the minute and the amount paid up in respect of the shares and the amount to which the shares are finally reduced as a result of reduction of capital i.e. the amount payable by any member is reduced to the difference between the amount paid up and the amount reduced. If the company is unable to pay the claim of any creditor entitled to object who was ignorant of the proceedings for reduction or of their nature and effect and who was not entered on the list of creditors then—

(a) every member of the company at the date of the registration of the order for reduction will be liable to contribute for the payment of the claim an amount not exceeding the amount, which he would have been liable to contribute if the company had commenced to be wound up on the day before that registration; and

(b) if the company is wound up, the Tribunal on the application of such creditor may settle a list of members so liable to contribute and enforce calls on them as if they were ordinary contributories in a winding up.

FURTHER ISSUE OF CAPITAL

A company may increase its capital—

1. By allotment of new shares.
2. By conversion of debentures or loans into shares.

1. Allotment of further shares [Section 62]

A company may desire to expand its activities or it may stand in need of more capital even in the absence of expansion of activities. The time at which and the persons to whom new shares are to be

allotted is an important question. If the directors or the majority shareholders are allowed to distribute the new issue at their discretion, they may offer it to their nominees, thus, adding to their own majority and reducing the strength of the minority. Section 62 deals with this kind of situation.

The object of section 62 is to prevent discrimination amongst shareholders and prevent the directors from offering shares to outsiders before they are offered to the shareholders. This right of shareholders to be offered new shares to them before they are offered to the public is known as shareholders right of *pre emption.*

SHAREHOLDERS' PRE-EMPTIVE RIGHT OR RIGHTS ISSUES

Where the Company decides to increase its subscribed capital of a company by allotment of further shares, such shares shall be offered to existing equity shareholders *pro rata, i.e..*, in proportion, as nearly as circumstances admit, to the capital paid up on those shares at that date. In case of listed companies, the information as regards the quantum of such issue and the proportion in which rights shall be offered shall be supplied to the concerned stock exchange in advance. Where the existing shareholders are given the right to apply for new shares in proportion to the shares which they already hold, the issue is called a 'rights issue'.

The right of a company to make an issue of shares under section 62 is not dependent upon the capacity of any shareholders to take up the shares offered. It may also be noted that the existing shareholders cannot object to increase on the ground that the value of the present shares would be thereby reduced.

Notice of offer

The offer to the existing shareholders must be made by notice specifying the number of shares offered and the time within which it should be accepted. Such time should not be less then 15 days and not exceeding 30 days. If the offer is not accepted within the prescribed period, it shall be deemed to have been declined. [Sec. 62(1) (a)].

Notice to contain right of renunciation

The notice shall also inform the shareholders that the offeree may renounce the whole or part of the offer in favour of any other person unless the articles otherwise provide. [Sec. 62(1) (*a*)].

After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the board of directors may dispose of such shares in such manner as they think most beneficial to the company.

Again if after making proportional allotment as nearly as the circumstances admit some shares are left, they may be disposed of by the directors in such manner as they think most beneficial to the company. The directors must act bonafide and if they act in any other way, they can be restrained by injunction.

Example : D company's articles provided that new shares should first be issued to existing shareholders. G company held so many shares in the D company that it could control the voting power. The company proposed to offer new shares to all shareholders except the G company. It was held that the D company could be restrained by injunction from doing this. [Gas Meter Co. Ltd vs. Diaphragm & General Leather Co. Ltd. (1925) 41 T.L.R. 342].

Exceptions

In the following cases, a company need not offer further issue of shares to the existing shareholders :

(1) Where a special resolution is passed to that effect by the company in general meeting.

(2) Where no such special resolution is passed, if the company at the general meeting passes an ordinary resolution to that effect and the approval of the Central Government is obtained. The Central Government will accord its approval if it is satisfied on an application by the Board of Directors that the proposal is most beneficial to the company;

(3) If any shareholder to whom the shares are offered declines to accept the shares or does not apply within the period specified in the notice.

(4) A private company need not offer its further issue to existing shareholders.

(5) An allotment of shares on conversion of debentures or loans into shares, or creditors subscribing for shares in terms of the loan raised.

Issue of shares in contravention of Section 62

The allotment of shares made contrary to the provisions of section 81 is not invalid, rather is voidable at the option of the director or a shareholder who is aggrieved by such an allotment. Such an allotment may be used as a weapon of defence when any right or liability arising out of such allotment is sought to be enforced.

2. Conversion of debentures or loans into shares. A company may issue shares to its lenders or debenture holders who have been given the option to convert their loans or debentures into shares. However, the company can do so only if such conversion has been approved before the issue of debentures or raising the loan by a special resolution. But debentures issued to Government or loans obtained from the Government may be converted into shares, in spite of the fact that the terms of the issue of the debentures or loans do not contain such a provision. The Central Government in public interest may order that any such debentures or loans may be converted into shares on such terms and conditions as in the opinion of the Central Government are reasonable in the circumstances.

In determining the terms and conditions the Central government shall have regard to the financial position of the company, the terms of the issue of debentures or loans, the rate of interest payable, and such other matters as it may consider necessary.

However, where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit. [Section 62(4)].

Notice of increase of share capital or of members (Section 64)

A company having a share capital shall within thirty days of the resolution authorising the increase of capital give notice to the Registrar. Such notice shall include particulars of the classes of shares affected and the conditions on which new shares are to be issued. A company having no share capital shall inform by similar notice any increase in its membership. The Registrar shall upon receipt of the notice record the increase and also make any alteration which may be necessary in the company's memorandum or articles or both.

If default is made in complying with these provisions, the company and every officer of the company who is in default, shall be punishable with fine which may extend to ₹ 1,000 for every day during which the default continues or ₹ 5 lacs which ever is less.

VOTING RIGHTS

The voting rights are governed by the provisions of section 47 of the Companies Act. Every member of a company is entitled to vote and when he exercises his right to vote, he is exercising a right of property., that is, an individual right in respect of which he has a right to sue. Voting rights of a member are not affected by the fact that his shares have been attached or pledged or a receiver has been appointed. The rights of various categories of shareholders are as follows.

Equity shareholder's rights. According to section 47(1) of the 2013 Act :

(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.

Preference shareholder's rights. Every holder of the preference share capital shall have in respect of such capital, a right to vote only on resolutions which directly affect rights attached to the preference shares. A resolution for winding up or repayment or reduction of share capital shall be deemed to be one affecting directly the rights of preference shareholders.

The preference shareholders shall have a right to vote on every resolution placed before the meeting where such dividend has remained unpaid for an aggregate period of not less than two years before the date of the meeting.

The voting rights of each holder of preference shares of either class will be in proportion in which the capital paid-up on his shares bears to the total equity capital of the company.

A company cannot by its articles or otherwise deny voting right to the holders of shares. It cannot put any restriction on the exercise of this right. For example, provision in the articles that "only shareholders holding five or more shares are entitled to vote" is invalid. The voting rights mentioned in Section 47 are further safeguarded by the provisions of Sections 106. Section 106 provides that the articles of the association of the company can provide that a member shall not exercise voting rights in respect of shares on which a call or other sums due to the company has not been paid. A public company or a private company which is a subsidiary of a public company shall not prohibit any member from exercising his voting rights on the ground that he has not held his shares or other interest in the company for any specified period preceding the date on which vote is taken.

Variation of shareholders rights (Sec. 48). Rights especially given to shares of a particular class by the terms of the memorandum or articles are referred to as the special rights of a class or class rights. Special class rights may likewise be created by the terms of issue or by a special resolution. These rights are usually concerned with dividend, voting or the distribution of assets in a winding up.

The rights of the holders of a class of shares may be varied with the written consent of the holders of at least three fourths of the issued shares of that class. Such rights can also be varied by a special resolution passed at a separate meeting of such shareholders provided that—

(a) the memorandum or articles provide for such variation ; or

(b) where there is no such provision, such variation is not prohibited by the terms of issue of the share or the class of shares. [Section 48].

The variation referred to in section 106 is variation to the prejudice of any class of shareholders and not variation adding to or enhancing the rights of any class. It is only where a variation results in the curtailment of the rights of any class or classes of shareholders, the consent or sanction of such class or classes will be necessary.

Rights of dissenting shareholders. Where the rights of a class of shareholders are varied, the holders of not less than 10 per cent of the issued shares of that affected class, may apply to Tribunal to have the variation cancelled provided they did not consent or vote for the variation. The application must be made within 21 days after the giving of the consent or passing of the resolution. Once such an application is made, the variation is not to take effect unless and until it is confirmed by the Tribunal. On hearing such application, the Tribunal may disallow the variation, if it is satisfied that the variation would unfairly prejudice the shareholders of the class in question. The decision of the Tribunal shall be binding on the shareholders.

The company must send a copy of the Tribunal order within 30 days to the Registrar.

If any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both. [Section 48(5)].

SEBI GUIDELINES REGARDING RIGHTS ISSUES [W.E.F. 27-1-2000]

Applicability

1. These guide lines apply to the rights issues made by existing listed companies (the companies whose equity capitals listed) These fore a company whose debentures/bonds are listed but not the equity (*i.e. shares) will not be governed by those guidelines.*

These guidelines are not applicable where the size of the issue is upto ₹ 50 lakhs.

Withdrawal of a Rights Issue

2. Rights issue cannot be withdrawn after the announcement of the record date. If done, then no security of the company shall be eligible for listing upto 12 months.

Underwriting

3. The underwriting of rights issue shall be optional.

Appointment of Registrar

4. Appointment of Registrars to Issue shall be compulsory.

Appointment of Merchant Banker

5. Appointment of Category-1 Merchant Banker holding a valid certificate of registration issued by SEBI shall be compulsory.

Partly Paid Shares

6. Partly paid shares, if any, must either be made fully paid or forfeited.

Letter of Offer

7. Letter of offer shall contain disclosures specified by SEBI [*See Section III of SEBI guidelines relating to contents of offer document. The Lead Merchant Banker shall :*

(i) ensure compliance of the requirements of SEBI guidelines with respect to the offer document relating to rights issues.

(ii) File with SEBI a copy of the offer document at least 21 days before filing of the same with the Regional Stock Exchange.

Agreement with Depository

8. The company shall enter into an agreement with the depository for dematerialisation :

(i) of securities already issued;

(ii) proposed to be issued;

(iii) the subscribers/shareholders must be given an option of holding the shares in a dematerialised mode or by way of share certificates.

Closure of Rights Issue

9. The rights issue must be kept open for a minimum period of 30 days. It cannot remain open for more than 60 days.

Minimum Subscription

10. SEBI requires the following clauses in respect of minimum subscription to be stated in the letter of offer.

Where the company does not receive the minimum subscription of 90% of the issue the entire subscription will be refunded to the applicants within 42 days from the date of sure of the issue. If there is delay in the refund of the application money by more than 8 days after the company becomes liable to pay the amount, *i.e.* forty two days after closure of the issue, the company will pay interest for the delayed period, @ 15% per annum as prescribed in Section 40 of the Companies act, 2013.

No Reservation in Rights Issues

11. No reservation shall be allowed in rights issue.

Promoters Contribution and Lock-in-period

12. The requirement of promoter's contribution shall not be applicable in case of rights issues.

Rights of FCD/PCD Holders

13. No company shall, pending conversion of FCDs/PCDs, issue any sharesby way right unless similar benefit is extended to the holders of such FCDs or PCDs. The benefitsshall be extendedby making a reservation of sharesin proportion to the convertible part of FCDs/PCDs. The sharesso reserved may be issued at the time of conversion of such debentures on the same terms on which the rights issue was made.

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Restriction on Further Capital Issues

14. No company shall make any further issue of capital in any manner, whether by way of issue or otherwise, during the period commencing from the submission of offer document to SEBI on behalf of the company for rights issue, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or undersubscription, etc.

Over Subscription not to be Retained

15. Over-subscription shall not be retained under any circumstances.

Issue to be made fully Paid-up

16. Issue shall be made fully paid-up within 12months except where the total issue size exceeds ₹ 500 crore.

Offer Document to be made Public

17. The draft offer document filed with SEBI shall be made public for a period of 21 days from the date of filing the offer document with SEBI.

The Lead Merchant Banker shall :

(a) simultaneously file copies of the draft offer document with the stock exchanges where the securities offered through the issue are proposed to be listed.

(b) make copies of offer document available to the public.

Lead merchant banker or stock exchanges may charges an appropriate sum to the person require sting for the copy of offer document.

No Complaints Certificate

18. After a period of 21 days from the date the draft offer document was made public, the Lead Merchant Banker shall file a statement with SEBI :

(a) giving a list of complaints received by it.

(b) a statement by it whether it is proposed to amend the draft offer document or not, and

(c) highlight of those amendments.

Dispatch of Issue Materia

19. In the case of rights issues, lead merchant banker shall ensure that the letters of offer are dispatched to all shareholders at leastone week before the date of opening of the issue.

After the prospectus or letter of offer has been filed with the Registrar of Companies or stock exchange the printed prospectus or letter of offer shall be forwarded to SEBI at least 10 days prior to the issue opening date.

Composite Issues

20. The Lead Merchant Banker shall ensure that the requirements of 'minimum subscription' is satisfied both jointly and severally, *i.e., independently for both rights and public issues.*

Under–writers

21. *(a) (i) If the issue is proposed to be closed at the earliest closing date, the Lead Merchant Banker shall satisfy himself that the issue is fully subscribed before announcing closure of the issue.*

(ii) In case, there is no definite information about subscription figures, the issue shall be kept open for the required number of days to take care of the underwriters' interests and to avoid any dispute, at a later date, by the underwriters in respect of their liability.

(c) In case there is a devolvement on underwriters, the Lead Merchant Banker shall ensure that the underwriters honour their commitments within 42 days from the date of closure of the issue.

(d) In case of under-subscribed issues, the lead merchant banker shall furnish information in respect of underwriters who have failed to meet their under writing developments to SEBI in the specified format.

Additional Facility for Applying

22. The Lead Merchant Banker shall ensure that an advertisement giving the date of completion of dispatch of letters of offer, is released in at least in one English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated. The advertisement must be published at least 7 days before the date of opening of the issue.

The advertisement must contain the following details :

(a) The centres other than registered office of the company where the shareholders or the persons entitled to rights may obtain duplicate copies of composite application forms in case they do not receive the original application form within a reasonable time even after opening of the rights issue.

(b) Where the shareholders have neither received the original composite application forms nor are they in a position to obtain the duplicate forms, they may make applications to subscribe to the rights on a plain paper.

(c) The advertisement shall also contain a format to enable the shareholders to the application on a plain paper containing necessary particulars like name, address, ratio right issue price, number of shares held, ledger folio numbers, number of shares entitled and applied for, additional shares if any, amount to be paid along with application, particulars of cheque, etc. to be drawnin favour of the company Account- Rights issues.

(d) The advertisement shall further mention that applications can be directly sent by the shareholder through Registered Post together with the application moneys to the company's designated official at the address given in the advertisement.

(e) The advertisement may also invite attention of the shareholders to the fact that the shareholders making the application otherwise than on the standard form shall not be entitled to renounce their rights and shall not utilise the standard form for any purpose including renunciation even if it is received subsequently.

(f) If the shareholder makes an application on plain paper and also in standard form, he may face the risk of rejection of both the applications.

Utilisation of Funds in Case of Rights Issues

23. The issuer company may utilise fundscollected against rights issues after satisfying Regional Stock Exchange that minimum 90% subscription has been received.

Compliance Report

24. The Post-Issue Lead Merchant Banker shall file.

(a) 3 Day Post Issue Monitoring Report—The report shall be filed on the 3rd day from the date of closure of the subscription of the issue.

(b) 50-Day Post-Issue Monitoring Report-This report shall be filed on the 50th day from the date of closing of subscription of the issue.

SHORT ANSWER QUESTIONS

1. What do you mean by share capital of a company ?
2. Define the term 'authorised capital'.
3. What is subscribed capital ?
4. What is the difference between issued and subscribed capital ?
5. What do you mean by reserve capital ?
6. Distinguish between capital reserve and reserve capital ?
7. How can a company alter its capital ?
8. How can a company reduce its capital ?
9. What do you mean by rights issue ?

TEST QUESTIONS

1. Discuss the various kinds of the share capital. How is the preference share capital distinguished from equity share capital ?
2. Explain fully the different methods by which a company can alter its share capital.
3. What are the different kinds of shares which a company can issue under the Companies Act, 2013 ? What are the provisions regarding further issue of share capital ?
4. Under what circumstances may the Central Govt. order conversion of debentures or loans into shares? What remedy is available to a company if the terms and conditions of such conversion are not acceptable to it ?
5. Explain the procedure for increasing, re-organising and reducing the share capital of a company ?
6. How and under what circumstances can a company reduce its share capital? Discuss the relevant procedure for the reduction of share capital.
7. How can the share capital of the company be reduced ? What is the liability of the members in respect of reduced shares ?
8. Indicate in detail the steps a public company has to take for raising additional equity capital.
9. Can new shares be offered by a company to outsiders without offering the same first to the existing shareholders ? If so, state the circumstances under which it can be done.
10. Can any loan made to a company be converted into shares in the company? If so, state when and how ?
11. How and in what circumstances can a company reduce, increase and reorganise its share capital ?
12. Discuss the voting rights of the members in a public company limited by shares both with reference to equity and preference share capital.

PRACTICAL PROBLEMS

Q. 1. A public company has two classes of shares, ordinary shares and 9% non-cumulative preference shares. It wishes to change the rights of the existing preference shares to 7% cumulative preference shares. There is no provision in the articles or memorandum, regarding such variation. Advise the company. If 15% holders of the preference shares are opposed to this, what should they do ?

Ans. According to Section 48 of the Act : The holders of not less than ten percent of the issued shares of a class, who did not consent to or vote in favour of the resolution for the variation, may apply to the Tribunal to have the variation cancelled. So, 15 percent holders of preference shares can apply to the Tribunal against the change of their rights.

Q. 2. D company's articles provided that new shares should first be issued to existing shareholders. G company held so many shares in D company that it could control the voting power. D company proposed to offer new shares to all shareholders except the G company. What remedy is available to the G company ?

Ans. D Company can be restrained by injunction from doing this act.

□□□

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MEMBERSHIP IN A COMPANY

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	REGISTERS	
Separate Register of Debentureholders	Under Rule 4 of the Companies (Management and Administration) Rules, 2014 every company that issues debentures or any other security shall maintain a separate register for debenture holders or security holders in **Form No. MGT-2.**	There was no requirement like this in 1956 Act.
Duplicate of foreign register	No requirement to maintain duplicate of the foreign register in India.	Section 158 of the 1956 Act required a duplicate of the foreign register to be maintained in India.
	ANNUAL RETURN	
Whether full annual return/only changes to be filed every year ?	Full annual return to be filed every year [No provisions like section 159(1) of the 1956 Act of filing full annual return once in 5 years and changes in between]	Section 159(1) of the 1956 Act provided that if any of the five immediately preceding annual returns has given the full particulars required as to past and present members and the shares held and transferred by them, the return in question may contain only changes in those particulars since the date of the AGM with reference to which the annual return in question is prepared.
Certification of annual return by CS in practice	The 2013 Act extends this requirement to unlisted companies having paid-up share capital of ₹ 10 crores and turnover of ₹ 50 crores or more [Rule 11 of the Companies (Management and Adminis-tration) Rules, 2014]	Only listed companies required to get annual return certified by a 'secretary in whole-time practice.'
Minimum number of members	Public company : – 7 or more Private company : – 2 or more One person company : – 1 (OPC)	Public company :– 7 or more Private company :– 2 or more No provision for OPC

Maximum number of members	Public company :– No limit Private company :– 200 OPC :– No limit of 200 is applicate	Public company :– No limit Private company :– 50 No provision for OPC

MEMBER

A company is composed of members, though it has its own entity distinct from members. The term 'member' refers to a person whose name appears on the register of members. On the other hand, the term 'shareholder' refers to a person who holds shares in a company.

Section 2(55) of the Companies Act defines a member as :

1. The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.
2. Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall be a member of the company.
3. Every person holding shares of the company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

The person desirous of becoming a member of a company must have the legal capacity of entering into an agreement in accordance with the provisions of the Indian Contract Act, 1872.

Members v. Shareholders

The terms 'member' and 'shareholder' have been used interchangeably in the Companies Act. The word 'shareholder' is used in relation to a company having a share capital and there can be no membership except through the medium of shareholding. A holder of shares becomes a member only when his name is entered in the register of members. But the term 'member' is wider in scope and may be used in relation to all types of companies. Member includes shareholder. A shareholder is a member but a member may not be a shareholder. A person may become a member of a company without holding any shares. Companies limited by guarantee or unlimited companies which may not have share capital, and therefore can have no shareholders but they do have members.

A shareholder may be distinguished from a member as follows :

1. A holder of a share warrant is a shareholder but not a member as his name is struck off the register of members immediately after the issue of such share warrant.
2. In the case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will only be members but not shareholders.
3. A person who subscribes to the memorandum of association immediately becomes a member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not the shareholder of the company.
4. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed a shareholder.
5. Similarly, a shareholder by transfer is not a member until his name is entered in the company's register of members.

WHO CAN BECOME A MEMBER ?

An individual or body corporate can be a member of a company. The general rule is that any person who is competent to contract may become a member. A contract to purchase shares is like any other contract and both the contracting parties must be competent to enter into the contract. The provisions of the Indian Contract Act, 1872, regarding the persons who can contract would apply. This is, however, subject to the provisions of the memorandum and articles of the company. The articles may provide that certain persons cannot become members of the company.

The membership rights of some categories of person are discussed below :

1. Minor : A minor in India cannot be a member because a contract with a minor is absolutely void here. Neither a minor nor his legal guardian can be made responsible for the payment of calls. Under section 2(55) of the Companies Act, a member is defined as a person who 'agrees in writing' to become a member. The company, therefore, cannot register a person unless the person desirous to be a member applies in writing. But a minor cannot agree to be a member of the company.

Where a minor has been allotted shares and his name has been entered in the company's register of members in ignorance of his minority, the company can remove his name when the fact of his minority comes to its knowledge. Similarly, the minor can also repudiate the allotment at any time during his minority. If the name of the minor continues on the register of members and neither party repudiates the allotment, the minor, does not incur any liability on the shares during minority. But the position will change after he attains majority. He has the option to repudiate his liability on shares with in a responsible time.

In case of fully paid shares, minor's name may be entered in the register of members if he happens to acquire the same by way of transfer or transmission. But where partly paid shares are transferred to a minor, the company may refuse to register the transfer.

A minor can be appointed as 'nominee'. In such a case the name of guardian should also be specified in the nomination form.

2. Company : A company is a legal person and hence is competent to contract. Therefore, it can become a member of another company. But it can invest money in another company only if it is so authorised by its memorandum of association.

3. Subsidiary company. A subsidiary company cannot be a member of its holding company. Any allotment or transfer of shares in a company to its subsidiary is void. This provision will not apply where the subsidiary is the legal representative of a deceased member of the holding company or is a trustee and the holding company is not beneficially interested under the trust. [Sec. 19]

4. Partnership firm : A partnership firm, being not a person in the eyes of law, cannot be a member of a company. However, a firm can purchase shares of a company in the individual names of its partners as joint shareholders. For that every partner is held liable jointly and severally for all acts of the firm done while he is a partner.

A firm may be a member of a non-profit making company licensed under section 8 but on its dissolution the membership ceases.

5. Foreigners : Foreigners can become members of companies registered in India but permission of the Reserve Bank of India under the Foreign Exchange Management Act, 1999 (FEMA) has to be

obtained for this purpose. The right of the foreigner as a member will be suspended if he becomes an alien enemy.

6. Fictitious person : A person who takes the shares in the name of fictitious person becomes liable as a member. Besides, such a person can be punished for impersonation under section 38.

7. Insolvent : An insolvent cannot become a member of the company, but if a member has become an insolvent, he remains a member as long as his name appears in the register. However, the trustee in bankruptcy may get his name registered as the proprietor of the shares.

Minimum number of members : According to section 3(1) of the Companies Act 2013, any seven or more persons in the case of a public company (two or more persons in the case of a private company and one person in case of a one person company), associated for any lawful purpose may by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Act in respect of registration, form an incorporated company, with or without limited liability. However, one person can form "One person company."

Maximum number of members. The maximum number of members of a private company is limited to two hundred **[As per Companies Act 2013 the maximum number have been increased from 50 to 200]** excluding the present and past employees of the company who continue to be the members of the company. There is no restriction with regard to the maximum number of members of a public company. Although one person company is a private company but the statutory limit of 200 member does not apply to it.

Joint members. If more than one person jointly apply for and are allotted shares in a company, each one becomes a member. In the case of joint holders, they can insiston having their names registered in such order as they may require. They may also require their holding to be split into several joint holding with their names in different orders so that all of them may have a right to vote as first named holder in one or the other joint holdings.

HOW TO BECOME A MEMBER OR MODES OF ACQUIRING MEMBERSHIP

A person may become a member of the company in any of the following ways :

1. By subscribing to the memorandum of association.
2. By application and allotment.
3. By transfer of shares.
4. By transmission of shares.
5. By entry as beneficial owner in the records of depository.
6. By estoppels or holding out.

1. Membership by subscription. [Section 7(3)]. Every subscriber to the memorandum of association is deemed to have agreed to become its member and on its registration must be put on the register of members. Membership of a subscriber of the memorandum is a consequent. Until the company is registered he is not deemed to be a member though the memorandum bears his signature as a subscriber.

Two conditions are necessary to make such a person as a member: (i) He will subscribe his name to the memorandum of association ; (ii) The company must be registered under the Companies

Act. In their case neither allotment of shares nor registration of their names in the register of members is essential. He acquires, as soon as the company is registered, the full status of a member with all the rights and liabilities. When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfils the obligation.

2. Membership by application and allotment : A person may become a member of a company by an application for shares subject to the formal acceptance by the company. The ordinary law of contracts applies to the agreement to take shares in a company. An application for shares may be absolute or conditional. If it is absolute, a simple allotment and notice thereof to the applicant will constitute the agreement. If it is conditional, the allotment must be made on the basis of the conditions specified. Where there is a conditional application for shares and an unconditional allotment, there is no contract constituted.

3. Membership by transfer : Shares in a company are movable property as provided in section 44 and are transferable in the manner as provided in the articles of the company. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company. As long as his name is not entered in the register of members, he is not a member. He does not acquire the status of a member merely by purchasing shares. Accordingly if the shares purchased by him have been forfeited by the company, he cannot challenge the validity of the forfeiture.

4. Membership by transmission. On the death of a member his shares vest in his legal representative. The legal representative can sell the shares without being registered, but subject to the provisions of the articles he is entitled to be put on the register of members if he so chooses. The official assignee is likewise entitled to be a member in place of a shareholder who is adjudicated insolvent. This process of acquiring membership is known as transmission. It takes place on the death or insolvency of a member or if the member is a company on its going into liquidation. In these cases no instrument of transfer need be delivered to the company. If a company without any reason refuses to accept a transmission, the same remedies are available as in the case of a transfer.

5. Membership by beneficial ownership. Every person who holds equity share capital of a company and whose name is entered as beneficial owner in the records of Depository, shall be deemed to be a member of the company.

6. By Acquiescence or estoppel. If the name of a person has been entered in the company's register of members due to mistake or inadevertance of the company and the person concerned does not object to it and holds himself out as a member, he shall be deemed to be a member of the company. He can, however, escape liability by taking prompt action to get his name removed from the register of members on permissible grounds.

TERMINATION OF MEMBERSHIP

A person will cease to be a member of the company when his name is removed from the register of members. A person may cease to be a member of a company by two different ways namely (1) by act of the parties and (2) operation of law. The former is effected voluntarily by the member in accordance with the law prescribed for this purpose ; on the other hand the latter is an involuntary act of the party.

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Two conditions are necessary to make such a person as a member: (i) He will subscribe his name to the memorandum of association ; (ii) The company must be registered under the Companies

Act. In their case neither allotment of shares nor registration of their names in the register of members is essential. He acquires, as soon as the company is registered, the full status of a member with all the rights and liabilities. When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfils the obligation.

2. Membership by application and allotment : A person may become a member of a company by an application for shares subject to the formal acceptance by the company. The ordinary law of contracts applies to the agreement to take shares in a company. An application for shares may be absolute or conditional. If it is absolute, a simple allotment and notice thereof to the applicant will constitute the agreement. If it is conditional, the allotment must be made on the basis of the conditions specified. Where there is a conditional application for shares and an unconditional allotment, there is no contract constituted.

3. Membership by transfer : Shares in a company are movable property as provided in section 44 and are transferable in the manner as provided in the articles of the company. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company. As long as his name is not entered in the register of members, he is not a member. He does not acquire the status of a member merely by purchasing shares. Accordingly if the shares purchased by him have been forfeited by the company, he cannot challenge the validity of the forfeiture.

4. Membership by transmission. On the death of a member his shares vest in his legal representative. The legal representative can sell the shares without being registered, but subject to the provisions of the articles he is entitled to be put on the register of members if he so chooses. The official assignee is likewise entitled to be a member in place of a shareholder who is adjudicated insolvent. This process of acquiring membership is known as transmission. It takes place on the death or insolvency of a member or if the member is a company on its going into liquidation. In these cases no instrument of transfer need be delivered to the company. If a company without any reason refuses to accept a transmission, the same remedies are available as in the case of a transfer.

5. Membership by beneficial ownership. Every person who holds equity share capital of a company and whose name is entered as beneficial owner in the records of Depository, shall be deemed to be a member of the company.

6. By Acquiescence or estoppel. If the name of a person has been entered in the company's register of members due to mistake or inadevertance of the company and the person concerned does not object to it and holds himself out as a member, he shall be deemed to be a member of the company. He can, however, escape liability by taking prompt action to get his name removed from the register of members on permissible grounds.

TERMINATION OF MEMBERSHIP

A person will cease to be a member of the company when his name is removed from the register of members. A person may cease to be a member of a company by two different ways namely (1) by act of the parties and (2) operation of law. The former is effected voluntarily by the member in accordance with the law prescribed for this purpose ; on the other hand the latter is an involuntary act of the party.

Cessation of membership by an act of the parties. A person may cease to be a member of the company by his own act in any of the following modes.

1. When a person transfers his shares. In such a case the transferor ceases to be a member as soon as the transferee is registered, but not before.
2. When his shares are validly forfeited by the company.
3. When a person makes a valid surrender of his shares to the company.
4. When a company sells the shares in exercise of its right of lien over them.
5. When he repudiates the contract on the ground of false or misleading statement in the prospectus of the company.
6. When he is holding redeemable preference shares and such shares are redeemed.

Cessation of membership by the operation of law. The mode of cessation of membership is effected by operation of law in the following ways.

1. When he dies.
2. When he is declared insolvent and the official assignee either disclaims or transfers the shares.
3. When the shares are sold in execution of a decree of the court.
4. When the company is wound-up.

Though one ceases to be a member, he remains liable as contributory and is also entitled to share in the surplus, if any.

RIGHTS AND LIABILITIES OF MEMBERS

Rights of members : When once a person becomes a member of a company, he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Act. Some of these rights can be exercised by him individually and others alongwith other members.

Rights of members or shareholders can be divided into two categories, namely

(1) Individual rights, and

(2) Corporate membership rights.

(1) Individual rights or Individual membership rights. Members enjoy certain rights in their individual capacity. They can enforce these rights in their own names. These rights are conferred on the members by the Companies Act. Such rights cannot be taken away from the members unless they consent. If such a right is in question a single shareholder can defy a majority consisting of all the other shareholders.

Some of these rights are as follows :

(i) To have the certificate of shares delivered or the certificate of stock issued to him within the prescribed time (S. 56).

(ii) To transfer shares subject to any restrictions imposed by the articles (S. 44).

(iii) To attend meetings of shareholders, receive proper notices and vote at the meetings (Sec. 47).

(iv) To associate in the declaration of dividends and to apply to the Trbunal for an injunction restraining the directors from paying dividends on an *ultra vires declaration or out of capital.*

(v) To obtain copies of memorandum and articles on request and payment of the prescribed fees (S. 17).

(vi) To have the first option to buy any new shares on a further issue of shares *(i.e., the right of pre-emption) by the company (S. 62).*

(vii) To apply to the Tribunal to have any variation or abrogation in his rights set aside by the Tribunal (S. 48).

(viii) To have notice of any resolution requiring special notice [S. 115].

(ix) To obtain on request minutes of proceedings at general meetings [S. 119].

(x) To remove directors by joining with others (S. 169).

(xi) To obtain a copy of the profit and loss account and the balance sheet (S. 129).

(xii) To apply for the appointment of one or more competent inspectors by the Govt. to investigate into the affairs of the company as well as for reporting thereon (Ss. 210).

(xiii) To participate in the appointment of an auditor or auditors at the annual general meeting (S. 139).

(xiv) To inspect the auditor's report at the annual general meeting of the company (S. 145).

(xv) To receive a share in the capital of the company and the surplus assets, if any, on the company's liquidation, (Sec. 320)

(xvi) To participate in passing of a special resolution that the company may be wound up by the Tribunal or voluntarily (Ss. 271).

(xvii) To participate in the appointment and in the fixation of remuneration of one or more liquidators in the case of a members' voluntary winding up and to fill any vacancy in the office of a liquidator so appointed by them (Ss. 310).

(2) Collective Rights or Corporate membership rights. Members have also certain rights as a group. These rights can be exercised only by the majority and not by the single shareholder or minority shareholders. Corporate membership rights are rights which the member has agreed to submit to the will of the majority provided that the will is expressed in accordance with the law and the articles. Thus, the shareholders in majority determine the policy of the company or exercise control over the management of the company. With respect to these rights, the principle of the supremacy of the majority applies.

(i) However, if and when the majority becomes oppressive or is accused of mismanagement of the affairs of the company, section 244 confers right, to not less than one hundred members of a company or not less than one-tenth of the total number of its members whichever is less or any member or members holding not less than one-tenth of the issued share capital of the company and in the case of a company not having a share capital, not less than one-fifth of the total number of its members, to apply to Tribunal under section 241 or 242 for relief in cases of oppression or for relief in cases of mismanagement respectively.

(ii) Section 100 of the Companies Act confers on members holding not less than one-tenth of the paid up share capital of a company right to requisition an extra ordinary general meeting of the company. The section also confers on members having not less than one-tenth of the total voting power in a company not having a share capital to requisition an extraordinary general meeting of the company. If the Board of directors of the company does not within 21 days from the date of deposit of a valid requisition in regard to any matter proceed to call

a meeting for the consideration of those matters on a day not latter than forty five days from the date of deposit of the requisition, the meeting may be called by the requisitionists themselves.

(iii) Under Section 169 of the Companies Act, 2013 the members have a right to get a director removed by a majority resolution in the company's meeting.

(iv) Under Section 210 of the Companies Act, 2013 the members have a collective right for :

- Making an application to the Central Government for investigation into the affairs of the company ; and
- Making an application to the Central Government for appointment of Government Nominee directors.

Liability of members. The liability of the members of a company depends on the nature of a company.

Company with unlimited liability. Every member of an unlimited company is liable in full for all the debts of the company contracted during the period of his membership.

Company limited by guarantee. The liability of the members of a company limited by guarantee is limited to the amount they undertook to contribute to the assets of the company in the event of winding up.

Company limited by shares. In the case of a company limited by shares, the liability of a member of company is the amount, if any, unpaid on his shares. If his shares are fully paid, his liability is nil for all purposes.

All money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company. [Sec. 10]. In the case of the death of a shareholder, his estate remains liable in respect of his shares. In the case of transfer of shares, the transferee on being registered as a holder becomes liable to pay all moneys thereafter becoming payable in respect of the shares.

The liability of a member continues so long as his name appears on the register of members of company. Thus, even if a member has transferred his shares and parted with the share certificate, he shall remain liable in respect of those shares until the name of the transferee is not registered in the register of members in his place.

If a member is holding partly paid-up shares and the company goes into liquidation, then he becomes liable as contributory to pay towards the assets of the company. [Section 2(26)]. In the case of persons holding fully paid-up shares, their names are included in the list of contributories but they are not liable to contribute. Further, even after a person ceases to be a member, he is liable as a past member in case the company goes into liquidation within one year after the cessation of his membership.

Register of Members

Section 88 of the Companies Act provides that every company shall keep and maintain a register of members in such form and in such manner as may be prescribed. The register of members shall indicate separately for each class of equity and preference shares held by each member residing in or outside India. The register of members shall include an index of the names included therein.

The following particulars must appear in the register ;

(a) The name, address, and occupation of each member ;

(b) In the case of a company having a share capital, the shares held by each member with distingushing numbers. However, in case of shares held by depository, distingushing numbers are not necessary ;

(c) Amount paid or agreed to be paid on those shares;

(d) The date on which each member's name was entered in the register.

(e) The date on which any person ceased to be a member ; and

When the shares are demated the name of the depository is entered in the register of members. The register of beneficial owners is maintained only by the depository and not by the company and the company only receives a status list of the beneficial owners periodically. Thus a company cannot furnish a copy of the list of beneficial owners in terms of section 94.

The register of members is a prima facie evidence of its contents including that of membership. It provides evidence whenever the question arises whether a person is or is not a member. Register of members is a public register.

Particulars of each joint holder have to be recorded. The names of minor members are entered along with the names of their guardians.

Provisions Relating to Register of Members

(1) **Register and index of beneficial owners [section 88].** The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be a register and index of members for the purposes of this Act.

(2) **Location of the register of members and right of inspection.** [Section 94]. The register and index of members must be kept at the registered office of the company. It may also be kept at any other place in India in which more than one tenth of the total number of members entered in the register of members reside, provided such a place has been approved by a special resolution in the general meeting and a copy of the proposed resolution has been sent to the registrar in advance.

The register of members is open to inspection of members as well as non-members. Any member may inspect the register of members free of charge. But an outsider can inspect it on payment of such sum as may be prescribed. The register shall be open for inspection during business hours for not less than two hours daily except when the register is closed under section 91.

3. **Making extracts.** Any such member, debenture-holder, other security holder or beneficial owner or any other person may–

(a) take extracts from any register, or index or return without payment of any fee; or

(b) require a copy of any such register or entries therein or return on payment of such fees as may be prescribed. [Section 94(3)].

If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues. [Section 94(4)].

The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it. [Section 94(5)].

4. **Power to close register :** A company may close the register of members for a total period of

45 days in a year, but not exceeding 30 days at any one time. Before such a register is closed, the company must give at least 7 days previous notice or such lessen period as specified by SEBI for listed companies or companies which intend to get their securities listed. [Sec. 91(1)] The register is usually closed during a period prior to the payment of dividend or the issue of new shares.

If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided in sub-section (1), or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for every day subject to a maximum of one lakh rupees during which the register is kept closed. [Section 91(2)].

A company is not bound to close its register even for a day, but if it does choose to close, the provisions of section 91 will have to be complied with. Thus the provisions of this section are permissive and not mandatory. Companies that are listed on the stock exchange are required to give notice of the closure of transfer books to the stock exchange.

5. Register prima facie evidence. [Section 95] The register of members is *prima facie evidence of any matters authorised to be inserted therein by this Act. The court will accept the same as correct until rebutted. Evidence may be admitted to prove that entries therein are not correct.*

Where a company is being wound up, it shall, as between the contributories of the company be, prima facie evidence of the truth of all matters purporting to be therein recorded. (Section 345)

A person whose name appears in the register of members, is deemed to be a member and will be held liable as a member unless he proves that he is not a member.[1] A person has a right to get his name removed from the register but he must exercise his right promptly. Similarly in case of transfer the transferor remains liable as a member so long as his name is there on the register of members.

6. Preservation of registers etc. The Companies (Preservation and Disposal of Records) Rules 1966 regulate the preservation and disposal of registers which the companies registered under the Companies Act 1956 are required to maintain.

It lays down that

(1) Register of members commencing from the date of the registration of the company is permanent and is not to be destroyed at any point of time.

(2) Index of members is also a permanent record and is not to be destroyed at any point of time.

(3) Register and index of debentureholders should be preserved for fifteen years till after the redemption of debentures.

(4) Copies of all annual returns prepared under section 92 and copies of all documents required to be annexed thereto under section 92 are to be preserved for eight years from the date of filing with the registrar of companies.

The Registrar of Companies may by order in writing direct any company to preserve any of the above registers and documents beyond the period specified above for retention.

Foreign register. Where a company is authorised by its articles to keep a branch register of members resident in any state or country outside India, it may keep such register in that state or country. Such a register is called 'Foreign Register'. Such a foreign register will contain the names

1. Bakshish Singh v. Khalsa Bank Ltd. AIR 1933 Lah. 1016.

and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India [Section 88[4)].

"The foreign register is deemed to be a part of the company's register of members and therefore, it should be kept in the same manner as the principal register and should be made available for inspection as and when required.

Rectification of Register of members (Section 59)

As the register of members of a company is a *prima facie* evidence of matters entered therein, it is quite likely that injustice may result from omissions or commissions in it.

Section 59 deals with an application before the Tribunal for rectification of the register of members. The application may be made by the person claiming to be aggrieved or any member or the company itself in any one of the following three circumstances namely :

1. If the name of any person is entered in the register of members without sufficient cause.
2. If the name of any person after having been entered in the register, is omitted therefrom without sufficient cause.
3. Default is made or unnecessary delay takes place in entering in the register the fact that a person has become a member or ceased to be a member.

The application shall be made in such form as may be prescribed to the Tribunal, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register. [Section 59(1)].

The Tribunal may, after hearing the parties to the appeal under sub–section(1) by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved. [Section 59(2)].

The provisions of this section shall not restrict the right of a holder of shares or debentures, to transfer such shares or debentures and any person acquiring such shares or debentures shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal. [Section 59(3)].

Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned. [Section 59(4)].

If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both. [Section 59 (5)].

ANNUAL RETURN [SECTION 92]

Section 92 provides that every company shall prepare an Annual Return containing prescribed particulars. The annual return shall be filed with the registrar within 60 days from the date of the holding of the annual general meeting. Where no annual general meeting is held in a particular year, then the annual return has to be filed within sixty days from the last day on which the meeting should have been held in accordance with the provisions of the Act.

Section 92 requires that where no annual general meeting had been held, the return must specify the reasons for not holding the meeting. The fact that no annual general meeting was held is no justification for not complying with the requirements of this section.[1] The directors are under an obliation to file the annual return even if the company ceased functioning.[2]

The object of filing the annual return is to enable the Registrar to record the changes that have occurred in the constitution of the company during the year. At the same time it affords an opportunity of obtaining certain additional information which would otherwise be available only at the company's office.

The annual return should be filed in the prescribed form and must contain the following particulars regarding :

(a) its registered office ;
(b) the register of its members ;
(c) the register of its debenture-holders ;
(d) its shares and debentures ;
(e) its indebtedness ;
(f) its members and debentureholders, past and present ;
(g) its directors, managing directors, managers and secretaries past and present.

Where any of the five[3] preceding returns contains full particulars of members, and shares held and transferred by them, the return to be submitted may contain only change in membership and shareholding instead of the full particulars.

Where the company has converted any of its shares into stock and given notice to the Registrar, the amount of stock held by each of the members concerned should be mentioned instead of the shares so converted.

In the case of company not having a share capital, an annual return shall be filed with the Registrar within sixty days from the date of the annual general meeting.

It shall contain the following particulars regarding :

(i) the address of the registered office of the company ;
(ii) the names of members with dates on which they became members and the names of persons who have ceased to the members since the date of the last annual general meeting with dates ;

1. State of Bombay v. Bhandhan A.I.R. 1961, S.C. 186.
2. Sukhbir Saran v. Registrar of Companies (1972) 42 Comp. Cas. 408.
3. Raised from two to five by the Companies Amendment Act,. 1988.

(iii) all such particulars with respect to the persons who, at the date of the return were the directors of the company, its manager and its secretary;
(iv) a statement containing particulars of the total amount of indebtedness of the company in respect of all charges which are or were required to be registered with the Registrar.

The copy of the annual return filed with the Registrar shall be signed both by a director and by the manager or secretary of the company. Where there is no manager or secretary, it shall be signed by two directors of the company, one of whom shall be the managing director, where there is one. The annual return is also required to be signed by a secretary in whole time practice, in the case of a company whose shares are listed on a recognised stock exchange.

The return shall be accompanied by a certificate signed by both the signatories of the return stating that the return contains the facts as they stand on the day of the annual general meeting correctly and completely and that since the date of the last annual return the transfer of all shares and debentures and the issue of all further certificates of shares and debentures have been appropriately recorded in the books maintained for the purpose.

In the case of a private company, the certificate must further state that the company has not, during the year, issued an invitation to the public to subscribe to the shares or debentures of the company and that the number of members does not exceed fifty, excluding the past and the present employees of the company.

Penalty. In case of non compliance with any of the provisions contained in sections 92 the company and every officer who is in default shall be punishable with fine upto fifty thousand rupees which may extend to ₹ 3 lakh and every officer in default shall be punishable with imprisonment for 6 months with fine of ₹ 50,000 (which may extend to ₹ 3 lakhs) with both.

TEST QUESTIONS

SHORT ANSWER QUESTIONS

1. Who can be a member of a company ?
2. Distinguish between a member and a shareholder.
3. Can a minor become a member in a company ?
4. Can a partnership firm become a member of a company ?
5. Give two instances when a person ceases to be a member of a company ?
6. Is every company required to maintain an index of its members ?
7. Where should the register and index of members of a company be kept ?
8. Is a company's register of members open to the inspection of public ?
9. What is an annual return ?
10. Who should sign the annual return of a company ?

TEST QUESTIONS

1. Define a 'member'. Distinguish him from a shareholder.
2. "Every shareholder of a company is known as a member while every member may not be known as a shareholder." Comment.
3. In what ways may a person become and cease to be a member of the company?
4. State the circumstances in which all the members of company will have unlimited liability though the company is a limited liability company.

5. Who can become a member of the company ? Can the following persons or institutions become members of a company :
   (a) minor, (b) company ; (c) partnership firm ; (d) foreigner, (e) insolvent.
6. Describe the circumstances under which a register of members may be rectified.
7. Enumerate the 'individual membership rights' as distinct from 'corporate membership rights'. On what consideration is such distinction founded.
8. "A register of members is not merely a record of members and their particulars but an adequate proof of title to the membership". Discuss.
9. What are the particulars to be recorded in a register of members of a company ? Where is the register to be maintained and who has to maintain it ? Can a member have access to the register ?
10. Explain the provisions of the Act relating to annual return. What are its contents and when must it be filed ?

PRACTICAL PROBLMES

Q. 1. **P is the father of Q, a minor. P as the guardian of Q applied to a company for the issue of shares in the name of Q. The company issued shares to and registered them in the name of Q. Has Q acquired the membership of the company ?**

Ans. No, Q has not acquired the membership of the company. Since a minor cannot contract, be cannot become a member of the company.

Q. 2. **A member requested the company in which he holds shares to provide a copy of the register of Members and paid ₹ 500. The company did not reply even after 16 days. What remedy he has ?**

Ans. In the given case, the member can apply to the Tribunal to compel the company to supply the copy. [*Section 94*]

Q. 3. **The name of X is found entered in the register of a company. But X contends that he is not a member of the company. The company maintains that X had orally agreed to become a member and hence his name was entered in the register and so he is a member. Is the contention of X valid ?**

Ans. The contention of X is valid and he cannot be regarded as a member of the company.

□□□

10

DEBENTURES AND CHARGES

COMPARATIVE CHART (Some of the Major Changes)

Points of comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
Registrable Charges	Under the 2013 Act, every charge on company's assets, property or undertaking is registrable. [See also Companies (Registration of Changes) Rules, 2014]	• Under the 1956 Act, only registrable charges on company assets/Undertaking were registrable.
Pledge of movable property	No exemption for pledges from registration	• Pledge not registrable.
Inspection of company's register of charges	• Under the 2013 Act, the reasonable restrictions on right to inspection can be imposed by articles. • There is no requirement under the 2013 Act that, inspection of register of charges to be allowed for at least 2 hours in each day.	• Under the 1956 Act, the reasonable restrictions on right to inspection of register of charges could be imposed by company in general meeting. • However, inspection was to be allowed for at least 2 hours in each day.

MEANING AND NATURE OF A DEBENTURE

Companies have to borrow large sums of money for business purposes. The loan requirements of a company may not be met by a single lender. One very easy method of doing so is to borrow by issuing debentures. The term debenture is defined in the Companies Act as,

> "debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not." **[Sec. 2 (30)].**
>
> "Debenture means a document which either creates a debt or acknowledges it and any document which fulfils either of those conditions is a debenture."[1] ***Chitty, J.***
>
> Thus, any bond or security issued by a company is a 'debenture.' It may be secured or unsecured. Debenture is, in reality, a loan to the company. The debenture certificate is an acknowledgement of loan.

1. Levy v. Abercorrio State and Slab. Co. (1887) 37. Ch.D. 260.

CHARACTERISTICS OF A DEBENTURE

1. Debenture Certificate. It is in the form of a certificate, like a share certificate. In other words it is an instrument in writing. An oral promise in acknowledgement of a debt is not a debenture.

2. Acknowledgement of indebtedness. The certificate is an acknowledgement of indebtedness.

3. Under Common Seal. It is usually under the seal of the company but it is not necessary. A certificate signed by two directors of a company and without bearing the company's seal is a valid debenture.

4. Debenture in a Series. It is one of a series of like debentures. But a single debenture may be issued to one man.

5. Repayment. It, usually, provides for the repayment of a specified principal sum at a specified date. But a company may issue irredeemable debentures with no undertaking to repay.

6. Payment of Interest. It provides for the payment of interest at a specified rate until the principal sum is paid back.

7. Creation of Charge. It is generally secured by a charge, fixed or floating on any part of the company's property or undertaking.

8. Movable Property. The debentures of a company are a moveable property, transferable in the manner provided by the Articles. (Sec. 44)

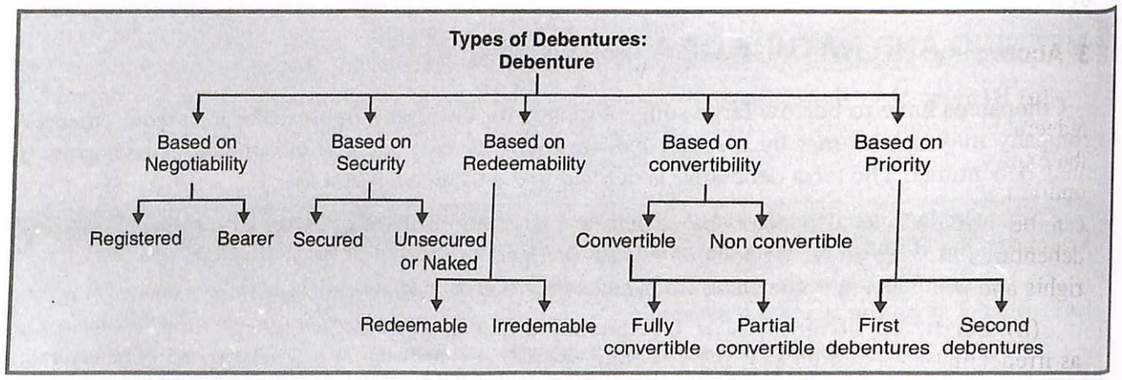
9. No Voting Rights. The debentures carry no voting rights at any meeting of the company. (Sec. 71).

10. Register and Index of Debenture Holders. The provisions as to Register and Index of Members, apply to Debenture Holders also. (Sec. 88).

11. Specific Performance. A contract with a company to take up and pay for any Debentures of the company, may be enforced by a decree of specific performance.

KINDS OF DEBENTURES

1. Debentures may be of different kinds which are as follows :



According to Negotiability :

(a) Registered debentures. A registered debenture is one which is registered in the name of a

holder in the books of the company. It is transferable in the same way as a share or in accordance with the conditions endorsed on their back, but a transfer to be complete has to be registered with company. These debentures are not negotiable instruments. Interest on such a debenture is payable to the registered holder or to the order of the registered holder. But coupons may be issued payable to bearer so far as interest is concerned. If such coupons are issued then the interest is payable on delivery of the coupons.

(b) Bearer debentures. A company may issue debentures payable to the bearer. These are negotiable instruments and the title to them is, therefore, transferable by mere delivery of the debenture to the transferee. In case of bearer debentures, the company keeps no register of debentureholders in respect of them, but if such debentures are secured they must be entered in the register of charges. The coupon is attached to the bearer debenture for payment of interest and must be presented for payment to the company's bankers when the date of payment arrives. The company can communicate with holders of bearer debentures only by advertisement.

The transferee of a bearer debenture becomes its holder and entitled to recover the principal and interest when due. Non- payment of principal and/or interest entitles him to apply for the winding up of the company.

2. According to Security

(a) Secured debentures. When some assets or property of the company are charged in favour of the debentureholders, the debentures are deemed to be secured.

The charges which a company may create on its assets may be :

(*i*) by way of specific charge or mortgage on particular property of the company;

(*ii*) by way of floating charge; or

(*iii*) by both a specific and floating charge.

(b) Unsecured or naked debentures. Debentures which do not carry any charge on the assets of the company are unsecured or naked debentures. In such a case the debentureholder is an ordinary unsecured creditor of the company. Further, these unsecured or naked debentures need not be registered with the Registrar of Companies as no charge over the properties of the company is created by the issue of such unsecured debentures.

3. According to Performances

(a) Redeemable debentures. Debentures issued by the company are generally redeemable. A redeemable debenture is one under which the principal money is paid-off to the debentureholder on the expiry of the fixed term. The company may redeem a certain number of debentures each year or option may be given to the company to redeem all of them by a specified date. Redeemed debentures can be reissued by the company either by reissuing the same debentures or by issuing other debentures in their place. Upon such reissue, the person entitled to the debentures will have the same rights and priorities as if the debentures had never been redeemed.

(b) Perpetual debentures or Irredeemable Debentures. Perpetual debentures are also known as irredeemable debentures. It is a debenture which is issued with no fixed date of redemption. Such debentures are payable only in the event of a winding up or on some serious default by the company or payable at a remote period—such as hundred years after issue. If debentures are issued as irredeemable or perpetual, there would be no time within which the company would be bound to pay

them. This does not mean that the company can never pay them off even if it wishes to do so. It only means that the creditors cannot at any time compel the company to redeem them.

4. According to convertibility

(a) Convertible debentures. Section 62 permits the issue of convertible debentures. It enables the issue of shares to debenture holders and creditors in exchange for the amount due to them where the terms of the issue of the debentures or loans provide for such exchange and such terms are approved both by the special resolution of the company and by the Central Government.

(b) Non-convertible debentures. When debentures do not give any option to their holders to convert them into preference or equity shares, such debentures are called non-convertible debentures. These are to be paid as and when they mature.

(c) Partly convertible debentures. Partly convertible debentures consist of two parts—convertible and non-convertible. The convertible portion(s) is/are convertible into equity shares at the expiry of specified period(s), whereas the non-convertible portion is redeemed at the expiry of a certain period(s). Where the conversion takes place at or after 18 months, the conversion is optional at the discretion of the debenture holder.

5. Classification according to Priority

1. First debentures. These are the debentures which are to be repaid in priority to other debentures which may be subsequently issued.

2. Second debentures. These are debentures which are to be paid after the first debentures has been redeemed.

DISTINCTION BETWEEN FULLY CONVERTIBLE AND PARTLY CONVERTIBLE DEBENTURES

Convertible debentures can be fully or partly convertible. The major points of distinction between fully and partly convertible debentures are highlighted below :

Features	Fully convertible debentures	Partly convertible
(i) Classification for debt equity ratio computation	Classified as equity for debt equity ratio computation.	Convertible portion classified as 'equity' and non-convertible portion as 'debt'.
(ii) Flexibility in financing	Highly favourable debt equity ratio.	Favourable debt equity ratio.
(iii) Capital base	Higher equity capital on conversion of debentures.	Relatively lower equity capital on conversion of debentures.
(iv) Suitability for which companies	Better suited for companies without established track record.	Better suited for companies with established track record.
(v) Servicing of equity	Higher burden of servicing of equity.	Relatively lesser burden of equity servicing.
(vi) Debenture Redemption Reserve	Not required.	Required to be created for 50% of the face value of the non-convertible portion.

(vii) Buyback arrangements	Not required.	Arrangement may be made buyback of the non-convertible portion of the debentures.
(viii) Popularity with Investors	Highly popular with investors.	Not so popular with investors.

DIFFERENCE BETWEEN SHARES AND DEBENTURES

Debentures are similar to shares in many respects. Both the shareholder and the debenture-holder invest their money in the company; both get some return on the investment; although one gets it in the form of dividend and the other in the form of interest. Both are moveable properties and are transferable. But shares are a part of the capital of a company whereas debentures constitute a loan.

Following are the points of distinction between the two:

1. Status. A shareholder is member of the company but a debenture holder is only a creditor of the company.

2. Voting right. A shareholder has a voting right whereas a debenture holder has no such right at the meeting of the company. Section 71 of the Companies Act prohibits the issue of debentures carrying any kind of voting rights at general meetings of the company.

3. Income. Interest on debentures is payable whether there are profits or not. But dividend on shares is to be paid only when the company has earned profits. Interest on debentures may be paid out of capital but dividend on shares can never be paid out of capital.

4. Repayment. Debentures are normally redeemable, that is, these are paid back. But share holders cannot be paid back their amount, except in case of buy back.

5. Discount on issue. Debentures can be issued at a discount whereas shares cannot be issued at a discount except as provided under section 53 of the Companies Act.

6. Security. Debentures are generally secured and carry a charge on the assets of the company whereas shares have no such charge.

7. Position at winding up. The debenture holder, being a secured creditor of the company is paid off prior to a shareholder in the event of winding up of a company. Whereas the shareholders are paid back only after all other claims have been satisfied.

Procedure for the issue of debentures. Debentures are issued in accordance with the provisions of the articles, usually by a resolution of the Board of directors.

Once a decision is taken by the Board of directors to issue debentures, the next step will be to draft prospectus relating to the issue.

The provisions of section 26 relating to prospectus apply to the issue of debentures as they apply to an issue of share capital.

Debentures may be issued at par, at a premium, or at a discount if permitted by the articles of the company. Debentures, unlike shares, may be issued at a discount without any restriction. The reason is that they do not form part of the capital of the company. But all sums allowed by way of discount must be stated in every balance sheet of the company until written off. Particulars of any commission, discount or allowance paid either directly or indirectly to any person for his subscribing or procuring subscription for debentures of the company must be filed with the Registrar.

Debentures may be redeemable at par or at premium but their redemption at a discount is not permitted.

Section 71 provides that no company shall, after the commencement of the Act issue debentures carrying voting rights at any meeting of the company.

The legal provisions as to allotment, issue of certificates etc, applicable to shares also apply to debentures. But the condition of minimum subscription is not applicable to the issue of debentures.

Issue of Debentures

- The power to issue debentures rests with the Board of Directors under section 179. The company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
- Any company can issue secured or unsecured debentures. An issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures for period exceeding 10 years but not exceeding 30 years.
- The debentures shall be secured by the creation of a charge on the properties or assets of company having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.
- Debentures may be issued at par, at premium or at discount if permitted by the articles of the company. Debentures unlike shares may be issued at a discount without any restriction.
- Any type of company can issue debentures–One person company, Small Company, Private Company, Public Company or Listed company.
- The company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of debentures execute a debenture trust deed to protect the interest of the debenture holder.
- A company shall pay interest and redeem the debentures in accordance with the terms and conditions of the issue.
- Debenture Redemption reserve is required to be created out of the profit of the company for the purpose of redemption of debenture.
- Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest, the tribunal may on the application and after hearing the parties concerned direct by order the company to redeem the debentures on payment of principal and interest due thereon.

On default in complying with the order of the Tribunal every officer in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than 2 lakhs rupees but may extend to 5 lakhs rupees or both.

DEBENTURE CERTIFICATES

As soon as allotment of debentures is made, the debenture certificate must be completed and kept ready for delivery within the prescribed time.

- Every company shall within three months after the allotment of any debentures or debenture stock and within two months after the application for the registration of the transfer of any debenture or debenture stock, deliver the certificates of all debentures and debenture stocks allotted or transferred. The Central Government may extend the period not exceeding nine months for delivering the certificates.

Debentures with pari passu clause. Debentures are often issued in a series with the pari passu clause i.e. a clause whereby all debentures of a particular series, though issued at different and varying times are to rank together, as regards the security created by them. The effect of a parri passu clause is that all the debentures of a series are to be paid rateably, and if there are insufficient assets to pay all the debentureholders in full, the amount is distributed in proportion to the amounts owing to each of them. Where the debentureholders of a series rank pari passu and a debentureholder gets a judgment, it would be for the benefit of all the debentureholders.

The company cannot create a new series to rank pari passu with the old series, unless power to do so is expressly reserved.

Transfer and transmission of debentures. Bearer debentures are transferable by simple delivery. Registered debentures are transferred in the same manner as the shares of a company are transferred. The Companies Act provides that the debentures shall be a movable property, transferable in the manner provided by the articles of the company. A duly filled in and properly stamped instrument of transfer together with the certificate relating to debentures or with the letter of allotment must be delivered to the company either by the transferor or by the transferee.

CONDITIONS FOR ISSUANCE OF SECURED DEBENTURES

The Companies (Share Capital & Debenture) Rules, 2014 provides that a company shall not issue secured debentures unless it complies with following conditions:-

(a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.

Provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;

(b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;

(c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and

(d) the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

(i) any specific movable property of the company (not being in the nature of pledge); or

(ii) any specific immovable property wherever situate, or any interest therein.

DEBENTURE TRUST DEED

Debenture trust deed is a written instrument legally conveying property to a trustee often for the purpose of securing a loan or mortgage. It will usually contain the manes of the trustees, the identity

of the beneficiaries and the nature of the trust property as well as the powers and duties of the trustees. The trust deed also contains provisions dealing with the rights of the debentureholders and the company. It constitutes trustees charged with the duty of looking after rights and interests of the debentureholders.

A trust deed shall be executed in the **Form No. SH-12** or as near therto by the company issuing debentures in favour of the debenture trustees within 60 days of allotment of debentures.

Debenture trust deed in Form No. SH-12 contains the following :

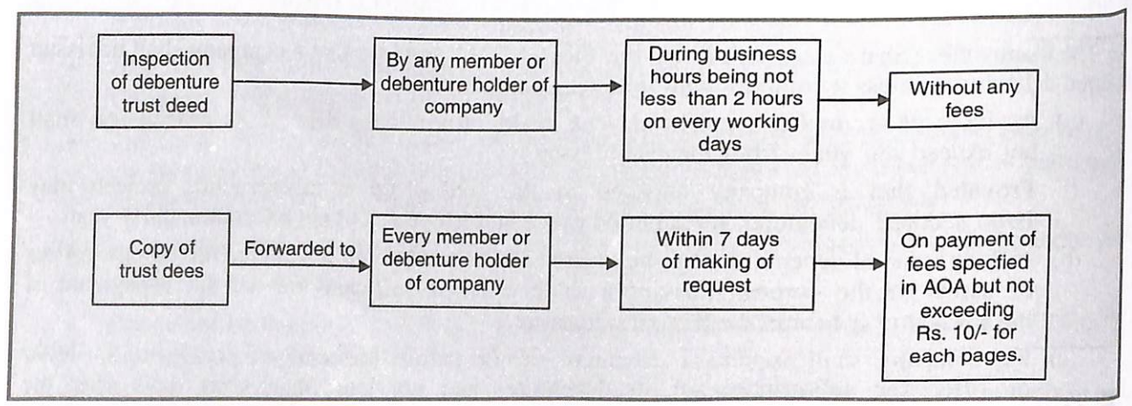
1. Description of debenture issue
2. Details of charge created (in case of secured debenture)
3. Particulars of the appointment of debenture trustee(s)
4. Events of defaults
5. Obligations of company
6. Miscellaneous.

Provisions of Debenture Trust Deed

1. Form. A trust deed shall be executed in the Form No. SH-12 or as near thereto by the company.

2. Time Period of execution. A trust deed shall be executed by the company issuing debentures if favour of the debentures trustees within 60 days of allotment of debentures.

3. Inspection and Copies.



Advantages of Debenture Trust Deed

The following are the advantages of having a trust deed :

1. The trustees hold the title deeds of mortgaged property which prevents the company from misusing the title deeds for any purpose.
2. The trustees are empowered to see that the property is kept insured and properly maintained.
3. The company can, with the consent of the trustees enjoy a number of powers over the property charged, *e.g. by way of sale, exchange, use transfer, or lease, thus enabling the company to put the property in advantageous use without jeopardizing the interest of the debentureholders.*

4. In case of a default by the company, the trustees are there to take the necessary steps instead of leaving to the initiative of individual debentureholders.
5. The trustees will have a legal mortgage of the property and will also hold the title deeds. So the persons who lend subsequently, cannot gain priority over the debentureholders.
6. The debentureholders can through the trustees sell the property charged, the thus realize the security without the aid of the court.

Debenture Trustee

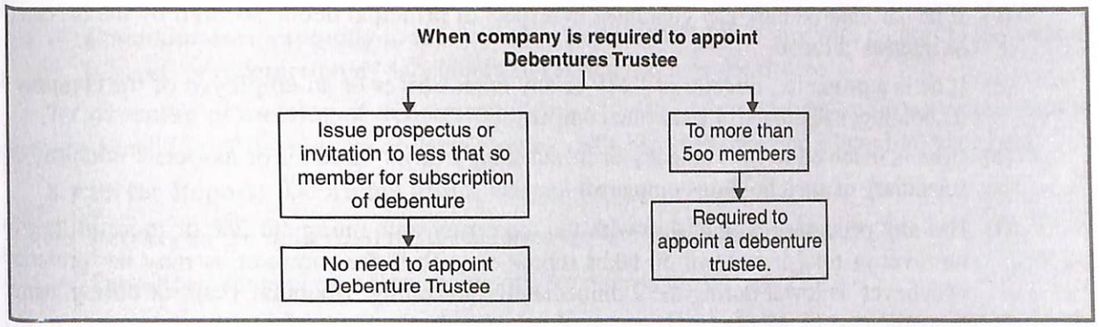
Debenture trustee is a person or group of persons appointed for the supervision of the common interest of debentureholder. The trustee acts as a watchdog to ensure that company's obligations under the trust deed are carried out and they can act expeditiously and effectively to safeguard the interest of the debentureholders.

Appointment of Debenture Trustee

Conditions for appointment of Debenture Trustees :

(a) The names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all subsequent notices or other communications sent to the debentureholders,

(b) Before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.



APPOINTMENT OF DEBENTURE TRUSTEES AND DUTIES OF DEBENTURE TRUSTEES

Section 71 of Companies Act, 2013 relates to the appointment of debenture trustees and enumerates their duties. It provides that the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

(i) any specific movable property of the company (not being in the nature of pledge); or

(ii) any specific immovable property wherever situate, or any interest therein.

However, no person shall be appointed as a debenture trustee, if he—

(i) Beneficially holds shares in the company;

(ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) has any pecuniary relationship with the company amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel

Disqualifications of a Debenture Trustee are :

(a) If he beneficially holds shares in the company;

(b) If he is beneficially entitled to moneys which are to be paid by the company to the debenture trustee;

(c) If he has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

(d) If he is a promoter, director or KMP or any other officer or an employee of the company or its holding, subsidiary or associate company.

(e) If he is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company.

(f) Has any pecuniary relationship with the company amounting to 2% or more of its gross turnover or total income of 50 lakhs rupees or such higher amount as may be prescribed whichever is lower during the 2 immediately preceding financial years or during current financial year.

(g) Is relative of any promotor or any person who is in the employment of the company as a director or KMP.

DUTIES AND FUNCTIONS OF DEBENTURE TRUSTEE

Functions of Debenture Trustee

(1) To protect the interest of debentureholders

(2) To redress the grievances of debentureholders effectively or efficiently.

Duties of Debenture Trustee

1. Ensures sufficiency of assets of the Company : Debenture trustee must ensure that the assets of the company issuing debentures and of the guarantor, if any are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debentureholders.

2. Ensures Correctness of letter of offer : Debenture trustee must satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed.

3. To Protect of Interest of the debentureholders. Debenture trustee performs such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debentureholders.

4. To Prevent any breach of the terms of issue of debentures or covenants of the trust deed. He must ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trustdeed and take such reasonable steps as may be necessary to remedy any such breach.

5. Appoints a nominee director on the Board of the company. Debenture trustee should appoint a nominee director on the Board of the company in the event of :

(i) 2 consecutive defaults in payment of interest to the debentureholders; or

(ii) default in creation of security for debentures; or

(iii) default in redemption of debentures.

6. Provides information to the debentureholders.

→ Debenture trustee informs the debentureholders immediately of any breach of the terms of issue of debentures or covenants of the trust deed.

→ Communicates promptly to the debenture holders defaults, if any with regards to payment of interest or redemption of debentures and action taken by the trustee.

7. Convening of meeting of debentureholders : It is the duty of debenturetrustee to take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held.

8. Call for Reports. Debenture trustee can call for :

→ Reports on the utilization of funds raised by the issue of debentures.

→ Periodical status or performance reports from the company.

9. Creation of Debenture Redemption Reserve. He ensures the implementation of the conditions regarding creation of security for the debentures if any and Debenture Redemption Reserve (DRR).

10. Convertion or redemption of Debentures. He ensures that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures.

11. File Petition before Tribunal. In case of the insufficiency of the assets of the company 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 debentureholders.

12. Redressing the Grievances of debentureholders. It is the duty of debenture trustee to redress the grievances of the debentureholders in a very effective and efficient manner.

Meeting of the debentureholders

The debentureholder can convene the meeting of the debentureholders on

(a) requisition in writing signed by the debentureholders holding atleast $1/10^{th}$ value of the debentures for the time being outstanding.

(b) On happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affect the interest of the debenture holders.

Liability of Trustee to Debentureholders

Debenture trustee is liable to debentureholders for any type of breach of trust and where he fails to show that he took the degree of care and due diligence required of him as a trustee.

The liability of debenture trustee shall be subject to such exemption :

1. Where majority of debentureholders holding not loss than $3/4^{th}$ in value of total debentures, present and voting in person agree, at the meeting summoned for the purpose, with respect to specific acts or omissions of the trustee.
2. Where trustee show that he took the degree of care and due diligence required of him as a trustee.

LIABILITY OF COMPANY TO CREATE SECURITY AND DEBENTURE REDEMPTION RESERVE

Mandatory Creation of Debenture Redemption Reserve. Section 71 requires every company which has issued debenture to create a Debenture Redemption Reserve (DRR). It provides that every company issuing debentures shall be under an obligation to create a debenture redemption reserve irrespective of the maturity period for redemption of debentures.

Utilization of DRR. Such reserve shall be credited with amounts appropriated on a yearly basis from profits of the company till the redemption is over. The company shall not utilise the debenture redemption reserve for any purpose other than discharging its liability towards the debenture-holders.

In other words, the purpose of DRR is to ensure that debenture-holders are protected and that profits generated by a company, are first allocated for payment to debenture holders rather than equity holders.

Conditions for creation of DRR :

(a) The DRR shall be created out of the profits of the company available for payment of dividend.

(b) DRR created should be equivalent to atleast 50% of the amount raised through the debenture issue before debenture redemption commences.

(c) Every company required to create DRR shall on or before the 30^{th} day of April in each year, invest or deposit as the case may be, a sum which shall not be less than 15% of amount of debentures maturing during the year ending 31^{st} days of March of the next year in any one or more of the following methods, namely :

- in deposits with any scheduled bank, free from any charge or lien.
- in unencumbered securities of the Central Government or of any Sate Government.

- in unencumbered securities mentioned in section 20 and subclause (a) to (d) and (ee) in Indian Trust Act 1882.
- in unencumbered bonds issue by any other company which is notified under section 20 subclause (f) of Indian Trust Act 1882.

(d) The amount invested or deposited shall not at any time fall below 15% of the amount of the debentures maturing during the year ending on 31^{st} day of March of that year.

(e) The DRR shall not be utilised by the company except for the purpose of redemption of debentures.

(f) In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issued in accordance with this sub-rule.

Failure in Redemption of Debentures

Where a company fails to redeem the debentures on the date of maturity or fails to pay interest on debentures when it is due the tribunal on application of any debentureholder or parties interested and after having parties concerned direct by order the company to redeem the debentures forthwith on payment of principle and interest due.

Penalty. On default of complying with order of tribunal every officer in default shall be punishable with imprisonment for term which may extend to 3 years or fine which shall not be less than 2 lakhs rupees but may extend to 5 lakh rupees or both.

Right of debenture holder to apply to NCLT. If the company fails to redeem the debentures on the date of maturity, the Tribunal on an application of any debenture holder shall after hearing the parties concerned direct the company to redeem the debentures forthwith by payment of principal and interest due thereon. 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.

Registration of trust deed. A copy of the trust deed and particulars thereof creating a charge on the assets of the company for the purpose of securing the issue of debentures after proper stamping, must be filed with the Registrar for registration within thirty days after the date of its creation. For the purposes of sub-section (13) of section 71 and sub-rule (1) a trust deed in Form No.**SH.12** or as near thereto as possible shall be executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.

The Registrar may accept for registration the delayed filing of the particulars of charges within a period of thirty days by imposing additional fees but not exceeding ten times the fee specified. The Registrar will extend such period if the company satisfies him that it had sufficient cause for not filing the particulars and instrument. [Section 77].

Liability of trustees for debentureholders. Trustees for debentureholders are in the same position towards their beneficiaries as any other trustees. They must exercise care and caution in exercising the powers which the trust deed confers on them otherwise they would be guilty of breach of trust. Any provision contained in a trust deed exempting a trustee from liability for breach of trust or negligence would be void.

REMEDIES OF DEBENTURE HOLDERS

Debenture holders may be secured or unsecured. The holder of an unsecured debenture is an unsecured creditor.

Like any other unsecured creditor, he has two remedies:

(1) he may sue for the principal and interest and execute the decree against the property of the company.

(2) he may present a petition for the winding up of the company under section 271 of the Act, on the ground that the company is unable to pay its debts.

If the company is already in the course of winding up, he may prove in such winding up the amount due to him like any other unsecured creditor.

A secured debenture holder stands in a stronger position as compared to unsecured debenture holder. In addition to the above two remedies available to unsecured debenture holder, he can exercise the following remedies.

1. Sale. If the debenture holder is the holder of a single debenture giving a charge on the assets of the company, he will have an express or implied power of sale. If there is a trust deed, the trustees have power to sell the property of the company. The liquidator cannot restrain a sale by the secured creditor without making payment of the debt, if not to the creditor, at least into the court. Any surplus of the proceeds of sale after payment of debts due to debenture holders is payable to the company.

2. Debenture holders action. When a company commits default in payment of debts, a debenture holder may bring an action against the company to obtain payment and to enforce the security. This is a 'debenture holders action'. He may sue on behalf of himself and all other debenture holders. Where there are separate actions brought by several debenture holders, the court may consolidate them.

3. Appointment of receiver. The debenture holders or the trustees may appoint a receiver to take charge of the assets subject to the charge provided they are so empowered. If they lack the power, they may apply to the court for an appointment. In such a case, the court then appoints a receiver and also manager, if necessary, for the purpose of the company's business. The court will also declare debentures to be a charge on the property of the company and direct an enquiry as to who are the debenture holders and orders a sale of property. In either case the fact of appointment must be brought to the notice of the Registrar within 30 days.

4. Foreclosure. A debenture holder may apply to the court for foreclosure so that the debenture holders become owners of the property charged. Foreclosure may extend even to the uncalled capital of the company. The court will grant this remedy only when all debenture holders have joined hands.

5. Valuation of security and proof of balance. If the company is being wound up and his security is insufficient, the debenture holder may value his security and prove for the balance of his debt or give up his security and prove for the whole debt. But he cannot claim and deduct interest accruing after winding up from the sale proceeds of the security.

If the holder of pari passu debentures owes a debt to the company and is unable to pay debt in full, the debenture holder cannot set off his debt against the liability he owes to the company. The rule of law is that a person who claims a share of a fund must pay up everything he owes to the fund before he can claim a share.

REGISTER AND INDEX OF DEBENTUREHOLDERS [SECTION 88]

Every company shall maintain a register of its debenture holders and enter therein the following particulars:

(i) The name, address and occupation of each debenture- holder.

(ii) The debentures held by each holder distinguishing each debenture by its number except where such debentures are held with a depository, and the amount paid or agreed to be considered as paid on those debentures.

(iii) The date on which each person was entered in the register as a debenture holder.

(iv) The date on which any person ceased to be debenture holder. No notice of any express or implied or constructive trust shall be entered on the register.

Every company having more than fifty debenture holders will maintain an index of debenture holders unless it is maintained in the form of an index. Any alteration in the register shall be entered in the index within fourteen days.

If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2), the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues.

NOMINATION OF SECURITIES [SEC 72]

Section 72 of the Companies Act 2013, provides that a holder of securities *i.e.* shareholders, debetureholders, depositors etc. of a company may, at any time, nominate a person to whom his securities shall vest in the event of his death.

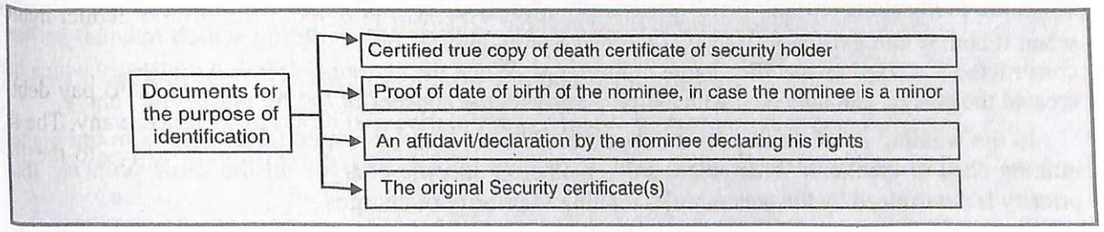
If the debentures of a company are held by more than one person jointly, the joint holders may together nominate a person to whom all the rights in the debentures shall vest in the event of death of all the joint holders.

A security holder can, at anytime, make nomination by filling in and sending **Form No. SH 13** to the company.

Where the nominee is a minor, it shall be lawful for the holder of debentures, to make the nomination to appoint, in the prescribed manner, any person to become entitled to shares in, or debentures of the company in the event of his death, during the minority.

Claim of Rights by Nominee

On the death of the securityholder *i.e.* shares, debentures etc. the nominee is required to furnish the following documents for the purpose of identification :



On being satisfied about the identity of the nominee, the company will request the nominee either to register himself as holder of security or to transfer the security of the nominee elects to be registered as a holder of security, he shall send a notice in writing to the company stating that he so elects.

The person is who is elected ad nominee is not entitled to exercise his voting right but is entitled to dividend and other benefits before being registered as a member. However, if the Board of Directors has issued a notice to the nominee to elect and no election either to transfer or hold the security in his name is made within a period of 90 days, the Board may withhold the payment of the dividend, bonus or other moneys payable/accruing to the security holders.

Cancellation or Change in Nominee

The holder of securities who has made the nomination can also cancel or change the nomination by nominating any other person in place of the present nominee by giving a notice of such cancellation or change in Form No. SH.14 .

The date of receiving the notice by company of such change or cancellation shall be the effective date of change or cancellation.

FIXED AND FLOATING CHARGES

It has already been stated that a company can issue secured and unsecured debentures. If the debentures are not secured by the assets of the company, the debentureholder's position is that of an unsecured creditor. Secured debentures are not secured by the assets of the company, these are issued by creating a charge on the assets of the company. The term 'charge' means generally interest. In 'Charge', there is no transfer of property, but only creation of right of payment out of specified property. The word 'charge' is defined in section 2(16) of the Act as including a mortgage. It also includes a lien or other equitable charge.

A charge is a security, given for securing loans or debentures. The security may be provided either by way of mortgage, hypothecation or pledge. It covers each and every mode of creating the security on the assets of a company, for the purpose of securing the repayment of any debt due by a company.

Sec. 2(16) of the Companies Act 2014 defines charges so as to mean an interest or lien created on the property or assets of a company or any of its undertaking or both as security and includes a mortgage.

The charge on the assets of a company for securing a debenture or a trust deed may be either (1) a specific or fixed charge; or (2) a floating charge.

Specific or fixed charge. A fixed or specific charge is created in respect of a definite and ascertained property. Such a charge is suitable for property which is more or less fixed. A mortgage of land is an example of fixed charge. It is, however, not necessary that the property should exist when the mortgage is created; if it is sufficiently identified the mortgage will attach to it irrevocably when it comes into existence. Hence, a mortgage of an aircraft or a building which has not yet been constructed is a fixed or specific charge or mortgage. When the charge is fixed, a company which has created the charge, can only deal with the property with the consent of the holder of the charge.

In the winding up of a company a debentureholder secured by a specific charge is in the highest ranking class of creditors. Where there are a number of specific charges on the same property, their priority is determined by the general rules relating to priority of charges.

Under a fixed charge the security of the debentureholder is confined to the asset comprising the fixed charge; he cannot proceed against other assets of the company.

Floating charge. A floating charge is peculiar only to companies as a type of security for the moneys borrowed by them. No other person or association or body of persons can create a floating charge on its assets. A floating charge does not attach to any definite property, but covers property which is constantly changing and the company can deal with it in normal course of its business, until it becomes fixed on the happening of an event.

A charge on the stock-in-trade from time to time of a business is a floating charge. When an item is sold out of the stock-in- trade, the charge ceases to attach to it and the buyer cannot be called on to pay the debt. When a new item is added to the stock- in-trade, the charge automatically attaches to it without any supplemental mortgage being executed, but the charge will continue to attach only so long as the item remains unsold. The consent of the debentureholders is not necessary for the company to deal with its assets. Lord Gower has defined the term floating charge as: "It is a charge which floats like a cloud over the whole assets from time to time falling within a generic description." The essence of a floating charge is that the security remains dormant until it is fixed or crystallises. The terms floating security and floating charge are synonymous.

A floating charge does not necessarily cover the whole of the property of the company but may be confined to a specific portion of the assets. It is in the nature of such a charge that the company shall continue as a going concern and the debentureholder has no power to interfere till his charge has become crystallised. Neither ownership nor possession is passed to the lender under this type of charge.

There is no prescribed form by which a floating charge is created. It is created by a deed and requires registration with the Registrar of Companies under section 77.

Characteristics of a floating charge. The characteristics of a floating charge are:

1. It is a charge on a class of assets present and future.
2. That class is one which, in the ordinary course of the business of the company would be changing from time to time.
3. It is contemplated that until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way.

Example : A film company borrowed a sum of money and declared a lien, on all the assets, including machinery etc. now lying or that may be bought hereafter until repayment. This was held to be a floating charge as it covered assets present and future of fluctuating nature and imposed no restriction on the use of them. [Re : Indus Film Corporation Ltd. A.I.R. 1930 Sind 100].

Tests as to whether a charge is a floating charge :

Whether a charge is a fixed or a floating charge will depend upon the words used in the document creating the change.

The principal tests whether the charge is a floating one are :

1. Is it a charge upon all or a certain class of assets, present or future ?
2. Would the assets charged in the ordinary course of business be changing from time to time ?

3. Has the company power to carry on its business in the ordinary way so far as regards the assets charged[1] ?

If the answer to these questions is in the affirmative, the charge is a floating charge.

CRYSTALISATION OF FLOATING CHARGES

When floating charge becomes a fixed charge. A floating charge would be useless if the lender could not convert it into a fixed charge. In certain circumstances the lender can do this and this process is called 'crystallisation'.

A floating charge may crystallise or become fixed in any of the following ways :

1. When the company ceases to carry on business ; or
2. When the company goes into liquidation ; or
3. When default is made in the payment of principal money or interest and the debentureholder brings an action to enforce his security ; or
4. When a receiver is appointed.

A floating charge may also crystallise on the happening of an event specified in the charging deed.

It may, however, be noted that the mere happening of such event is not enough to crystallise the charge, but the debentureholder must, on the happening of such event, take some steps to enforce his security *e.g. by appointing a receiver when the business ceases. It is only then that the charge is said to crystallise or become a fixed charge.*

Example: A company issued debentures by which it promised to pay the principal amount at a distant day and interest on fixed days half-yearly. The debenetures created a floating charge on all the properties of the company. The company reserved the right to sell or otherwise deal with its property until the company made a default in the payment of interest for three months after the same should have become due. The company defaulted in the payment of interest for more than 3 months and the debenture holders took no steps to enforce their security. In the meantime, the company mortgaged its assets. It was held that the mortgage had priority. [Government Stock Investment Co. Ltd.V. Manila Railway Co. Ltd. (1897) A. C. 81].

PRIORITY OF CHARGES

1. A fixed charge already existing at the time when the floating charge became fixed will have priority over it. In spite of the fact that floating charge is a present security, still it leaves the company free to create a specific charge of its property having priority over the floating charge. Even if the creditor who takes subsequent specific mortgage with the knowledge of the floating charge, he will have priority.

Examples: A coal company issued two series of debentures ranking parri passu and both were secured by a floating charge over the assets of the company. Later it borrowed 4,000 from W secured by a charge on some specific assets. W was unable to obtain repayment, so he brought an action against the company for the enforcement of the fixed charge. It was held that W had a fixed charge ranking in priority to the floating charge of the debentureholders. [Wheatly v. Sikstone Co. Ltd. (1885) 29 Ch. D. 715]

1. Illingworth v. Houldsworth (1904) A.C. 355.

2. A company cannot create a fixed charge in priority to the floating charge after it has crystallised. On crystallisation it attaches specifically to all the assets which the borrower owns on the date of crystallisation and which he acquires thereafter. After that the borrower can sell or mortgage that property subject to the charge. Any transfer of the assets after the charge crystallises means that the purchaser from the company takes the assets subject to the charge.

3. A company cannot, however, create a further floating charge on the same assets to rank in priority to or *pari passu with the existing charge unless such a power is specifically reserved.*

4. A debenture creating a charge, whether floating or fixed, over any immovable property, is required to be registered both under section 77 of the Companies Act and section 17 of the Registration Act and priority among charges of same nature shall be determined from the date of registration under the Companies Act only.

EFFECT OF WINDING UP ON FLOATING CHARGE

Section 332 imposes an important condition for the validity of the floating charge. It provides that a floating charge on the assets of the company created within 12 months immediately preceding the commencement of the winding up is invalid, except in the following cases :

(a) If the company immediately after the creation of the charge was solvent; or

(b) to the extent to which any cash was paid or to be paid to the company in consideration of the floating charge, together with interest thereon at the rate of 5% p.a. The rate of interest may be varied by the Central Government by notification in the official gazette.

The object of section 332 is to prohibit companies which are in insolvent conditions from creating a floating charge on its undertaking to secure past debts or for moneys which do not come in the hands of the company.[1]

It may be noted that the effect of section 332 is to nullify the floating charge. But the debt is not affected and it becomes an unsecured debt. If the debt secured by the charge has been paid by the company before winding up commenced, the liquidator cannot recover the amount paid, except in the case of fraudulent preference.

DISTINCTION BETWEEN FIXED AND FLOATING CHARGE

The following are the points of distinction between a fixed charge and a floating charge.

1. Fixed charge is a charge created on specified assets of permanent nature such as land, building or heavy machinery. A floating charge is usually created on current assets raw material or finished goods. However, a floating charge on fixed assets is permissible.
2. In the case of a fixed charge, the company cannot deal or sell the property charged without the consent of the chargeholder.On the other hand, the company can deal with the property subject to a floating charge in any manner it likes. It has not be seek permission from the lender for selling it or converting it into some other assets.
3. A specific charge prevails over a floating charge even if created or registered later. This is, of course, subject to any contrary agreement with the charge- holder holding the floating charge.

1. Orleans Motor Co. (1911) 2 Ch. 41.

4. When a floating charge crystallises, it becomes fixed and the assets comprised therein are subject to the same restrictions as the fixed charge.
5. According to section 332 of the Companies Act, a floating charge created within 12 months preceding the commencement of winding up of the company is invalid and void. However, it is subject to the exceptions contained in the section.

REGISTRATION OF CHARGES

Charges to be registered

All charges are not required to be registered. Only nine types of charges need compulsory registration under section 77 with the Registrar of Companies.

They are:

1. A charge for securing any issue of debentures.
2. A charge on uncalled share capital of the company. Unless there is an express power given in the memorandum or the articles there cannot be a mortgage or charge of unpaid capital.
3. A charge on any immovable property wherever situated or any interest therein.

   As the expression used is immovable property wherever situate, the charge requires registration even where it is an immovable property situated in a foreign country.
4. A charge on any book debt of the company. Book debts are debts arising in the ordinary course of business and are usually entered in the trade books of the company.
5. A charge, not being a pledge, on any movable property of the company. To constitute a pledge, delivery of possession, actual or constructive to the pledgee is necessary. Pledge is not required to be registered as the possession of the goods passes to the pledgee and the company cannot charge it further even if willing to do so.
6. A floating charge on the undertaking or any property of the company including stock in trade.
7. A charge on calls made but not paid.
8. A charge on a ship or any share in a ship.
9. A charge on goodwill, on a patent or licence under patent, on a trade mark, or on a copyright, or a licence under a copy right.

PROCEDURE OF REGISTRATION OF CHARGES

(1) Particulars to be fixed with the Registrar. Where any of the charges mentioned in section 77 is to be registered, the following particulars are to be submitted to the Registrar.

(i) Date and description of the instrument creating charge;

(ii) Amount secured by the charge;

(iii) Short particulars of the property charged. If the property charged is subject to charge, date of acquisition of property;

(iv) Gist of the terms and conditions and extent and operation of the charge;

(v) Names and addresses of the persons entitled to charge;

(vi) Date and description of the instrument modifying the charge;

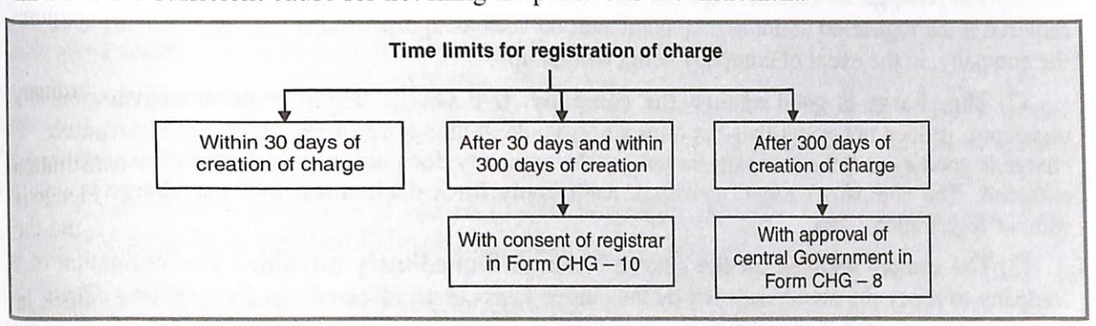
(2) Who should effect registration ?

Primarily, it is the duty of the company to send to the Registrar the required particulars, but any body interested in the charge which requires registration under section 77 is at liberty to do it and recover from the company the fees paid by him to the Registrar on registration [Sec. 78].

Where a company fails to register the charge, the person in whose favour the charge is created may apply to the Registrar for registration and the Resistar may, on such application within a period of 14 days after giving notice to the company, unless the company itself registers the charge or show sufficient cause why such charge should not be registered, allow such registration.

(3) Time of registration

The Act requires, a company to file within 30 days of the creation of a charge with the Registrar complete particulars together with instrument, if any, creating or evidencing the charge or a verified copy of the same. However, the Registrar may accept for registration the delayed filing of the particulars of charges within a period of thirty days by imposing additional fees, but not exceeding ten times the fee specified in Schedule X. The Registrar will extend such period if the company satisfies him that it had sufficient cause for not filing the particulars and instrument.



(4) Extension of time by Central Government

Section 87 provides for the remedies available to the company for the failure on its part to registrar the charge with the Registrar within prescribed time limit. The company or any insterested person may apply to the Central Government and seek extension of time for filing the particulars for registration. But before passing any order, the Central Government must be satisfied that the omission was :

(a) accidental; or

(b) due to inadvertence or some other sufficient cause; or

(c) not of a nature prejudicial to the position of the creditors or shareholders; or

(d) it is just and equitable to grant relief.

(5) Certificate of registration. On registration the Registrar shall issue a certificate of registration stating therein the amount thereby secured. Such a certificate will be conclusive evidence that the requirements as to registration have been complied with [Section 77].

(6) Provisions relating to registration of charges to apply to modification of charges. Whenever the terms or conditions of any charges are modified, it shall be the duty of the company to

send the Registrar the particulars of such modification. Provisions relating to registration of a charge will also apply to such modification of charge. [Section 79]

(7) Copy of instrument creating charge to be kept by company at registered office. The company shall keep a copy of every instrument creating any charge at the registered office of the company [Section 85].

Date of notice of charge. [Section 80]. Where a charge is registered under section 77, any person acquiring such property shall be deemed to have acquired the same with notice of the charge. Such notice is from the date of registration of the charge with the Registrar.

Acquisition of property subject to a charge. [Section 79]. Where a company acquires any property which is subject to a charge registerable under section 77, the company shall file with the Registrar particulars of such charge together with a copy of the instrument creating the charge within 30 days on which the acquisition is completed. On default, the company and every officer of the company who is in default shall be liable to fine which may extend to ₹ five thousand.

CONSEQUENCES OF THE FAILURE TO REGISTER CHARGES

The consequences of non-registration of charges will be as follows :

(1) The charge is void as against the liquidator and other creditors. Where any charge required to be registered is not registered, it will be void as against the liquidator and any creditor of the company, in the event of company being wound up.

(2) The charge is good against the company. If a charge which requires registration is not registered, it does not mean that the transaction is altogether void or the debt not recoverable. The charge is good against the company so long as the company does not go into liquidation and it may be enforced. The company cannot, therefore, itself apply for a declaration that the charge is void for want of registration.

(3) The money secured on the charge becomes immediately payable. The obligation of the company to repay the money secured by the charge is not at all affected. In fact, section 77 provides that in such a case the money becomes immediately payable and the company cannot repudiate it on the ground of non-registration.

(4) Subsequent mortgage will get priority on registration. The company may give subsequently a valid mortgage to secure the same debt. If a subsequent creditor even with notice of the first charge takes a registered charge before the first charge is registered, he obtains priority.

> **Example:** A company on June 10, mortgaged some property to A to secure ₹ 50,000. The mortgage was not registered. In December the company issued debentures to B, creating a floating charge on the same property and it was registered. B had notice of A's mortgage. It was held that B would have priority. [Re : Monolithic Company (1915) Ch. 643].

(5) No right of lien on the documents of title. When a charge is void for non-registration, no right of lien can be claimed on the documents of title, as they were only ancilliary to the charge and were delivered pursuant to the charge.

(6) Charge-holder assumes the status of an unsecured creditor. During liquidation, a creditor with an unregistered charge assumes the status of an unsecured creditor, as the charge is void against the liquidator.

(7) Penalties. As stated earlier, failure to register charges required to be registered does not invalidate the transaction in any way but exposes the officers of the company to penalty.

Omission to register particulars of charges as required is punishable with fine. The company *and* every officer of the company or other person who is in default shall be liable to a fine upto ₹ 25,000 to ₹ 1 lac or imprisonment of 6 months or both.

If the company is guilty of any default in complying with any of the requirements as to registration, the company shall be liable to a fine upto ₹ 1 lac to 10 lacs [Section 86].

REGISTER OF CHARGES

The Registrar and every company has to maintain a register of charges. The Registrar shall keep in respect of each company a register containing the particulars of all charges requiring registration. A similar register has to be maintained by the company. The various provisions of the Companies Act relating to register of charges are discussed below.

1. Register to be kept by the Registrar (Section 81)

The Registrar has to keep in respect of each company a register containing the particulars of all the charges requiring registration.

Every company shall forward to the Registrar for being entered in the register kept the particulars of all the charges requiring registration in such form and manner, and after payment of such fees as may be prescribed.

The particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges for the purpose of section 81 of the Act.

The register kept in pursuance of section 81 shall be open to inspection by any person on payment of such fee as may be prescribed for each inspection.

2. Company's register of charges (Section 85)

Every company shall keep at its registered office a register of charges and enter therein all charges specifically affecting property of the company and floating charges on the undertaking or any other property of the company.

Section 143(1) of the 1956 Act mentioned the particulars to be entered in the register of charges to be maintained by the company. Section 85 of the 2013 Act does not mention the particulars to be entered. Rule 10 of the Companies (Registration of Charges) Rules, 2014 provides that every company shall keep at its resgistered office a register of charges in **From No. CHG. 7** and enter there in particulars of all the charges registered with the registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any entry in the register of charges, he is liable to a fine upto ₹ 25,000 to 1 Lakh rupees.

3. Index to register of charges

The Registrar shall keep a chronological index in the prescribed form and with the prescribed particulars of the charges registered with him under the Act.

SHORT ANSWER QUESTIONS

1. What is a debenture ?
2. What are perpetual debentures ?
3. Can a company issue irredeemable debentures ?
4. Distinguish between shares and debentures.
5. Can debentures with voting rights be issued by a company ?
6. Can debentures be issued by a company at a discount exceeding 10% of the face value ?
7. Distinguish between debenture and debenture stock.
8. Can a company redeem its own debentures during its life time ?
9. What is the effect of *pari passu clause in the repayment of debentures ?*
10. What is meant by 'Trust Deed' ?
11. Is a company bound under the Companies Act to maintain a 'Register of Debentures'?
12. Can a public limited company pay 15 per cent per annum rate of interest on its debentures?
13. Can a company pay premium at the time of redemption of debentures ?
14. Can unsecured debenture be issued to the public ?
15. What is mean by debenture holder's action ?
16. Distinguish between fixed and floating charge.
17. In what events a floating charge is crystallised ?
18. Can a floating charge become fixed charge ?
19. A fixed charge was created one month subsequent to a floating charge. Which shall have priority ?
20. Why is registration of certain charges compulsory ?
21. Which charges are required to be registered ?
22. Must a charge on book debt be registered ?
23. Can a company charge any part of its reserve capital ?
24. Can a company charge its uncalled capital ?
25. What is the effect of a failure to register a registrable charge ?
26. Under what circumstances certain charges be void against the liquidator or the creditors of a company?
27. By whom are the charges to be registered ?
28. What is the time during which a registrable charge should be registered ?
29. Can Registrar of companies extend the time for the registration of a charge after 30 days of its creation ?

TEST QUESTIONS

1. Define debenture. Discuss the different kinds of debentures.
2. Discuss the remedies available to debenture holders for the realisation of their security. What is the effect of *parri passu* cause in the repayment of debentures.
3. What is meant by a 'Trust Deed' ? What are the advantages of a Trust Deed ?
4. What are the different types of debentures ? How they may be secured ? Can debentures be issued at a discount ? Can debentures which have redeemed be re-issued and what is the effect of such re-issue ?
5. What particulars must a company enter into the register of debenture- holders?

6. Distinguish between a shareholder and a debentureholder and state their rights at the time of the winding up of the companies.
7. Distinguish a floating charge from a specfic charge. In what events does it crystallise ? What is the position of the holders of debentures of a company secured by a floating charge when a receiver is appointed on their behalf *vis-a-vis payment of debts of a company such as rent, rates, taxes and wages ?*
8. Explain and discuss the nature of floating charge as security. What is the effect of a floating charge on :
   (i) mortgage affected subsequently ; (ii) winding up.
9. What is a floating charge ? How does it differ from a fixed charge ? Discuss the characteristics and effects of a floating charge. What are the consequences if a floating charge created by a company on its undertaking is not registered with the Registrar of companies ?
10. What is a charge ? In what way does a fixed charge differ from the floating charge ? Can a floating charge become fixed charge ? If so, under what circumstances?
11. What is a charge ? Enumerate the statutory provisions for their registration. State the circumstances under which certain charges may be void against the liquidator or the creditors of a company.
12. What information must be entered in the register of charges maintained by the company ? What is the effect of a failure to register a registrable charge ?

PRACTICAL PROBLEMS

Q. 1. "A company charged all its machinery, stock in trade and movable goods present and future. It was also provided that the properties shall be in the lender's possession which was actually given to him." Discuss the nature of the charge.

Ans. Since the possession of the properties has been given to the lender, the element of possession made it something wholly inconsistent with the concept of floating charge. Hence, it is a fixed charge.

Q. 2. The debentures issued by the company created a floating charge on the company's property, with the condition that the company was not to create any prior charge. The manager of the company having forgotten this commitment deposited the title deeds of the company's property with the bank by way of security for a loan obtained. The bank also happened to hold some of the company's debentures on deposit for one of its customers. How would you decide the issue of priority of charges between the debentureholders and the bank ? if the bank has a notice of the prohibition ?

Ans. The company has been prohibited from creating certain subsequent specific mortgage and in such a case the Bank who takes a subsequent specific mortgage with notice of the prohibition shall have no priority over the floating change.

Q. 3. A company in June 2010 mortgaged some property to A to secure ₹ 5,000. The mortgage was not registered. In December 2010 the company issued debentures to B creating a floating charge on the same property and it was registered. B had notice of A's mortgage. Has B priority over the claims of A ?

Ans. The company may give a subsequently valid mortgage to secure the same debt. If a subsequent creditor even with notice of the first charge takes a registered charge before the first charge is registered, he obtains priority. Hence B, has priority over the claim of A.

Q. 4. On Jan 10, 2012 a company in consideration of a past debt of ₹1,00,000 and a future advance of ₹ 1,50,000, issued debentures to a creditor accompanied by a floating charge over its assets. On June 25, 2012 an order for winding up is passed. State the right of the creditors in winding up.

Ans. If the company immediately after the creation of the charge was solvent, the charge will be valid in full. Otherwise, the charge is void as to the past debt of ₹ 1,00,000 and is valid as to the fresh advance of ₹ 1,50,000 plus interest thereon at the rate 5% (*Section 332)*

Q. 5. A public company obtained a loan by mortgage of its plot of land just 35 days back. No one concerned with the transaction remembered that the mortgage required registration with the Registrar of Companies within 30 days of its creation. What should be done to rectify the omission to register the mortgage ?

Ans. Section 77 requires a Company to file within 30 days of the creation of the charge with the Registrar complete particulars together with instrument, if any, creating or evidencing the charge. Since the 30 days have already expired, the Registrar may accept for registration the delayed filing of the particulars of charges by imposing additional fee and the company satisfies him that it had sufficient cause for not filing the particulars.

Q. 6. X Ltd. delivered title deeds of immovable property worth ₹ 25 lakhs as security for the loan of ₹ 20 lakhs obtained from Hind Bank Ltd. for its new project. As no charge was registered with the Registrar of companies for this, the bank demanded back the money immediately. Is the bank justified ? Explain.

Ans. Under section 77, Where the charge is not registered within the stipulated period, the money secured on the charge becomes immediately payable. Section 77 provides that in such a case the money becomes immediately payable. Hence the Bank is justified.

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11

TRANSFER AND TRANSMISSION OF SHARES

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
Transfer and transmission of securities	Section 56(1) of the 2013 Act provides for transfer by company of such interest by execution of instrument of transfer and delivery of the same to company within 60 days from the date of execution for getting the transfer of interest, registered in transferee's favour. [See rule 11 of the Companies (Share Capital and Debentures) Rules, 2014]	No procedure or mechanism for transfer of interest of a member in a company having no share capital. Such interest is nevertheless transferable under the Transfer of Property Act, 1882 (general law of transfer of property).
Personation of shareholder	Section 57 of the 2013 Act provides punishment for personation of any securityholder and not limited to personation of shareholder.	Section 116 of the 1956 Act provides for punishment for personation of shareholder.
Contract for transfer of securities	Any contract or arrangement between 2 or more persons in respect of transfer of securities shall be enforceable as a contract.	No provisions in this regard in the 1956 Act.
Power to direct rectification	The 2013 Act has transferred these powers from CLB to the Tribunal.	To power to rectification was conferred on the CLB by the 1956 Act.

RIGHT OF SHAREHOLDER TO TRANSFER SHARES

Transferability of shares is a great beneficial feature of Company form of organisation. A transfer is a change of ownership by voluntary act of parties. The investor in shares of a company cannot withdraw his money from a company. He can only convert his investment into cash outside the company in the share market or by private sales. The company gets permanent capital, the shareholder liquid investment. That is why from the very inception of companies, free transferability of shares has been considered to be of primary importance. Section 44 declares that the shares of a

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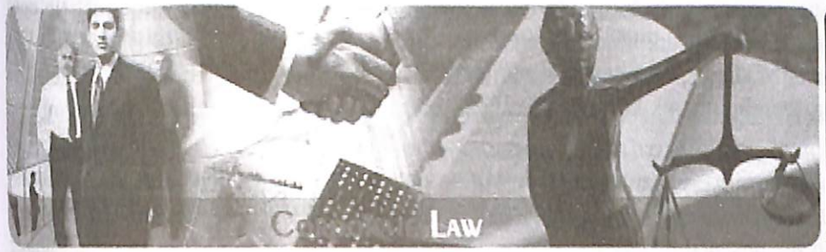

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Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
Transfer and transmission of securities	Section 56(1) of the 2013 Act provides for transfer by company of such interest by execution of instrument of transfer and delivery of the same to company within 60 days from the date of execution for getting the transfer of interest, registered in transferee's favour. [See rule 11 of the Companies (Share Capital and Debentures) Rules, 2014]	No procedure or mechanism for transfer of interest of a member in a company having no share capital. Such interest is nevertheless transferable under the Transfer of Property Act, 1882 (general law of transfer of property).
Personation of shareholder	Section 57 of the 2013 Act provides punishment for personation of any securityholder and not limited to personation of shareholder.	Section 116 of the 1956 Act provides for punishment for personation of shareholder.
Contract for transfer of securities	Any contract or arrangement between 2 or more persons in respect of transfer of securities shall be enforceable as a contract.	No provisions in this regard in the 1956 Act.
Power to direct rectification	The 2013 Act has transferred these powers from CLB to the Tribunal.	To power to rectification was conferred on the CLB by the 1956 Act.

RIGHT OF SHAREHOLDER TO TRANSFER SHARES

Transferability of shares is a great beneficial feature of Company form of organisation. A transfer is a change of ownership by voluntary act of parties. The investor in shares of a company cannot withdraw his money from a company. He can only convert his investment into cash outside the company in the share market or by private sales. The company gets permanent capital, the shareholder liquid investment. That is why from the very inception of companies, free transferability of shares has been considered to be of primary importance. Section 44 declares that the shares of a

Q. 5. A public company obtained a loan by mortgage of its plot of land just 35 days back. No one concerned with the transaction remembered that the mortgage required registration with the Registrar of Companies within 30 days of its creation. What should be done to rectify the omission to register the mortgage ?

Ans. Section 77 requires a Company to file within 30 days of the creation of the charge with the Registrar complete particulars together with instrument, if any, creating or evidencing the charge. Since the 30 days have already expired, the Registrar may accept for registration the delayed filing of the particulars of charges by imposing additional fee and the company satisfies him that it had sufficient cause for not filing the particulars.

Q. 6. X Ltd. delivered title deeds of immovable property worth ₹ 25 lakhs as security for the loan of ₹ 20 lakhs obtained from Hind Bank Ltd. for its new project. As no charge was registered with the Registrar of companies for this, the bank demanded back the money immediately. Is the bank justified ? Explain.

Ans. Under section 77, Where the charge is not registered within the stipulated period, the money secured on the charge becomes immediately payable. Section 77 provides that in such a case the money becomes immediately payable. Hence the Bank is justified.

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11

TRANSFER AND TRANSMISSION OF SHARES

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
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company shall be movable property, transferable in the manner prescribed by the Companies Act and the Articles of Association. It appears that the articles of the company may impose certain restrictions upon the transfer of shares, but Articles cannot absolutely take away the right of members to transfer shares making thereby shares non-transferable. Such restrictions shall be *ultra vires the Companies Act.*

The articles of a public company may and those of a private company must restrict right to transfer of shares but Articles cannot indiscriminately or into to prohibit the right of the transfer as it is given by the statute. In the absence of any restriction in the articles of association the shareholder can transfer his shares to any person even to a pauper or even if the transfer is made to escape liability provided that the transfer is real and bonafide.

Restrictions on Transfer of Shares

While free transferability of shares is assured, permission is also given to companies to place reasonable restrictions on transferability. This became necessary to enable companies to safeguard their friendly or family identity in case of private companies and in the case of public companies to protect themselves from unscrupulous persons attempting to take over control through market operations.

The Depositories Act, 1996 has made far reaching changes. Section 22A of the Securities Contracts (Regulation) Act, 1956 has been omitted and Sections 58 and 58 have been inserted in the Companies Act, 2013 in the matter of transfer of shares of public listed companies. The effect of the new provisions is to ensure that the shares in a public company are freely transferable.

Section 58 and 59 in the Companies Act and Section 7 of the Depositories Act provide for free transfer of securities in any company (other than a private company). For instance, once the agreed consideration is paid and the purchase transaction is settled, the transfer of a security is effected forthwith and the transferee enjoys all the rights and obligations associated with the security. If the securities are in the depository mode, depository would effect the transfer on the basis of information from the participants. If the securities are in physical form the company would effect the transfer on receipt of the transfer deed.

As regards restrictions on the transfer of shares, a distinction is made between the shares of a private company and a public company.

1. Private Companies

In case of private companies, the restrictions on transfer of shares are generally contained in the 'articles of association' of a company which empowers the directors to restrict the right of members to transfer the shares. The directors may put such restrictions as they consider necessary in the interest of the company. It is usual to empower directors to refuse to register the transfer of shares to any person to whom they consider undesirable. As a matter of fact, the Companies Act itself requires a private company to impose some restrictions on the right to transfer the shares. Legally, the private companies are separate legal entitles just like public companies, but from the business and personal point of view they are comparable to partnerships than to public companies. To maintain their control over the members, the directors usually impose certain restrictions by articles on the transferability of shares *e.g., the articles may provide that on the insolvency of a member his shares would be transferred at a fair value to a nominee of the directors.*

Generally, Articles of a private company provide that any member intending to transfer his shares

should offer the shares first to members of the company. If there is any dispute about pricing of shares, the dispute will be settled by an independent authority. Shares can be transferred to non-member only if any member is not willing to buy the shares. This is termed as 'preemption' clause.

If a private company refuses to register the transfer or transmission, it shall, within 30 days from date of lodgement of transfer deed or intimation about transmission, send notice of refusal to the transferee and the transferor or the person giving intimation about transmission. The Company will have to give reasons for refusal to transfer, if it decides to refuse the transfer. [Sec. 58(1)]

2. Public Companies

In case of public companies, the restrictions on transfer of shares cannot be imposed. In view of Section 58, a public company cannot impose *any restrictions upon members' right to transfer their shares. This section clearly declares that the shares or debentures or any interest of any member in a public company shall be freely transferable.[Sec. 58(2)]*

The rationale for the introduction of the said provision is to act as a check on the arbitrary exercise of power by a public company and to protect the interests of the minority shareholders. Section 58 is meant to ensure that the directors of the company do not refuse a legally permissible transfer.

Section 58(2) of the Companies Act, 2013 provides that any contract or arrangement between two or more persons in respect of securities shall be enforceable as a contract.

However, public companies may impose some restrictions on the right of members to transfer shares. *Regulation 20 (Table F)* provides that the Board of directors may refuse to register the transfer of partly paid shares to person whom they do not approve. *Further*, the Board of directors may refuse to register the transfer of any share on which the company has a lien.

Restrictions on Transfer of Shares under the Companies Act

Section 222(1) of the Companies Act, 2013 empowers the Tribunal to impose restrictions on the transfer of any share for a period not exceeding three years. Such an order may be made by the Tribunal in the following circumstances :

(a) on a reference made by the Central Government in connection with investigation of (i) the ownership of any company under Section 216.

(b) on a complaint by any person made in this behalf and there is necessity to find out the relevant facts by imposing restrictions on transfer of shares.

Where the Tribunal has reason to believe that transfer of shares in a company is likely to affect the composition of the Board of Directors in such a way that would be prejudicial to the public interest, it may order that transfer of shares in the company during a period not exceeding three years shall be void.

The following are the grounds on which Board may refuse registration of transfer in case of physical shares :

(a) If partly paid up shares are being transferred and the transferee is known to be financially incapable of paying balance calls.

(b) Where partly paid up shares are being transferred to a minor incapable of entering into a contract.

(c) When the transferor is a debtor of the company and the company has a lien on such shares.

(d) When the transferor has not paid the due call money.

(e) Where the instrument of transfer is incomplete, irregular and defective and not properly stamped.

(f) On any other ground which is just and equitable and is in the general interest of the company.

The power of the directors to refuse to register transfer in case of physical shares is subject to the following restrictions :

(i) Even if the articles confer absolute discretion on the directors to refuse to register transfer, it must be exercised in the interest of the company. Such a power must be exercised in good faith *i.e. legitimately for the purpose for which it is conferred. If the directors do not act bonafide and in the interest of the company, the Tribunal* may set aside the decision of the directors refusing a transfer of shares.

(ii) The refusal to register transfer of shares must be conveyed in writing to the transferor and the transferee within two months of the date on which the instrument of transfer was lodged with the company.

(iii) The power to disapprove of a transfer of shares is vested in the Board of directors and not in any individual director. Thus, a mere failure to apporve a transfer caused by a deadlock on the Board, is not a formal exercise of right to refuse and the transferee is entitled to be registered as a member of the company.

Example : An application for transfer of shares was deposited with a company. A sub-committee of the Board of directors refused to register the transfer. On an appeal to the Company Law Board (now the Tribunal) it was held that the decision was not valid as the refusal was made by a sub-committee and not by the Board of directors. **[T.N. Kuriakos v. Premier Tyres Ltd. decided on 13.6.1983 (CLB)]**

(iv) The directors cannot refuse to register a transfer of shares effected by a court sale, even if the Articles of Association empowers them to do so.

TRANSFER OF SHARES UNDER DEPOSITORY SYSTEM

Shares are traditionally held in physical or paper form. This method has its own inherent weaknesses like loss/theft of certificates, forged/fake certificates, cumbersome and time consuming procedure for transfer of shares etc. Therefore, to eliminate these weaknesses, the Depositories Act, 1996, provides for an alternate mode of effecting transfer of shares. Investors will, however, have the choice of continuing with the existing share certificates and adopt the existing mode of effecting their transfer.

A depository is a system which holds your shares in the form of electronic accounts in the same way a bank holds your money in a savings account.

Depository System provides the following advantages to an investor.

1. The shares cannot be lost or stolen or multilated.
2. You never need to doubt the genuineness of your shares *i.e.,* whether they are forged or fake.
3. Share transactions like transfer, transmission etc. can be effected immediately.
4. Transaction costs are usually lower than that in the physical segment.

5. There is no risk of bad delivery.
6. Bonus/Rights shares allotted to you will be immediately credited to your account.
7. You will receive the statement of account of your transactions/holdings periodically.

The Depositories Act provides for the establishment of one or more depositories. Every depository will be required to be registered with the SEBI and receive a certificate of commencement of business on fulfilment of such conditions as may be prescribed. When you decide to have your shares in electronic form, you should approach a Depository Participant (DP) who is an agent of the depository and open an account. You should surrender your share certificates in physical form and your DP will arrange to get them sent to and verified by the company and on confirmation credit your account with an equivalent number of shares . This process is known as dematerialisation. The investors names in register of companies concerned will be replaced by the name of the depository as the registered owner of the securities. The investors will, however, continue to enjoy the economic benefit from the shares as well as voting rights on the shares concerned.

Share in the depository mode shall cease to have distinctive numbers. An investor, who opts for a depository mode may at any time, opt to choose out of it and claim share certificate from the company by substituting his name as the registered owner in the place of the depository. This process is known as rematerialisation.

It may be noted that the provisions of Section 56 are inapplicable to transfer where transferee and transferor are entered as beneficial owners in records of depository.

REMEDIES AGAINST REFUSAL TO TRANSFER

On company's refusal to register the transfer of shares, the remedies have been given to the aggrieved person under Sections 58 and 59 of the Companies Act, 2013. Section 58 is applicable to private and public Companies both.

The remedies against refusal to register the transfer of shares may be discussed under the following two heads :

1. Remedies in case of private companies.
2. Remedies in case of public companies.

REMEDIES IN CASE OF PRIVATE COMPANIES

On company's refusal to register the transfer of shares, the aggrieved person has the following remedies :

1. Right of appeal to the National Company Law Tribunal (Sec. 58). If a private company refuses to register a transfer of shares, then it is required to send notice of refusal to the transferee and the transferor. The company is also required to give reasons for such refusal.

On company's refusal to register the transfer of shares, the transferor or the transferee may prefer an appeal to the Tribunal against the refusal.

The appeal should be in writing and should be filed within the time as stated below.

(a) where the company gives a notice of refusal, the appeal should be filed within 30 days of the receipt of such notice, and

(b) where the company does not give any notice of refusal, the appeal should be filed within 60 days from the date on which the instrument of transfer was delivered to the company

On filing an appeal with the Tribunal, the Tribunal must give an opportunity to the company and the aggrieved party, to make their representations before issuing any order.

The Tribunal, while dealing with an appeal made under Section 58(3) or 58(4) may, after hearing the parties, either dismiss the appeal, or by order –

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order ; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

If a person contravenes the order of the Tribunal under this section, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

2. Right to apply to the Tribunal for rectification of the register of members (Sec. 59). The transferee also has a right to go to the Tribunal for the rectification of the register of members. Under the Section 58(5), the Tribunal may direct rectification of the register and also direct the company to pay damages, sustained by any aggrieved party :

REMEDIES IN CASE OF PUBLIC COMPANIES

The directors of a public company have no discretionary powers to refuse to register the transfer of shares. A public company is bound to accept a transfer for which all the appropriate papers have been filed.

If a public company refuses to register the transfer of shares, the transferee has the following remedies.

1. Right of appeal to the National Company Law Tribunal. If a public company without sufficient cause refuses to register the transfer of shares within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, is delivered to the company, the transferee may, within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal. [Section 58(4)].

The Tribunal, while dealing with the appeal , may, after hearing the parties either dismiss the appeal or by order direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of order. [Section 58(5) (a)].

2. Right to apply to the Tribunal for rectification of register of members. The Tribunal has also been given the power to order rectification of the register of members by the company. The Tribunal may by order direct rectification of the register and also direct the company to pay damages, if any, sustained by the party aggrieved. [Section 58(5)(b)].

Where any person contravenes the order of the Tribunal under section 58, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

PROCEDURE FOR TRANSFER OF SHARES

A transfer is incomplete until registered and the transfer or remains legal owner of the shares.

Section 56 of the Companies Act lay down the under mentioned procedure to be followed for the transfer of shares :

1. Transfer ordinarily by a member. Ordinarily shares can be transferred by a person who is the holder thereof and whose name appears in the register of members. However, a legal representative of a deceased member, although he may not be a member, is also entitled to transfer shares. Oral transfers are not recognised by the Act. Moreover, transfers made during winding up are void unless sanctioned by the liquidator in case of voluntary winding up or by the court in other types of winding up.

2. Transfer must be in the prescribed form. A company shall not register a transfer of shares unless a proper instrument of transfer duly stamped and executed and signed by both the transferor and the transferee is delivered to the company within a period of 60 days from the date of execution [Sec. 56(1)] It must also contain particulars regarding the name, address and occupation of the transferee. The relative share certificate must be attached to it and if no such certificate has yet been issued, the letter of allotment must be attached to the transfer form.

Where the instrument of transfer signed by the transferor and the transferee has been lost the Board may register a transfer on the application by the transferee and on his executing a bond of indemnity.

It may be noted that Section 56 excuses the production of the instrument of transfer in case it is lost but there is no excuse for the non-production of the certificate or allotment letter. That is to say, there can be no registration of a transfer without production of the certificate or allotment letter. The instrument of transfer is required to be in a prescribed form (Form No. 7B). Articles of Association cannot prescribe any other form for transfer of shares. Before such prescribed form is signed by or on behalf of the transferor and before any entry is made, the form should be submitted to the prescribed authority [*viz. the Registrar). The Registrar, as the prescribed authority, will then stamp or otherwise endorse on the instrument the date on which it is so presented.*

A company cannot register a transfer of shares, unless share certificate is attached to the application for transfer and if registered, the registration will be void. Thus an article which provided for the automatic transfer of shares to a director's widow on his death has been held invalid.[1]

The transfer instrument complete in all respects together with the share certificate must be presented to the company for registration within a period of sixty days from the date of execution. However, proviso to Section 56(1) of the Companies Act, 2013 provides that if the transfer instrument has been lost, the company may register the transfer on such terms of indemnity as the Board of directors may deem fit. In the absence of share-certificate, the letter of allotment should be sent to the company along with the transfer instrument. Thus, 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.

3. Application for transfer. An application for registration of transfer may be made either by the transferor or transferee.

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1. Re Greene (1949) 1 All E.R. 167.

(b) where the company does not give any notice of refusal, the appeal should be filed within 60 days from the date on which the instrument of transfer was delivered to the company

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2. Transfer must be in the prescribed form. A company shall not register a transfer of shares unless a proper instrument of transfer duly stamped and executed and signed by both the transferor and the transferee is delivered to the company within a period of 60 days from the date of execution [Sec. 56(1)] It must also contain particulars regarding the name, address and occupation of the transferee. The relative share certificate must be attached to it and if no such certificate has yet been issued, the letter of allotment must be attached to the transfer form.

Where the instrument of transfer signed by the transferor and the transferee has been lost the Board may register a transfer on the application by the transferee and on his executing a bond of indemnity.

It may be noted that Section 56 excuses the production of the instrument of transfer in case it is lost but there is no excuse for the non-production of the certificate or allotment letter. That is to say, there can be no registration of a transfer without production of the certificate or allotment letter. The instrument of transfer is required to be in a prescribed form (Form No. 7B). Articles of Association cannot prescribe any other form for transfer of shares. Before such prescribed form is signed by or on behalf of the transferor and before any entry is made, the form should be submitted to the prescribed authority [*viz. the Registrar). The Registrar, as the prescribed authority, will then stamp or otherwise endorse on the instrument the date on which it is so presented.*

A company cannot register a transfer of shares, unless share certificate is attached to the application for transfer and if registered, the registration will be void. Thus an article which provided for the automatic transfer of shares to a director's widow on his death has been held invalid.[1]

The transfer instrument complete in all respects together with the share certificate must be presented to the company for registration within a period of sixty days from the date of execution. However, proviso to Section 56(1) of the Companies Act, 2013 provides that if the transfer instrument has been lost, the company may register the transfer on such terms of indemnity as the Board of directors may deem fit. In the absence of share-certificate, the letter of allotment should be sent to the company along with the transfer instrument. Thus, 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.

3. Application for transfer. An application for registration of transfer may be made either by the transferor or transferee.

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1. Re Greene (1949) 1 All E.R. 167.

Notice to the transferee. When the shares proposed to be transferred are partly paid and application has been received from the transferor, the transfer shall not be registered unless the company gives notice of the application to the transferee and the latter raises no objection to the transfer within 2 weeks of the receipt of such notice. However, no such notice need to be served on the transferee when the application for transfer has itself been received from him and thereby, his no objection can be presumed.

Notice to the transferee shall be deemed to have been duly given if it is despatched by pre-paid registered post to the transferee at the address given in the instrument of transfer, and shall be deemed to have been duly delivered at the time at which it would have been delivered in the ordinary course of post.

Notice to the transferor. The Act does not require notice to be served on the transferor if the application for transfer is received from any person other than the transferor, whether the shares are fully paid or partly paid. But as a measure of caution, it is desirable that notice should be sent to the transferor, informing him about the lodgement of the instrument of transfer stating that if no objection is raised within the specified time, the company will proceed to register the transfer. This notice is served to ensure that the instrument of transfer is genuine and not a forged one.

4. Receipt of transfer instrument by the company. On receipt of the transfer instrument in the prescribed form alongwith the share certificate or allotment letter, the company shall take the following steps for effecting the transfer of shares :

(i) The company shall give an acknowledgement for the same.

(ii) The instrument is to be checked thoroughly in order to find out whether the same is in order.

(iii) Where the instrument of transfer is received from the transferee and shares are partly paid, the company has to send a notice to the transferee to make balance of payment on the shares.

(iv) It is also desirable to send notice to the transferor, by way of caution.

(v) Before effecting any transfer, the company should ensure that the instrument is lodged within a period of sixty days from the date of execution and prescribed by Section 56(1) of the Companies Act.

(vi) Where the shares are intended to be transferred to a company, it should be ascertained as to whether :

(a) the Memorandum and Articles of Association empower the transferee company to make the investment;

(b) the Board of directors of the intended transferee has passed the necessary resolution and has empowered the person concerned to deal with the matter in this behalf;

(c) the person executing the deed on behalf of the body corporate has valid authority to do so ;

(vii) After making thorough scrutiny, the officer in charge will put his initials on the form and the particulars of the instrument will be entered in the Shares Transfer Register.

(viii) At periodic intervals the register along with necessary transfer documents and enclosures will be put up to the Board or the Share Transfer Committee.

(ix) Where transfers are duly approved, endorsements will be made on the share certificates in favour of the transferees and will be certified by the secretary or an officer authorised by the Board in this behalf.

(x) Necessary entries shall be made in the Register of Members in regard to the transferor and the transferee.

5. Delivery of share Certificate. The company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates within a period of one month from the date of receipt by the company of the instrument of transfer.

6. Issue of new share certificate. Where the company has approved transfer of shares, it must keep ready for delivery a new share certificate within two months after the application for the registration of the transfer and deliver the same to the transferee.

7. Transfer when complete. Transfer becomes complete and the transferee becomes a shareholder only when the transfer is registered in the company's register.

RELATIONSHIP BETWEEN TRANSFEROR AND TRANSFEREE UNTIL REGISTRATION

Until the transferee's name has been entered on the register of members, the position is as follows :

1. On completion of earlier mentioned formalities, the transfer of shares should ordinarily be deemed to have been effected as nothing more remains to be done on the part of the transferor and the documents delivered to the transferee carry with them the right and title to be registered as the owner of the shares.
2. Until the registration takes place the transferor is the trustee of shares for the transferee and he continues to be the legal owner of the shares. A relation of trustee (transferor) and beneficiary (transferee) is thereby established between them.
3. The transferor must comply with the reasonable directions that may be given by the transferee with reference to the rights attached to the shares. A transferee may direct the transferor to vote as per his instructions. But an unpaid vendor of shares is not bound to vote according to the wishes of the purchaser.
4. The transferee is liable to indemnify the transferor against future calls paid by him in respect of the shares, from the date of the transfer.
5. The transferor must also pay over to the purchaser any dividend or other rights which he may receive from the company as the holder of those shares.

Certification of transfer. Where a person purchases a number of shares, only one certificate of shares is issued in respect of the whole lot of shares so that when he desires to transfer a part of his shares, he is required to produce before the company his certificate of shares alongwith the instrument of transfer for the purpose of certification. The company then endorses on the instrument of the transfer the fact of the certificate having been lodged with the company. The company will cancel the old certificate and prepare two new share certificates to be delivered to the transfereror and the transferee. This is known as the certification of transfer.

The certification of shares amounts to a representation by the company that the document which evidences the title to the transferor has been produced to the company. It gives neither warranty of the transferor's title nor any guarantee on the part of the company.

Example : A shareholder transferred his shares to two persons and lodged a certificate with the company. The company certified the transfer but returned the original certificate to the transferor instead of destroying it. The transferor afterwards borrowed money on it. It was held that the company was not liable to the lender as the share certificate is neither a negotiable instrument nor a warranty of title on the part of the company issuing it. [Bishop v. Balkis Consolidation Company, (1890), 85 QBP 512 (C.A.)]

Splitting of Joint Holding of Shares

If the joint shareholders want splitting of the share and registering them in their individual names, they must follow the procedure prescribed for transfer of shares. The instrument of transfer should be stamped with the prescribed stamp duty in respect of shares and will have to be executed by all the joint holders as transferors and by the individual in whose name the shares are to be registered as the transferee.

Transposition of Names in Respect of Joint Holding of Shares

In case of joint share holdings, one or more of them may require the company to alter the serial order of their names in the register of members. There is no need of execution of transfer for transposition of names provided such request is made in writing by all shareholders jointly to the company.

Transfer of Shares during Winding Up

Any transfer made during winding up of the company is void unless it is made with the sanction of the Tribunal in compulsory winding up (*i.e.,* winding up by the order of the court) or under the supervision of the court and with the sanction of the liquidator in case of voluntary winding up (Section 334). If at the commencement of the winding up, the transfer was incomplete by reason of want of registration only, the Tribunal has to order the registration. But where an agreement for the sale of shares in a company was made in ignorance that a petition for winding up had been presented, the Tribunal may not allow the transfer. Like the Tribunal in compulsory winding up, a voluntary liquidator has a right to register the transfer in case it is incomplete for want of registration only at the time of commencement of winding up.

Forged Transfer

Where the signature of the transferor on any instrument of transfer is forged, transfer made on the basis of such an instrument will be a forged transfer. A forged transfer is a nullity and cannot affect the title of the shareholder whose signature is forged. A person receiving shares under a forged instrument of transfer gets no rights. He is bound to return the shares to the person to whom they rightfully belong. If a company transfers shares under a forged instrument of transfer, the true owner can compel the company to restore his name and to pay him any dividends he has missed with interest. If however through his own negligence or conduct the transferor had so acted as to induce the company to believe that transfer was genuine, that would create an estoppel disentitling him to succeed.

If the company has issued a share certificate under a forged transfer and he has sold the shares to an innocent purchaser, the company is liable to compensate such a purchaser if it refuses to register him as a shareholder.

If any company has been put to loss by reason of forged transfer, it can claim an indemnity from the person presenting the transfer for registration even though he is quite innocent of the forgery.

Example : T and H were joint owners of some shares of the company. T forged H's signatures and transferred the shares to a bank. The bank sent the transfer to the company for registration, and the company registered the name of the bank as the shareholder. Later the bank transfered the shares to a third party. The forgery was discovered and H obtained a judgement against the company compelling them to buy equivalent shares and register it in its name and to pay him the missing dividends with interest. The company sued the bank for an indemnity. It was held that the bank was bound to indemnify the company against the liability to H, upon an implied contract that the transfer was genuine.

[Sheffield Corporation v. Barcley. (1905) A.C. 392]

To protect themselves against the consequences of forged transfers, the companies usually inform the transferor that a transfer has been received for registration so as to give him a chance to prevent a fraudulent transfer. But the transferor is not prejudiced by the fact that he has received notice and may prove that the transfer is a forgery.

Consequences of forged transfer

1. A forged transfer is a nullity an, as such, the original owner of the shares remains the share holder and he will be entitled to receive dividends, etc.
2. If the company has issued a share certificate and he has sold the shares to an innocent purchaser, the company cannot deny his title.
3. If the company has been put to loss on account of the forged transfer, it may recover the loss from the person who procured registration.

Blank Transfer

A transfer signed by the transferor, but with a blank for the name of the transferee is called a blank transfer. In a blank transfer neither the transferee's name and signature not the date of sale are filled in the transfer form. The transferee is at liberty to sell it again without filing his name and signature to a subsequent buyer. The process of purchase and sale can be repeated any number of time with the blank deed and ultimately when it reaches the hands of one who wants to retain the shares, he can fill in his name and date and get it registered in the company's books. Until a transferee is so registered as a shareholder the transferor will continue to be the shareholder of the company, and he remains liable for the unpaid amount if any.[1]

The advantage of blank transfer is that it saves the trouble of complying with the formalities of transfer every time the right to the shares is passed from hand to hand and it also saves the payment of stamp duty on each successive transfer.

A transfer in blank, when accompanied by the share certificate, carries to the transferee both the legal and equitable right to the shares and also the right to call upon the company to register the transfer.[2]

The facility of blank transfers has been used for illegal purposes. Sometimes it is used to avoid taxes. Besides the identity of the real owner may be concealed.

If provides that every instrument of transfer shall be in prescribed form bearing the date of issue stamped by the prescribed authority and the said instrument shall be delivered to the company for registration—

(a) in the case of shares dealt in or quoted on a recognised stock exchange any time before the register of members is closed for the first time after the stamped date or within twelve months from the date put on the form by the prescribed authority, whichever is later; and

(b) in any other case, within two months from the date of such presentation to the prescribed authority.

TRANSMISSION OF SHARES

A company cannot register a transfer without a duly executed instrument of transfer. However,

1. Re the Indian Special Bank Ltd. (1915) 17 Bom. L.R. 342.
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there is one exception. A company may register as shareholder any person to whom the right to any shares in the company has been transmitted by operation of law. Transmission of shares occurs on the death or bankruptcy of a member, or if the member is a company, on its going to liquidation U/s 56(2). Since transmission is by operation of law, transfer deed is not essential for transmission. No stamp duty is payable on transmission.

In the event of death or insolvency of the shareholder, his shares devolve upon his legal representatives *i.e.* executors when the shareholder dies leaving a will, or administrator when he dies intestate, that is, without making a will. The legal representatives of the deceased shareholder can sell the shares without being registered subject to the provisions of the articles. For this purpose, the company is bound to accept the evidence of succession certificate and enter his name in the registered members. The company cannot insist on the production of probate or letters of administration.

In case of insolvency of the shareholder, his shares vest in the Official Assignee or Receiver, who may get himself registered as the holder of these shares or sell them. He can also disclaim partly paid shares or fully paid shares which are subject to mortgage or pledge.

Section 56(2) of the Companies Act, 2013 empowers 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.

Section 56(4) requires that every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities transmitted within.

A period of one month from the date of receipt by the company of the intimation of transmission under sub-section(2), in the case of a transmission of securities.

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. [Section 56(5)].

Section 101 of the Companies Act, 2013 provides that the level representatives are entitled to receive notices of general meetings of the company even though they are not registered as members but they shall not be entitled to exercise any rights available to members in respect of the shares of the deceased shareholder.

Transmission in case of dematerialisation of shares. Transmission is the process by which securities of a deceased accountholder are transferred to the account of the surviving joint holder(s)/nominee/legal heir(s) of the deceased accountholder. The process of transmission in the case of dematerialised holdings is more convenient, as the transmission formalities for all securities held in a demat account can be completed by submitting documents to the DP. Whereas in the case of physical securities, the surviving joint holder(s)/nominee/legal heir(s) has to correspond independently with each company in which shares are held.

Transmission of Shares in Case of Nomination (Section 72)

Section 72 provides for the transmission of shares where nomination has been made.

Any person who becomes a nominee by virtue of the provisions of section 72, upon the production of such evidence as may be required by the Board and subject as hereinafter provides, elect, either—

(a) to be registered himself as holder of the share ; or

(b) to make such transfer of the share as the deceased shareholder could have made.

In order to make transfer of shares, it is essential that a nominee should first get his name registered. In view of this new provision, it would be necessary for the Government to suitably modify the existing form for transfer of shares and debentures and provide requisite columns for particulars of nominee. It appears that no stamp duty is liable to be paid if the nominee elects himself to be registered as holder of the shares.

If the person being a nominee, so becoming entitled, elects to be registered a holder of the share himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the decreased shareholder.

The nomination cannot be implemented by the Company if the deceased holder of shares had transferred his shares, before his death. In other words, the nomination stands terminated if the interest in the shares stands transferred. The registered holder of shares can transfer the securities at any time even after appointment of the nominee.

All the limitations restrictions and provisions of this Act relating to the right to transfer and the registration of transfers of shares shall be applicable to any such notice or transfer as aforesaid as if the death of the member had not occurred and the notice or transfer were a transfer signed by that shareholders.

A person, being a nominee, becoming entitled to a share by reason of the death of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share except that he shall not, before being registered a member in respect of his share or debenture, be entitled in respect of it to exercise any right conferred by membership in relating to meetings of the company. However, the Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the share or debenture, and if the notice is not complied with within ninety days, the Board may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the share or debenture, until the requirements of the notice have been complied with.

DIFFERENCE BETWEEN TRANSFER AND TRANSMISSION OF SHARES

1. Transfer of shares is the result of the act of parties whereas transmission of shares takes place on account of operation of law.
2. Transfer of shares requires certain formalities to be observed mentioned in section 56, for example, a company shall not register a transfer of shares unless a proper instrument of transfer duly stamped and executed is delivered to the company. But no such formalities are required in the case of transmission of shares.
3. Shares are generally transferred for a consideration. But in transmission there is none.
4. In case of transfer of shares, as soon as the transfer is complete, the liability of the transferor ceases. But in case of transmission of shares, the shares continue to be subject to the original liabilities. If there is a lien on the shares, it will subsist even though the transmission of shares has taken place.
5. A private limited company cannot refuse transmission of shares if parties establish their rights by production of documents like succession certificate etc. (The reason is that transfer is a voluntary act where as transmission is by operation of law).

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In order to make transfer of shares, it is essential that a nominee should first get his name registered. In view of this new provision, it would be necessary for the Government to suitably modify the existing form for transfer of shares and debentures and provide requisite columns for particulars of nominee. It appears that no stamp duty is liable to be paid if the nominee elects himself to be registered as holder of the shares.

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The nomination cannot be implemented by the Company if the deceased holder of shares had transferred his shares, before his death. In other words, the nomination stands terminated if the interest in the shares stands transferred. The registered holder of shares can transfer the securities at any time even after appointment of the nominee.

All the limitations restrictions and provisions of this Act relating to the right to transfer and the registration of transfers of shares shall be applicable to any such notice or transfer as aforesaid as if the death of the member had not occurred and the notice or transfer were a transfer signed by that shareholders.

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4. In case of transfer of shares, as soon as the transfer is complete, the liability of the transferor ceases. But in case of transmission of shares, the shares continue to be subject to the original liabilities. If there is a lien on the shares, it will subsist even though the transmission of shares has taken place.
5. A private limited company cannot refuse transmission of shares if parties establish their rights by production of documents like succession certificate etc. (The reason is that transfer is a voluntary act where as transmission is by operation of law).

6. During 'lock-in' period, transfer of shares is not permissible but transmission is.
7. Permission of official liquidator/Tribunal is required for transfer of shares. But no such permission is required in case of transmission of shares.
8. SEBI Regulations regarding substantial acquision of shares and takeovers are not applicable in case of transmission of shares.

Reliance Industries Ltd. has in its Annual Report, included a document entitled 'An Investor's Guide to Depositories'. The same is being reproduced here (with minor changes) for the benefit of students.

AN INVESTOR'S GUIDE TO DEPOSITORIES

The National Securities Depository Limited (NSDL) is an organisation promoted by the Industrial Development Bank of India, the Unit Trust of India and the National Stock Exchange of India Limited to provide facilities for holding securities in Depository Account and transfer the ownership of the securities through Electronic Account Transfer. Bombay Stock Exchange is the second organisation that has floated a Depository.

It is our endeavour to allay the fears of the common investor by providing explanations for the doubts that are bound to arise in their minds. Through this publication, we hope to inform the investors on the functioning of a depository and the advantages of holding securities in an electronic environment.

1. What is a Depository ? A depository is an organisation where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a depository participant.

A depository can be compared to a bank. If an investor wants to utilize the services offered by a depository, the investor has to open an account with the depository through a depository participant- this is very similar to the opening of an account with any of the branches of a bank in order to utilise the services of that bank.

2. So, is a depository just another form of a custodial service, the only difference being that the securities are held in an electronic form ? No, the two are different. The depository can legally transfer beneficial ownership which a custodian cannot. The main objective of a depository is minimise the paper work involved with the ownership, trading and transfer of securities.

3. What is dematerialisation ? - Dematerialisation is a process by which the physical certificates of an investor are taken back by the Company/Registrar and actually destroyed and an equivalent number of securities are credited in the depository account of that investor. This is done at the request of the investor.

4. Who is a depository participant ? - Similar to the brokers who trade on your behalf in and outside the stock exchanges, a depository participant is your representative (agent) in the depository system. Your depository participant will maintain your securities account balances and intimate to you the status of your holding from time to time. According to SEBI guidelines, financial institutions, banks, custodians, stock brokers, etc., can become participants in the depository.

5. What is the procedure to be followed for dematerialisation ? – (*a*) A Dematerialisation Request Form (DRF) available with your Depository Participant has to be filled-in and deposited with your Depository Participant together with share certificates after writing "Surrendered for Dematerialisation" on the face of each certificate.

(*b*) Your depository participant will send your request along with the share certificates to the Company for confirmation of its genuineness simultaneously to Registrars and Transfer Agents through the Depository. After checking the records, the Registrar and Transfer Agents shall destroy the share certificates and send a confirmation of dematerialisation to the Depository. The Depository then confirms the dematerialisation of shares to your Depository Participant to credit the holding of shares in your account electronically. This entire exercise gets completed in about 15 days of submission of dematerialisation request.

6. Can the electronic holdings be converted back into certificates ? Yes, definitely. This conversion of electronic shares into physical certificates can be made by way of rematerialisation.

7. What is the procedure for rematerialisation ? On receiving of electronic holding of shares into paper form, in consultation with the Depository, the Company will issue new share certificate(s) in paper form with new range of Certificate No.(s) against the shares held by the shareholder in the electronic form. The shareholders have an option to rematerialise part of the securities held in electronic form. This process of rematerialisation will, at the maximum, take 30 days.

8. Will I get back the same certificates after rematerialisation ? It does not really matter at all. The registrar will print new certificates with a new range of certificate numbers. You will usually be alloted a new folio number ; however if you already have an existing folio number, you may be allotted the same.

9. Why should I deposit my securities with the Depository ? Depositing your securities with the Depository will give you freedom from the worries of loss of share certificates through theft, mutilation, fire, etc. When you sell your shares, the paper work required will be reduced to a minimum. Investors will also prefer to buy shares which are already in the depository mode. Thus, you will increasingly find it easy to sell your shares whenever you wish to. In addition, as the depository system becomes popular, brokers will be increasingly reluctant to deal with physical shares.

10. Why should I as an Investor prefer to buy shares in the depository mode ? When you buy shares already in the depository mode, you will become the owner of those shares in the depository within a day of the settlement being completed. You will not have to apply to the Company for registering the shares in your name. Thus, there will be no possibility of loss or theft when the share certificates are posted to the Company. You will have no fear that any fake or stolen shares may have been delivered to you.

11. What are the facilities offered by the Depository ? The Depository, through Depository Participants offers the following facilities to the investors, who hold security in electronic form :

- Maintains the record of shareholders who hold shares an electronic form.
- Converting the paper form of share certificates into electronic form through the process of dematerialisation.
- Converting the shares held in electronic form into paper form, *i.e.*, Share Certificate(s) through the process of rematerialisation
- Carries out settlement of trades not done on the stock exchange (Off-market trades).
- Effects settlement of securities traded in depository mode on the stock exchanges.

12. What are the principal advantages of Depository system. The main advantages of the Depository System are enumerated as under :

- No requirement of filling-up the transfer deed(s) and lodging/despatching to the company for transfer.

- No bad delivery of shares.-
- No loss of share certificate(s) in postal transit.
- No courier/postal charges
- Exemption of stamp duty on transfer of shares.
- Shares purchased in electronic mode, will be transferred in the name of purchaser within a day of completion of settlement.
- Much faster payment of sale of shares.
- No scope for theft/forgery damage of share certificates.
- Minimum handling of paper.

13. How to sell/purchase the shares in Electronic form ? Once you open an account with the Depository Participant, you can purchase/sell shares in electronic form.

Selling of shares held in electronic form is very similar to selling of paper form of shares. Instead of signing the transfer deed as seller and delivering it with share certificates to a broker, you shall give to your depository participant debit instructions for selling your shares.

You can trade through any broker of your choice registered with the Stock Exchanges having an Electronic Form of trading but you have to provide the details of your account with the Depository Participant.

You will receive your money from the share broker in the same manner as you receive now.

- When you want to buy shares in depository system, you must inform your broker your Depository Account No. so that the shares bought by you are credited into that account.
- The payment for the shares in the depository system can be made in the same way you pay for the purchase of any physical shares.
- Inform your broker that you want to buy/sell shares in the electronic form. Shares held in Electronic form always command a premium due to the various advantages of trading in Electronic form.
- The Depository Participant will provide you a statement updated every fortnight (like a pass-book) giving details of your holdings. The rest of the procedure for buying shares in this system is similar to buying physical shares. Thus, the shares you have bought are transferred in your name(s) in less than a week of your purchase, with no fear that the transfer of shares may turn out to be bad deliveries or fake shares.

14. Can the shares in electronic form be pledged/hypothecated ? Yes, by making an application in the prescribed form to the Depository Participant the shareholders have an option to pledge/hypothecate their shares held in electronic form.

15. Can the shares with Depository participant be frozen ? Shareholders who hold the shares in electronic form have an option to freeze their accounts temporarily by making an application to the Depository Participant.

16. What are the implications of capital gains tax ? While calculating capital gains tax, the cost of acquisition of shares shall not be determined with reference to cost of acquisition of specific identifiable shares but be ascertained on the principle of first in first out. That is shares acquired first by the beneficial owner would be deemed to have been transferred first irrespective of the intention of the holder. This principle is applicable only on shares held in Electronic form.

17. Why should broker become reluctant to deal with physical shares ? Apart from the risk arising out of having to deal with the paperwork and keeping account of the share certificates, the brokers are exposed to the risk of bad deliveries in the present system. (Bad deliveries are those share certificates which the registrar cannot transfer because of some problem with the transfer deed such as the mismatch or absence of seller's signature on the transfer deed, outdated or invalid transfer deed, etc). It may take upto one year for the broker to discover that such a risk exists. As against this, in the depository mode, the broker will be free from the worries of bad deliveries. The broker's only risk will be that the investor does not own the shares which the investor has sold. The broker will, thus prefer to sell securities that are in the depository mode.

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- No bad delivery of shares.-
- No loss of share certificate(s) in postal transit.
- No courier/postal charges
- Exemption of stamp duty on transfer of shares.
- Shares purchased in electronic mode, will be transferred in the name of purchaser within a day of completion of settlement.
- Much faster payment of sale of shares.
- No scope for theft/forgery damage of share certificates.
- Minimum handling of paper.

13. How to sell/purchase the shares in Electronic form ? Once you open an account with the Depository Participant, you can purchase/sell shares in electronic form.

Selling of shares held in electronic form is very similar to selling of paper form of shares. Instead of signing the transfer deed as seller and delivering it with share certificates to a broker, you shall give to your depository participant debit instructions for selling your shares.

You can trade through any broker of your choice registered with the Stock Exchanges having an Electronic Form of trading but you have to provide the details of your account with the Depository Participant.

You will receive your money from the share broker in the same manner as you receive now.

- When you want to buy shares in depository system, you must inform your broker your Depository Account No. so that the shares bought by you are credited into that account.
- The payment for the shares in the depository system can be made in the same way you pay for the purchase of any physical shares.
- Inform your broker that you want to buy/sell shares in the electronic form. Shares held in Electronic form always command a premium due to the various advantages of trading in Electronic form.
- The Depository Participant will provide you a statement updated every fortnight (like a pass-book) giving details of your holdings. The rest of the procedure for buying shares in this system is similar to buying physical shares. Thus, the shares you have bought are transferred in your name(s) in less than a week of your purchase, with no fear that the transfer of shares may turn out to be bad deliveries or fake shares.

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You will receive your money from the share broker in the same manner as you receive now.

- When you want to buy shares in depository system, you must inform your broker your Depository Account No. so that the shares bought by you are credited into that account.
- The payment for the shares in the depository system can be made in the same way you pay for the purchase of any physical shares.
- Inform your broker that you want to buy/sell shares in the electronic form. Shares held in Electronic form always command a premium due to the various advantages of trading in Electronic form.
- The Depository Participant will provide you a statement updated every fortnight (like a pass-book) giving details of your holdings. The rest of the procedure for buying shares in this system is similar to buying physical shares. Thus, the shares you have bought are transferred in your name(s) in less than a week of your purchase, with no fear that the transfer of shares may turn out to be bad deliveries or fake shares.

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26. Are there any additional security features which depository participants will offer me to protect my account ? Yes, every transaction in your account will be authorised by you. You can authorise any transaction by affixing your signature. NSDL will send out holdings statements to some beneficial owners picked at random. In case the balance in your account as per your pass-book does not tally with the balance as per the statement sent by NSDL, you can contact your depository participant for clarification.

27. Is it possible for me to get the securities allotted to me in public offerings directly in the electronic form ? Definitely, in fact in the public issue application form itself there is a provision for you to indicate the manner in which you want the securities to be allotted to you. All you have to do is to mention your client account number and the name of the depository participant and any allotment due to you will be credited into the account.

28. Who will give me the benefits arising out of my holdings, say a bonus or a dividend ? When any corporate event such as rights, bonus or dividend is announced for a particular security, the depository will give all the details of the clients having electronic holdings of that security as of record date/book closure to the registrar. The registrar will then calculate the corporate benefits due to all the shareholders. The disbursement of cash benefits such as dividend/interest will be done by the registrar whereas the distribution of securities entitlements will be done by the depository based on the information provided by the registrar.

29. Do I have any option for the manner in which I wish to receive my corporate benefits ? In case of those corporate events where you can exercise you option such as a rights issue or optional conversion of debentures to shares, or issue of Bonus Shares, you do have a choice of either physical or electronic mode of holdings. If you do not opt for your holdings in electronic mode, your entitlement will be given to you in physical mode.

30. In case of discrepancies in corporate benefits whom do I contact ? You can approach your depository participant who in turn will contact the registrar for clarifications regarding allotment of securities. In case of discrepancies in cash benefits you will have to contact the registrar.

SHORT ANSWER QUESTIONS

1. Can a public company impose restrictions on the transfer of fully paid shares ?
2. Is it compulsory that the articles of association of a private company must impose restrictions on transfer of shares ?
3. Is it must that the instrument of transfer should be in the prescribed form ?
4. Can the Board of Directors refuse to register a transfer of listed shares ?
5. Can the Board of Directors refuse to register a transfer of unlisted shares ?
6. Is it necessary to excute a written instrument of transfer in case of transfer of a share warrant ?
7. What are the rights of a transferor or transferee of shares in a public limited company on refusal to register transfer of shares by the Board of Directors of the comapny ?
8. What powers vest with the court to make an order against refusal to register transfer of shares of the company ?
9. What is a forged transfer ?
10. What is meant by certification of shares ?
11. Is the bearer of a share-warrant also a member ?
12. Is there any need for execution of transfer deed for transposition of names in respect of the joint shareholding ?

13. Under what cirumstances shares can be transferred during the winding up of company ?
14. Is there any limit as to currency of a 'blank transfer' ?
15. Is there any difference between transfer and transmission of shares ?

TEST QUESTIONS

1. How are the shares in a company transferred ? Can the Board of directors refuse to register a transfer of shares ? What is the remedy open to the transferee in such a case ?
2. "A shareholder has a right to transfer his shares to whom he pleases even to a pauper." In the light of the above statement discuss the effect of transfer of shares.
3. To what extent may a company restrict the right of shareholders to transfer their shares.
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5. What are the provisions under the Companies Act, 2013, relating to share transfers and their registration ?
6. Distinguish between transfer and transmission of shares. Discuss in this connection the rights of the legal representative of the deceased shareholder.
7. What is certification of transfer ? Discuss the liability of a company to a person who acts on the faith of an erroneous certification made by a company negligently.
8. What is forged transfer ? Discuss the effect of forgery on transfer of shares.

PRACTICAL PROBLEMS

Q. 1. A buys 200 shares in a company from B on the faith of a share certificate issued by the company. A tenders to the company a transfer to himself from B duly executed together with B's share certificate. The company discovers that the certificate in the name of B has been fraudulently obtained and refuses to register the transfer. Is A entitled to get the registration of the transfer ?

Ans. A forged transfer is a nullity and as such, the original owner of the shares continues to be the shareholder. Further, if a person obtains a certificate by theft or fraud and succeds in getting himself registered as a member, the original owner does not cease to be the owner of the shares and a member of the company.

It is, therefore, clear that A is not entitled to get the registration of shares. The company may refuse to register the transfer on the ground that a certificate in the name of B has been fraudulently obtained. As such, A has no right to get registration of transfer. But A can claim damages as he has relied upon the share certificate issued by the company.

Q. 2. X as the shareholder of a company holds 25 shares. X dies leaving Y as his legal representative. The legal representative Y is not a member of the company. Y transfers 25 shares of the deceased member to Z. Is the transfer valid ? State reasons for your answer.

Ans. It is clear that Y can make a valid transfer of shares.

Q. 3. A is the holder of 100 shares in the Alembic Chemical Works Ltd. B unlawfully removes the shares from A's almirah, forges the latter's signature on the transfer deed and sells the scrips to D, who again sells them under blank transfer to E. The company registers the shares in E's name. Subsequently A on the discovery of the loss, claims that his name should be replaced on the share register.

(i) Discuss the rights of A and E.

(ii) Would it make any difference if the shares had been registered in the name of D before the latter sold them to E ?

Ans. (i) A can compel the company to restore his name in the register of members because a forged transfer is a nullity. However, B is bound to indemnify the company which in turn is bound to indemnify E.

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Ans. (i) A can compel the company to restore his name in the register of members because a forged transfer is a nullity. However, B is bound to indemnify the company which in turn is bound to indemnify E.

(ii) In the second case, the company would be liable for damages both to D and E. But the company can recover the same from B.

Q. 4. Mr. A, a shareholder transferred by way of gift his shares in a company to B. By the time the transfer deed and relative share certificate were submitted by B to the company, A was dead. The company refused to register the transfer on the ground that the share transfer was no longer valid. What is the remedy available to B to enforce the share transfer ?

Ans. B can enforce the transfer of shares, B had acquired a good title to the shares and registration with the company was a formality.

Q. 5. Mahavir Spinning Miles Ltd., a public listed company, rejected registration of transfer of 1,000 shares in favour of Yogender on the ground that he was a direct competitor and rival in the business. The company further contends that the transfer was motivated by ulterior factors. Yogender, on the other hand, claims that the rejection was without sufficient cause and that the shares formed only 1% of the total paid-up capital and that the rejection was malafide. Advise the right course of action with suitable case law.

Ans. Mahavir Spinning Miles Ltd. is not entitled to contend that a business rival should not be allowed to buy shares in the company. The grounds under which transfer of shares can be rejected are contained in Section 58 and 59 of the Companies Act, 2013. The registration of shares can be refused only on the grounds that transfer was in violation of SEBI Act, SICA or any other law in force.

Refusal on any other grounds in respect of a public limited company cannot be considered to be sufficient cause for refusal to transfer the shares. In view of this, action taken by Mahavir Spinning Miles Ltd. is not tenable and correct.

(This problem is based on Mc Dowell & Co. Ltd. v. Shaw Wallace & Co. Ltd. [2002] 108 CC 306 (CLB) 35 Sch.444 (CLB)).

Q. 6. 5,000 equity shares in a company were standing registered in the joint-names of Smt. S and Shri K. A dispute arose between them. Shri K requested the company to split the holdings half and half and show his name as the first joint-holder in one half of the holdings so split. Discuss whether the company can entertain Sri Krishan's request ?

Ans. The company cannot register transfer/transmission of shares merely on request of one of the joint shareholders unless a proper instrument duly stamped is lodged. Therefore, Krishnan's request of splitting the holdings cannot be entertained by the company.

□□□

12

COMPANY MANAGEMENT (DIRECTORS)

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	APPOINTMENT OF DIRECTORS	
Compulsory appointment of woman director	• Such class or classes of companies as may be prescribed shall have a woman director. Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that the following class of companies shall point at least one woman director — (i) every listed company; (ii) every other public company have— (a) paid-up share capital of one hundred crore rupees or more; or (b) turnover of three hundred crore rupees or more : The paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account. A company, which has been incorporated under the Act and is covered under above provisions shall appoint at least one woman director within a period of six months from the date of its incorporation. Any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.	No provisions regarding this in the 1956 Act.

At least 1 director who stayed in India for 182 days or more	Every company shall have at least one of the directors who has stayed in India for 182 days or more in the previous calendar year.	No such requirement in the 1956 Act.
Independent director	• Listed public company shall have at least one-third of the total number of directors as independent directors. The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.	No such requirement in the 1956 Act.
Limitation of liability of non-executive directors and independent director	Nowithstanding 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.	No such provisions in the 1956 Act.
Maximum number of directors	Maximum number of directors in public company as well as private companies is 15. A company may appoint more than 15 directors after passing a special resolution. (No need for Central Govt. approval as under the 1956 Act to increase number of directors beyond permissible maximum).	No such requirement for private company. Maximum number of directors : 12 for public company. Need for Central Govt. approval to increase number of directors beyond permissible maximum.
Declaration by person proposed to be appointed as director	Every person proposed to be appointed as a director shall furnish : (i) his DIN and (ii) a declaration that he is not disqualified to become a director under this Act. [Under Rule 8 of Companies (Appointment and Qualification of Director) Rule, 2014; **Form DIR-2**]	No such declaration required.
Disqualifications for appointment as director	• The 2013 Act permanently debars from directorship of a company any person who is convicted of any offence and sentenced to imprisonment of 7 years or more. • Section 164 of the 2013 Act contains the following two new grounds for disqualifying a person from directorships of companies which were not there in section 274 of the 1956 Act :	No such provisions in 1956 Act.

	– he has been convicted of the offence dealing with related party transactions at any time during the last preceding five years; – he has not obtained Director Identification Number.	
Limit on maximum number of directorships	• Maximum number of directorships that an individual can hold including alternate director-ships is 20 of which not more than 10 can be of public companies. • General meeting by special resolution can specify lesser number than 20/10 companies. No such provision in 1956 Act.	15 directorships.
	RESIGNATION OF DIRECTORS	
Resignation of director	Section 168 of the 2013 Act deals with resignation of directors. [See rules 15 and 16 of the Companies (Appointment and Qualifi-cation of Directors) Rules, 2014]	No provisions covering director's resignation.

NEED FOR DIRECTORS

A company being an artificial person cannot act by itself. It has neither a mind nor a body of its own. It must act through some human agency. The persons by whom the business of the company is carried on are termed as directors. The institution of the company is composed of two organs, the general body of shareholders and the board of directors. The board is the managerial body to whom is entrusted the whole management of the company. It is constituted by the general body (*i.e. by members) Directors are accountable to the members. Directors owe a duty to the members to exercise care, skill and diligence in discharge of their functions.*

Statutory requirement to have directors. The Act has recognised the need for directors and their vital position in a company. It requires every company to have its Board of Directors.

As per Section 149, every public company shall have at least 3 directors and every private company shall have a minimum of 2 directors. The maximum number of directors is 15. For one person company, minimum one director must exist.

Meaning of Board of Director's Section 2(10), "Board of Directors or Board in relation to a company means the collective body of the directors of that company." In fact, the expression directors is also used to mean the 'Board of Directors'. The Board directs, controls, manages and superintends the affairs of a company. It formulates the general policy of the company.

Directors can exercise powers only when they act collectively. An individual director has no authority to act on behalf of the company, unless he is so authorised by the :

(i) Act

(ii) Articles of Association

(iii) A resolution of the Board of Directors

(iv) A resolution of the shareholders

otherwise, all the powers in the Board of directors are exercisable by the directors collectively *i.e. by the Board.*

WHO IS A DIRECTOR ?

Statutory definition of director

According to Section 2(34) of the Companies Act, 2013, "director" means a director appointed to the Board of a company.

Definition based on Function

Sir George Jessel is of the same opinion when he observed in *Re Forest of Dean Coal Mining Co.*

"It does not matter much what you call them so long as you understand what the true position is, which is that they are commercial men managing a trading concern for the benefit of themselves and all other shareholders."

The important factor to determine whether a person is or is not a director is to refer to the nature of the office and its duties. It does not matter by what name he is called. Thus "function is everything name matters nothing."

Deemed Directors

A person in accordance with whose directions and instructions the Board of Directors of a company is accustomed to act shall be deemed to be a director of the company. Such persons have been addressed under English Law as 'Shadaw Director'. The person in accordance with whose directions or instructions the BOD is accustomed to act need not necessarily be an individual. The person may even be a body corporate. However, no person shall be deemed to be a director of a company if the Board acts on the advice given by him in his professional capacity such as Solicitor, Chartered Accountants etc.

Only individuals to be Directors

No body corporate, association or firm shall be appointed director of a company and only an individual shall be so appointed (Section 149). It is because that the office of a director is to some extent an office of trust. There should be somebody readily available who can be held responsible for the failure to carry out the obligations of such an office. It will be difficult to fix that responsibility if the director is a body corporate, association of persons or firm.

If all the members of a company are bodies corporate, it will be impossible to comply with this section, except when :

(a) the company's articles provide that no qualification shares are necessary so that outsiders may be appointed as directors of the company ; or

(b) the members who are bodies corporate appoint their own nominees and transfer qualification shares to them.

Executive and Non-executive Director

Director

↓

↓ Inside Directors/Executive Directors	↓ Non-executive/Outside Directors
Whole time employee of the company associated with day to day working of Company and receive remuneration.	These Directors are not in employment of the company. Instead of receiving remuneration they receive sitting fee. They serve the Boards of more than one companies.
Examples. M.D., W.T.D., Technical Director, Executive Director.	**Examples. Professional directors, Nominee director, Statutory director etc.**

Number of Directors

The Minimum and Maximum Number of Directors. Every public company must have at least 3 directors and every private company must have a minimum of 2 directors and every one person company must have 1 director. (Section 149).

The Act has prescribed the maximum number of directors as 15. However a company may appoint more than 15 directors after passing a special resolution.

Implication where number of directors fall below statutory minimum. Since the provision of minimum number of directors is mandatory and any business transaction after the fall of directors fall below the statutory minimum was held to be invalid.

Approval of Central Government

In the case of a public company any increase in the number of directors of more than 15, the shareholders can do so by passing a special resolution in the general meeting.

Number of Directors

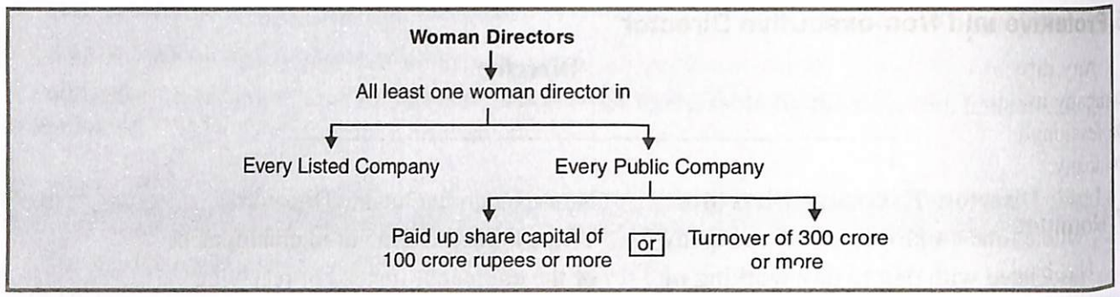
	Public Company	Private Company	One Person Company
Minimum Number of Directors	3	2	1
Maximum Number of Directors	15	15	15
For more than 15 directors	Pass a special resolution	Pass a special resolution	Pass a special resolution

WOMAN DIRECTOR :

Under Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, the following companies shall appoint alteast ONE WOMAN DIRECTOR

(i) every listed company.

(ii) every other public companies having a paid share capital of ₹ 100 crores or more or turnover of ₹ 300 crore or more.



TYPES OF DIRECTORS

Following are the categorises of directors who constitute 'Board' of a company :

1. Ordinary Directors

Ordinary directors are also referred to as simple who attend Board meeting of a company and participate in the matters put before the Board. These directors are neither whole time directors nor managing directors.

2. Managing Director

"Managing director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management.

3. Whole-time/Executive Directors

Whole-time Director Executive Director includes a director in the whole-time employment of the company.

4. Additional Directors

Additional Directors are appointed by the Board under section 161 of the Companies Act, 2013 between the two annual general meetings subject to the provisions of the Articles of Association of a company. Additional directors shall hold office only up to the date of the next annual general meeting of the company. Number of the directors and additional directors together shall not exceed the maximum strength fixed for the Board by the Articles.

5. Alternate Director

According to the provisions of section 161 of the Companies Act, 2013, an Alternate Director is a person appointed by the Board if so authorised by the Articles or by a resolution passed by the company in the general meeting to act for a director called "the original director" during his absence for a period of not less than three months from India. Generally, the alternate directors are appointed for a person who is Non-resident India or for foreign collaborators of a company.

6. Professional Directors

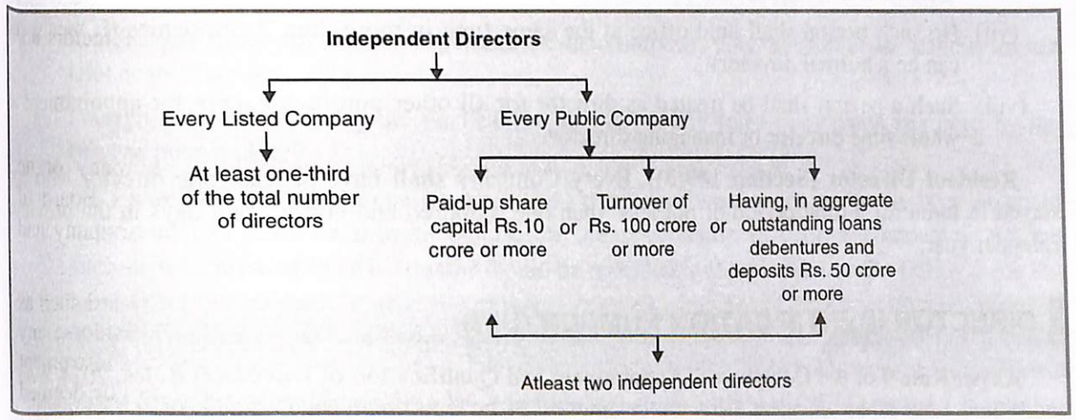
Any director possessing professional qualifications and do not have any pecuniary interest in the company are called as "Professional Directors". In big size companies, sometimes the board appoints professionals of different fields as directors to utilise their expertise in the management of the company.

7. Nominee Directors

The banks and financial institutions which grant financial assistance to a company generally impose a condition as to appointment of their representative on the Board of the concerned company. These nominated persons are called as nominee directors.

8. Independent Directors

Section 2 (47) defines "independent director" to mean an independent director referred to in section 149(5).



9. Small shareholders directors

Explanation to provision of section 152(1) provides that a small shareholder means a shareholder holding shares of nominal value of ₹ 20,000 or less in a public company. A shareholder holding any number of shares up to ₹ 20,000 will be able to participate in the election of directors from the small shareholders.

Small shareholders may have a directors

Public company having :

(a) a paid up capital of 5 crore rupees or more,

(b) One thousand or more small shareholders may, have a director elected by such small shareholders in the manner as may be prescribed. Small shareholder means a shareholder holding shares of nominal value ₹ 20,000 or less in such public company. [Section 152 (1)]

It is to be noted that the appointment of directors by small shareholders is optional and not mandatory.

As per Rule 7 of the Companies (Appointment and Qualification of Directors) Rules 2014

(i) A company may act suo moto to elect a small shareholders' directors.

(ii) It may also act upon the notice in writing of atleast 1/10 of small shareholders, proposing the name of a small shareholders.

(iii) The notice must be given 14 days before the meeting. The notice shall be accompanied by a statement signed by the person whose name is being proposed stating :

(a) his DIN (Director Identification Number) ;

(b) that he is not disqualified to become a director under the Act ;

(c) his consent to act as a director of the company.

(iv) The notice must be signed by 100 small shareholders.

(v) In case of listing company, the election of small shareholders director will be through postal ballot.

(vi) The tenure of such a director shall be for a maximum period of 3 years and he shall not retire by rotation. On expiry of the tenure, such director shall not be eligible for re-appointment.

(vii) No such person shall hold office at the same time in more than 2 companies (It means the can be a normal director).

(viii) Such a person shall be treated as director for all other purposes except for appointment as whole time director or managing director.

Resident Director [Section 149(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.

DIRECTOR IDENTIFICATION NUMBER (DIN)

As per Rule 9 of the Companies (Appointment and Qualification of Directors) Rules, 2014, every individual who is an existing Director or intends to be appointed as Director of a Company, is required to apply for Director Identification Number electronically in Form DIR-3 to the Central Government for allotment of a DIN. This application is to be made electronically. A provisional DIN is generated by the system, which remains valid for a period of 60 days.

Section 152(3) provides that no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154.

DIN is not required for directors of foreign company having branch offices in India, but DIN is required by foreign directors of Indian companies.

DIN is essential for every director including nominee directors and Government appointed directors. However, only those directors who are required to sign e-forms are required to obtain digital signature certificate (DSC). Other directors need not have DSC.

The concept of a Director Identification Number (DIN) has been introduced for the first time with the insertion of Sections 153 to 159 of **Companies Act, 2013** As such, all the existing and intending Directors have to obtain DIN within the prescribed time-frame as notified.

Under the government regarding companies, **Director Identification Number** is mandatory and compulsory for becoming the director of a Company. Any person desirous of becoming Director of a private or public company has to apply for the allotment of Permanent Din Number to the Central

Government of India as per the Form DIN-1. We have all kinds of support for making the allotment of DIN an easy affair for the clients. Thus avail our peerless Directors Identification Number Services and that also at a very nominal charge.

Salient Features of DIN

- Every person or individual desirous of being appointed as the Director of a company ought to apply for the DIN, or should have the DIN obtained beforehand
- The application for the allotment of DIN, is to be duly supported with the proof of residence and identity proof of the applicant, duly attested photocopies of any of the following viz. PAN card, Driving License, Passport, Voter ID Card, Ration card, Electricity Bill and Bank Statement
- DIN is essential for the e-filing of Forms. PAN or other documents can never be used as an alternative to the DIN. DIN is mandatory for all directors who hold office of the director in any national, international, or multi-national company located in India
- Resignation from the post of Directors of one company, does not affect the validity of the DIN or its discretionary powers
- Foreign nationals holding the post of the director in any Indian company, is forced by the rules to possess DIN
- Only one DIN is needed to be appointed as a director of a company, on the basis of which an individual can hold an infinite number of the directorship in various companies. All the successive directorship of a director would be recorded in the database of the DIN

DIGITAL SIGNATURE CERTIFICATE (DSC)

A Digital Signature Certificate, like hand written signature, establishes the identity of the sender filing the documents through internet which sender can not revoke or deny. Accordingly, Digital Signature Certificate is a digital equivalent of a hand written signature which has an extra data attached electronically to any message or a document. Digital Signature also ensures that no alterations are made to the data once the document has been digitally signed. A DSC is normally valid for 1 or 2 years, after which it can be renewed.

These certificates are accepted for IFFCO, Northern Railway, MCA 21, E-filing, E -tendering etc.

There are basically 3 types of Digital Signature Certificates Class-1, Class-2 & Class-3 each having different level of security.

All the authorized signatories of company under MCA21 require Class-2 Digital Signature Certificate.

Similarly any document filed by CA/CS/CWA & TAX PRACTIONERS under MCA21 require Class-2 Digital Signature Certificate.

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NUMBER OF DIRECTORSHIP [SECTION 165]

- Maximum number of directorship including alternate directorship → 20
- Maximum number of public companies in which a person can be appointed as a Director → 10

  Public companies shall include private companies that are either holding or subsidiary company of a public company.
- Subject to the provision of subsection (1) of section 165 a member of a company may, be special resolution, specify the number less than 20 or 10 companies, as the case may be, in which a director of the company can act as director.
- Any person holding office as director in companies more than the limits before the commencement of the Act shall within a period of 1 year from such commencement.
  (a) choose companies in which he wishes to continue to hold the office of Director.
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- No person shall act as director in more than the limits :
  - ✓ after dispatching the resignation of his office as director or non-executive director
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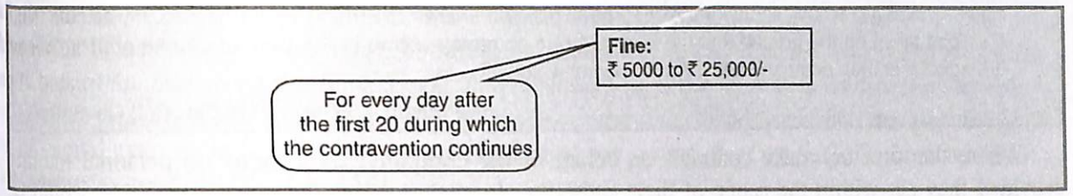
The prohibition that a director shall not hold the office of a director in more than 20 companies does not extend to the holding of directorship in foreign companies as they do not come within the definition of "company" in the Act.

Penalty

If a person accepts an appointment as a Director in the companies above the prescribed limits



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Penalty for acting as director in more than 20 companies.

Any person who holds office or acts as a director of more than 20 companies in contravention of the above provisions shall be punishable with fine of ₹ 5000 which may extend to ₹ 25,000 for every day of default in respect of each of those companies.

ROLE OF DIRECTORS

It is very difficult to define precisely the position of directors in a company. The Companies Act, 2013, is also silent on this issue. Directors have been described sometimes as trustees, sometimes as agents, or sometimes as managing partners.

They have some attributes of all of them, but they are neither trustees nor managing partners in full sense of the term.

The legal position can be discussed as under :

1. Directors as Agent
2. Directors as Trustees
3. Directors as Officers in the company
4. Directors as Employees
5. Directors as Managing Partners

1. Directors as agents

Directors are, in the eyes of law, agents of the company for which they act. Th general principles of the law of agency apply to the company and its directors. This position has long been established in *Ferguson v. Wilson wherein Cairns L.J. said.*

"Directors are merely agents of a company. The company itself cannot act in its own person for it has no person ; it can only act through directors and the case is as regards those directors merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable ; where the liability would attach to the principal and principal only, the liability is the liability of the company."

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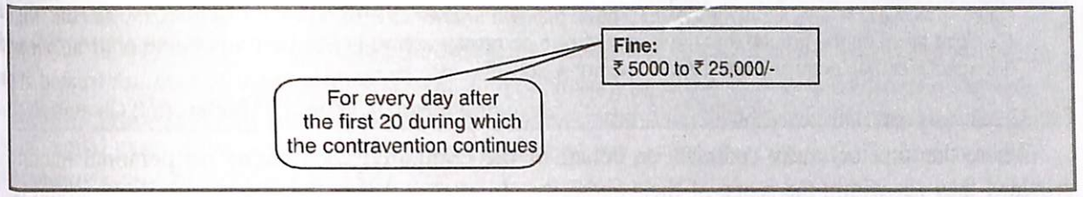

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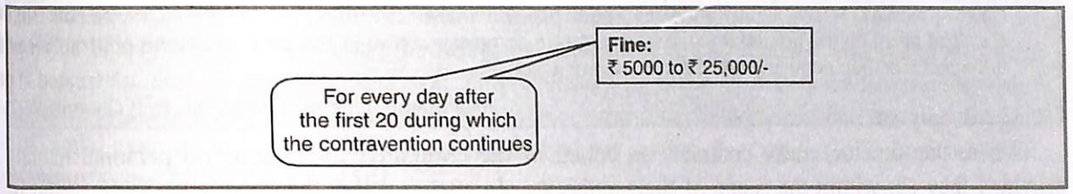

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1. Directors as agents

Directors are, in the eyes of law, agents of the company for which they act. Th general principles of the law of agency apply to the company and its directors. This position has long been established in *Ferguson v. Wilson wherein Cairns L.J. said.*

"Directors are merely agents of a company. The company itself cannot act in its own person for it has no person ; it can only act through directors and the case is as regards those directors merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable ; where the liability would attach to the principal and principal only, the liability is the liability of the company."

Example : F had an option to subscribe for some of the company's shares. Accordingly he applied for the shares. The directors allotted the whole of its authorized capital to other persons, including themselves. Consequently the option given to F became worthless. F sued W, one of the directors of the company, claiming inter alia that W should transfer some of his own shares to F and pay damages. It was held that F's claim failed on the ground that the directors of a company acting in the normal course of their duties are agents for their company and incur no personal liability

[Ferguson v. Wilson. (1866) L.R. 2 Ch. App. 77]

Where the directors make contracts on behalf of the company, they incur no personal liability provided they act within the scope of their authority. In such a case, the company alone would be liable.

Example : E agreed to supply goods to a company. The contract was made at a board meeting at which H was the chairman. The payment was to be made by the issue of 600 of the company's debentures. E constantly pressed for the debentures but none was issued and eventually the company went into liquidation. It was held that H was not liable to an action at the suit of E.

[Elkington v. Hurter (1892), 2 Ch. 452].

Directors incur a personal liability in the following circumstances :

1. Where they contract in their own names.
2. Where they use the company's name incorrectly, *e.g.* by omitting the word 'Ltd'.
3. Where director's exceed their power *e.g.* where they borrow in excess of the limits imposed upon them.

But the position of directors differ from that of the agents in the following respects :

(i) Notice to an agent amounts to a notice to the principal. However a notice to a director does not amount to a notice to the company except where director in entrusted with a duty to receive the same.

(ii) Whereas agents are appointed directors are elected.

(iii) The agents work for commission but it is not so in case of directors.

(iv) The ordinary agent acts according to the instructions of his principal but directors donot.

(v) An agent may enter into a contract in his own name. A director cannot enter into a contract in his own name. If he does so, the company is not liable.

(vi) An agent may not disclose the name of his principal. A director must disclose the name of his principal.

Hence the directors are not agents in the true sense.

2. Directors as trustees

The directors have also been described as trustees of the company. "A trustee is a person who is the owner of the property, deals with it as principal as owner and a master, subject only to an equitable obligation to account to some person to whom he stands in relation of trustee.

They are trustees

(i) of the company's money or property which comes into their hands or which is actually under their control, and

(ii) of the powers entrusted to them.

(i) Directors as trustees of the Company's money or property

As trustees of the company's money and property, directors are accountable for their proper use and are required to refund or restore the same if improperly used. Such property must be applied for the specified purposes of the company and a mis-application of it is a *breach of trust. And ever since joint stock companies were invented, directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees.* Thus, when directors pay dividend out of capital even though the company has not earned any profits, they are liable for breach of trust. [Re. *Sharpe's case (1892) 1. Ch. 154].*

(ii) Directors as trustees of powers conferred upon them

The directors of a company are trustees for the company, and with reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as trustees and on their death the cause of the action survives against their legal representatives.

Directors are the trustees of the powers conferrred upon them and they must exercise those powers *bonafide and for the benefit of the company as a whole. Buckley also supports the above view. He has observed :*

"Directors are the trustees of the powers committed to them as for instance, of the power of approving transfer of shares ; of the power of allotment of shares ; of the power of employing the funds of the company ; of the power of making calls ; or receiving payment of calls in advance ; of the power of forfeiting shares and as trustees they may be rendered liable for their misuse."

Example. A company was in no need of further capital but the directors made a fresh issue to themselves and their supporters in order to control the majority of the voting power and to defeat the wishes of the existing majority shareholders. It was held that the directors had abused their fiduciary powers and the allotment was invalid and void. **[Piercy v. S. Mills and Co. Ltd. (1920) 1, Ch. 77].**

Directors are trustees of the company and not of individual shareholders. The principle has been firmly established in *Percival v. Wright.*

Directors bought shares from a shareholder, while they were negotiating the sale of the company at a very high price. The directors did not disclose the fact to the shareholder. It was held the purchase of the shares was good. [(1902) 2 Ch. 421].

But it is not accurate to call them trustees in a strict legal sense :

(i) A trustee can't be an employee of the trust but a director can be an employee of the company.

(ii) A person can be a director in a maximum of 15 companies. A person can be a trustee in any number of trusts.

(iii) The property of a trust is vested in the trustees but the directors merely manage the property of the company which is not vested in them.

(iv) A trustee is not entitled to remuneration but a director is entitled to remuneration (including sitting fee for attending board meetings).

(v) An artificial person can become a trustee but an artificial person cannot become a director. As, only individual can be a director.

Director may better be considered to stand in a fiduciary position towards the company and be treated as a quasi trustee.

3. Directors as officers

Under Section 2(59), "officer" includes any director, manager or key managerial personnel or any person in accordance with whose direction or instruction the Board of Directors or any one or more of direction is or are accustomed to act.

Under section 2(59) of the Companies Act, they are liable to certain penalties if the provisions of the Companies Act are not complied with.

Moreover whether or not a director is in the employment of the company, he shall always be treated as an officer of the company.

4. Directors as employees

Although directors are agents of the company, they are not employees or servants of the company. Hence they cannot claim their remuneration as a preferential creditor in the event of winding up of a company under section 327 of the Companies Act, 2013.

But where any director, besides being a director, is also in the service or employment of the company such as secretary, manager, accountant or otherwise, he will be treated as an employee. As such he will be entitled to the remuneration and other benefits admissible to him as an employee in addition to his rights as a director to sitting fee, etc. A managing director holds such a double role.

5. Directors as managing partners

The directors are also sometimes described as managing partners because like a partner of a firm, they manage the affairs of the company and they are also usually important shareholders of the company. They do all proprietorial functions like allotting shares, making calls, forfeiting shares etc.

However, all the partners of a firm act on the principal of mutual agency. But it is not so in the case of directors. A director has no authority to bind the other directors and shareholders. Moreover, directors are subject to retirement by rotation whereas partners of a firm are not. Hence, the directors are not managing partners in the full sense.

Thus, directors are described as trustees, agents or managing partners. It does not matter much what you call them, so long as you understand what their true position is, which is that they are commercial men, managing a trading concern for the benefit of themselves and all other shareholders in it.

The Board of directors are the brain and the only brain of the company which is the body and the company can act only through them.

LOANS TO DIRECTORS

Section 185 provides that, except where otherwise provided in this Act, a company (hereinafter called 'lending company') shall not, directly or indirectly, advance any loan (including any loan represented by a book debt) to any of its directors or to any other person in whom the directors is interest or give any guarantee or provide any security in connection with any loan taken by him or such other person.

***The aforesaid prohibition of section 185 shall not apply to a private company:**

(a) In whose share capital no other body corporate has invested any money;

(b) If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or 50 crore rupees, whichever is lower; and

(c) Such a company is not in default in repayment of such borrowing subsisting at the time of making transactions under this section. – *Vide MCA Notification dated 5-6-2015*

Section 185 shall also be not applied to a Government company is case it obtains approval of Section 185 shall be not applicable to a Government which is administratively in charge of the company, or as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

Person in whom the director is interested means-

(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;

(b) any firm in which any such director or relative is a partner;

(c) any private company of which any such director is a director or member;

(d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(a) any body corporate, the Board of directors, managing director or manger, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any directors or directors, of the lending company.

The following transactions are, however, not covered by the aforesaid restrictions: -

[As amended by companies (Amendment) Act, 2015 w.e.f 26-5-2015]

(a) the giving of any loan to managing or whole-time director-

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution; or

(b) giving of any loans or gurantees or securities for the due repayment provided that the lending company charges an interest at a rate not less than the bank rate declared by the Reserve Bank of India.

(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company.

Provided that the loans made under clauses (*c*) and (*d*) are utilised by the subsidiary company for its principal business activities.

Penalty: If any loan is advance or a guarantee or security is given or provide in contravention of the aforesaid provisions, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is advanced or gurantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six

months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

APPOINTMENT OF DIRECTORS

The success of a company depends to a great extent, upon the competence and honesty of its directors. It is therefore desirable that the administration of companies should be in right hands. The appointment of directors is accordingly regulated by the Act.

For being appointed as a director the person must comply with following provisions :

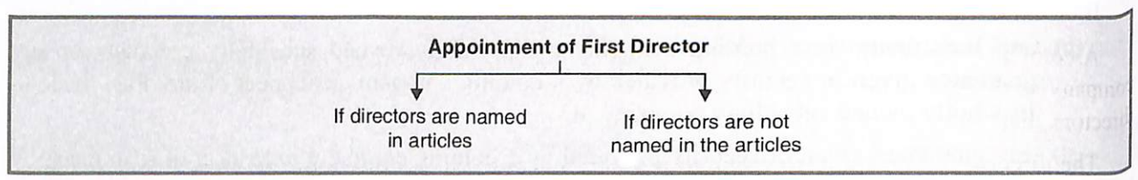
1. Otherwise expressly provided in the Act, every Director shall be appointed by the company in the General Meeting.
2. Every proposed Director shall have DIN.
3. Every proposed Director shall furnish DIN and a declaration that he is not disqualified to become a Director
4. Proposed Director shall give his consent in Form DIR-12 to hold the office as director and such consent be filed with the Registrar in Form DIR-12 within 30 days of his appointment.

Directors may be appointed in the following ways :

1. By the Articles as regard first directors (Section 152).
2. By the Company at General Meeting (Sections 152 & 160).
3. By the principle of Proportional Representation (Section 163).
4. By the Board (Section 161).
5. By Third parties (Section 152).
6. By the Central Government.
7. By the Small Shareholders.
8. By the Tribunal in Sick Industries (*i.e.* special directors).

Now let us understand them one by one :

(1) Appointment of First Directions (Sec. 152)



(a) If directors are named in articles. Directors named in the articles shall be the first directors.

(b) If the directors are not named in the articles

The articles prescribe the manner of appointment of first directors	When all subscribers to the memorandum are bodies corporate. The Articles do not prescribe manner of appointment of first director :
• First directors shall be determined in the manner specified in the Articles.	All the subscribers to the Memorandum who are individuals shall be deemed to directors, until directors are duly appointed at a general meeting u/s 152.
• The names of first directors shall be determined in writing by the subscribers to Memorandum or a majority of them (Regulation 60 of Table F).	

In other words, if all the subscribers to the memorandum happen to be bodies corporate, none of the subscribers can be deemed to be directors and the company will have no directors until the first directors are appointed under section 152(2).

In case of one person company (OPC), an individual being member shall be deemed to be its first Director until the Director(s) are duly appointed by the member provide for any qualification shares, only those subscribers who hold such shares shall be deemed to be directors.

When all subscribers to the memorandum are bodies corporate.

If all the subscribers to the memorandum happen to be bodies corporate, none of the subscribers can be deemed to be directors and the company will have no directors until the first directors are appointed under Section 152(2).

2. Appointment of directors at general meeting (Section 152(2))

Except for the first directors, the subsequent directors are appointed by the company in the general meeting. Section 152(2) provides that not less than two third of the total number of directors of a public company, or of a private company which is subsidiary of a public company must be appointed by the company in general meeting. These directors must be subject to retirement by rotation. The remaining directors of such a company and the directors generally of a purely private company must also be appointed by the company in general meeting. In other words, not more than one third of the total number of directors can act as non-retiring directors *i.e. not subject to retirement by rotation.*

Example : A company has six directors. It can appoint only 2 directors (1/3rd of six) as permanent directors if it wants to do so. The remaining four directors shall be liable to retire by rotation.

The object of Section 152(2) is to prevent the mischief of self perpetuating management.

(i) Retirement by Rotation (Section 152(6)) : 2/3 of the directors liable to retire by rotation, only 1/3 shall retire at every annual general meeting. It follows that all such directors must retire in the course of 3 years, 1/3rd retiring in each year.

If the number is not three or a multiple of three, then any fraction shall be rounded off as one.

A company has 9 directors. Out of 9, 3 directors can be appointed as permanent directors if the company so desires. The remaining 6 directors will be liable to retire by rotation. Out of 6 directors, directors shall retire, in each of 3 years.

The directors to retire by rotation at every annual general meeting must be those who have been longest in office since their last appointment. As between persons who become directors on the same day, those who are to retire will, subject to any agreement among themselves, be determined by lot.

Rotational director means a director retiring by rotation and does not include additional, alternate, debentureholders' or central governments nominee directors. Similarly directors appointed by financial institutions in pursuance of the agreement entered into by these institutions with the company are not liable to retire by rotation.

Such nominee directors are also not to be taken into account for computing one-third number of directors liable to retire.

(ii) Where annual general meeting is not held

The directors cannot prolong their tenure by not holding an annual general meeting in time. They would automatically retire from office on expiry of the maximum permissible period within which such meeting ought to have been held. To call annual general meeting is the duty of directors and by omitting to convene such meeting, they cannot take advantage of their own default.

(iii) Deemed Reappointment of a retiring director

At the annual general meeting at which a director retires, the company may fill up the vacancy by appointing the retiring director or some other person thereto. [Sec. 152(6)(e)]

Adjournment of meeting. If the place of the retiring director is not so filled, and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned. [Sec. 152(7)(a)]

Automatic Reappointment. If at the adjourned meeting also the vacancy is not filled, and the meeting has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting. [Sec. 152(7) (b)]

(iv) No automatic reappointment.

At an adjourned meeting, a retiring director shall not be deemed to be automatically reppointed in the following cases :

- Where a resolution for the reappointment of such director was put and lost.
- Where the retiring director has, in writing, expressed his unwillingness to continue, or
- Where he is not qualified or is disqualified for appointment, or
- Where a resolution (special or ordinaly) is necessary for his appointment or reappointment.
- Where it is resolved to fill two or more vacancies by a single resolution.

In case the vacancy is not filed at the AGM and the retiring director donot get automatically reappointed, the vacany may be filled by the Board of directors.

(v) Fresh Appointment

Or

Appointment of a director other than a retiring director (Section 160) and Rule 3 of Companies (Appointment and Qualification) Rules, 2014.

Section 160 provides the procedure of appointment of a person other than retiring director.

(i) Persons who can give notice for directorship

(a) A person who is not a retiring director can give notice in writing signifying his candidature

(b) A member (proposer) can give a notice of the candidature of any other person

(ii) Requirement of notice

A notice in writing signifying his candidature must be left at the office of the company at least fourteen days before the date of the meeting alongwith a deposit of ₹ one lakh which shall be refunded to such person or as the case may be to such member, if the person succeeds in getting elected as a director. In other words, if such person is not elected as director, he or the member, as the case may be, will not be entitled to the refund of ₹ one lakh and it will be forfeited by the company.

(iii) Notice by the Company to members

The company shall inform the members at least seven days before the meeting about the

candidature. It is not necessary for the company to serve individual notices upon the members if the company advertises such candidature not less than seven days before the meeting, in at least two newspapers. One of the newspapers must be in English language and the other in the regional language of the place where the registered office of the company is located. [Rule 13 of companies (Appointment and Rules, Qualification 2014]

Non compliance of procedure prescribed such as non-circulation of notice to members, would render the appointment invalid.[1]

(vi) Appointment of each director to be voted individually

Appointment of each director must be made through a separate resolution of the simple majority unless the meeting unanimously resolves otherwise.

(vii) Filing of Written Consent by directors

Section 152 requires a new director *(i.e. other than a retiring director) to file his written consent to act as director within 30 days of his appointment.*

3. Appointment of directors by proportional representation (Section 163)

Directors of a Company are generally appointed by simple majority. As a result majority shareholders controlling 51% or more votes may elect all directors and a substantial minority, as high as 49%, may find no representation on the Board.

Section 163 intends to protect the interests of minority shareholders by giving them an opportunity to place their nominees on the Board.

The articles of a company may provide that the appointment of not less than 2/3 of the total number of directors of a company shall be according to the principle of proportional representation. (Section 163)

Such appointment may be by :

(1) Single Transferable Vote. Under it a quota of Votes is fixed.

Say 6000 votes are cast.

The number of directors are 5.

The quota will be $\frac{6,000}{5+1} + 1 = 1001$ Votes

Any one getting 1001 votes will be elected. The voter is asked to give ranking to all i.e., 1, 2, 3, 4, 5. Candidate getting 1001 gets elected excess of votes for the elected candidate are passed to the second ranking candidate so on.

(2) Cumulative Voting. In this method

Total No. of Votes	= Number of shares × No. of Directors to be elected.
Say Number of Shares	= 10,000
No. of Directors	= 10
Total Votes	= 10,000 × 10 = 10,0000
Director must get	$= \frac{1,00,000}{10}$ = 10,000 votes to win.

1. Namita Gupta V Cachar Native Joint Stock Co. Ltd. (1999) 98 Comp. as 655.

Such appointment shall be made once in three years and interim casual vacancies may be filled up according to section 161.

Directors elected on the principle of proportional representation cannot be removed under the provisions of section 169.

4. Appointment by directors. The directors are empowered to appoint—

(i) Additional directors

(ii) Alternate directors

(iii) Directors filling casual vacancy

(i) Additional directors. The board of directors may appoint additional directors from time to time if so authorised by its articles. The number of directors and additional directors must not exceed the maximum strength fixed for the board by the articles. The additional directors shall hold office only upto the date of the next annual general meeting (Sec. 161).

It may be note that without a power given by the Articles, the Board cannot appoint additional directors.

Powers of Additional Directors

Additional directors will enjoy the same powers and rights as other directors. The purpose of section 161 is to enable the board to appoint competent persons who may otherwise find it difficult to come in by election.

Appointment by Resolution only

An additional director can be appointed by passing a resolution at a Board meeting or by passing a resolution by circulation.

Term of office of an additional directors

The additional director is entitled to hold office only upto the date next annual general meeting of the company.

If the annual general meeting of the company is not held, or cannot be held, the person appointed as additional director vacates his office on the last day on which the annual general meeting should have been held in terms of section 96 of the Act.

Additional directors is not a retiring director.

An additional director holds office upto the next AGM *i.e. he does not retire at next AGM. Hence he is not a retiring director.*

Obligation to take qualification shares

An additional director is required to take the qualification shares, if the Articles of Association of the Company require holding of qualification shares.

(ii) Alternate directors

Condition for appointment of alternate director

An alternate director acts in the place of a director who is absent for more than three months from the State in which board meetings are held.

Term of Office

He cannot hold office for a period longer than that permissible to the original director in whose place he has been appointed. He must vacate office on the return of the original director.

The Department of Company Affairs has clarified that the alternate director vacates his office whether or not the original director attends the Board meeting on his return to the state.

Power to appoint

The *board of directors* may appoint an alternate director if authorised *(i) by the articles or (ii) by a resolution of the company at general meeting.*

Neither the shareholders of the company nor the original director can exercise the power to appoint alternate director. Moreover an alternate director is neither an agent of the original director nor his proxy.

Moreover, an alternate director is not obliged to act as per instructions of the original Director.

Position of an alternate director

- An alternate director is subject to the same liabilities and supposed to perform the same duties as any other director.
- The alternate director merely fills a temporary vacancy in the office of director.
- An alternate director is not required to hold any qualification shares.
- Alternate directorship held by a person cannot be counted towards maximum number of directorship which a person can hold.

Consent

An alternate directors is required to file his cansent with the Registrar within 30 days of his appointment.

(iii) Casual Vacancy

What is casual vacancy ? A casual vacancy is a vacancy where the office of any director appointed in general meeting is vacated before the term of office expires in the normal course, such as death, resignation or insolvency. It means any vacancy other than one caused by retirement of a director by rotation or by efflux of time is a casual vacancy.

Power to fill casual vacancy is on the Board

A casual vacancy is to be filled only at a meeting of the Board and not by means of a resolution passed by circulation.

Tenure of office. A person, who is appointed as a director in a casual vacancy, shall vacate the office on the date when the original director in whose place he is appointed would have held office of it had not been vacated.

Consent.

The director appointed to fill the casual vacancy must file his consent with the Registrar within 30 days of his appointments.

Vacancy created by resignation etc of a director appointed to fill casual vacancy

Where the casual vacancy filed by the board is again vacated, the resulting vacancy is not a casual vacancy and cannot be filed by the Board, as Section 161 applies only in case of casual vacancy in the office of any director appointed by the company in general meeting. However in such a case, the Board should appoint additional director if so authorised by articles.

5. Appointment by third parties. Section 152 permits one third of the total number of directors of a public company and of a private company which is a subsidiary of a public company to be appointed by parties other than shareholders on a non-rotational basis.

The articles may give right to debentureholders, financial corporations or banking companies who have advanced loans to the company to nominate directors on the board of company.

The number of directors so nominated should not exceed one third of the total strength of the board.

They are not liable to retire by rotation.

6. Appointment by the Central Government. The Central Government has the power to appoint directors on an order passed by the NCLT to effectively safeguard the interest of the company or its shareholders or the public interest to prevent mismanagement or oppression. Such directors shall hold office for a period not exceeding three years on any one occasion.

The power can be exercised by the NCLT either on a reference made by the central government or on an application

(i) of not less than one hundred members of the company or

(ii) of members of the company not holding less than one tenth of the total voting power therein.

A director appointed by the Central Government shall not be :

- taken into account for purpose of reckoning 2/3 or any other proportion of the total number of directors.
- required to hold qualification shares.
- required to retire by rotation.
- not required to hold qualification shares

He shall keep the government informed of the affairs of the company to enable it to take appropriate action.

7. Appointment by Small Shareholders. The small shareholders, in case of a public company having

(i) paid up capital of ₹ 5 crore or more, and

(ii) having at least 1000 shareholders holding shares of nominal value of ₹ 20,000 or less may elect at least one director to represent them on the Board.

A company may act :

(i) suo motu on its own — it is optional to appoint a small shareholder's director.

(ii) or it may act on the notice of not less than 1/10th of the total number of Small Shareholders.

(iii) Such notice shall be given at least 14 days before the meeting.

(iv) the notice must be signed by 100 Small Shareholders.

(v) The tenure of office of the Small Shareholder director shall be 3 yrs.

(vi) Such director shall not be subject to retirement by rotation.

(vii) A person can't be a small shareholders director in more than 2 companies.

8. Appointment of Special directors by the Tribunal in case of Sick Industrial Companies

The NCLT can appoint one or more persons who possess knowledge, expertise in management and control of the affairs of any other company to be a special director on the Board of a Sick Industrial Company.

Any provision regarding share qualification, age, limit, number of directorship, removal from office etc shall not apply to a special director appointed by NCLT.

Appointment of Directors to be voted individually [Section 162]

- At a general meeting of a company, a motion shall not be moved for the appointment of 2 or more persons as directors of the company by a single resolution, unless a resolution has first been agreed at meeting without any vote being cast against it.
- Resolution moved in contravention of section 162(1) shall be void whether any objection was taken or not.
- Motion for approving a person for appointment or for nominating a person for appointment shall be treated as a motion for his appointment.

SHARE QUALIFICATION

Qualifications for Director

The Companies Act does not lay down any specified academic qualification for appointment as a company director, not even qualification shares. So far as the Act is concerned a director need not hold any shares and need not be a member of a company.

The articles of association generally require that the qualification of director shall be the holding of a specified number of shares known as qualification shares. A director must hold atleast on share in a company.

The articles of a company generally provide for such qualification shares so that directors may have personal interest in the company.

Time limit of obtaining qualification shares

Unless he is already qualified, he must obtain the qualification shares within two months after his appointment as a director. Any provision in the articles of a company in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months will be void. The date of appointment is the date when the result of a poll for the election was announced to the company by the scruitneers and not the date when the poll was taken.

Amount of Share qualification

(i) The nominal value of qualification shares shall not exceed ₹ 5,000

(ii) Where the nominal value of one shall exceed ₹ 5000, share qualification shall be holding of one share only.

It may be noted that the bearer of share warrant is not deemed to be a holder of qualification shares.

Any provision requiring a director to hold as qualification shares more than this amount will be invalid. The holding of share warrant shall not be deemed to be the holding of qualification shares.

It is not essential for the director to buy his shares directly from the company. The director must

hold these shares in his own right. Until the required number of shares are registered in the name of the director, he is not qualified. Lodging of shares transfer form is not the holding of shares.[1]

Liabilities in respect of qualification shares

If the company is wound up during this period of two months, such director cannot be placed on the list of contributories in as much as there is no express or implied contract under which he would be bound to take the qualification shares.

Consequences of failure to hold qualification shares

(i) If a director fails to obtain within 2 months or at anytime thereafter ceases to hold the qualification shares, he automatically varates office after the expiry of said 2 months and cannot act as a director and no notice of the director is required.

(ii) If a person acts as a director when he knows that the office of director held by him has become vacant, he shall be punishable with fine upto ₹ 5000 per day for the period he acts as a director [Section 283 (2A)]

(iii) If a person acts as a director of a company without holding the qualification shares, he will be punishable with fine which may extend to ₹ 500 for every day for the period he acts as a director (Section 272)

In a nut shell, if a person acts as a director after the expiry of said 2 months without taking qualification shares, he shall be liable to a cumulative fine upto ₹ 5,500 (₹ 5,000 + ₹ 500) for everyday for the period he acts as a director (Section 272 read with section 283).

Directors not required to hold qualification shares

The following directors are not required to hold qualification shares

(i) Technical Director, unless articles so provide

(ii) Directors representing special interest

(iii) Directors appointed by the central government

(iv) The directors of an independent private company.

DISQUALIFICATIONS OF DIRECTORS (SEC. 164)

The circumstances in which a person cannot be appointed as a director of a company are enumerated in Section 164. According to this section, a person cannot be appointed as a director of a company, if

(I) U/S 164(1) :

(a) he has been found to **be of unsound mind** by a competent court and the finding is in force ;

(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 of an offence** involving moral turpitude and sentenced to imprisonment for not less than 6 months and a period of 5 years has not elapsed since the expiry of his sentence ;

(e) he **has not paid any call** in respect of shares of the company held by him for a period of six months from the last day fixed for the payment;

1. Coal Products Pvt. Ltd. v. Ram Avtar Jalan (1969) 39 Comp. 223.

(f) he **has been disqualified by an order of the court or Tribunal** of an offence in relation to promotion, formation or management of the company of fraud or misfeasance in relation to the company.

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

(h) he has not complied with provisions u/s 152(3) **(*i.e* he has not obtained DIN)**

• U/S 164(2) :

Such person is already a director of a company which :

(A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or

(B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more :

In addition to the disqualification mentioned above there is another disqualification namely, the person should not be a minor or under any disability but should be competent to contract.

An independent private company may provide for additional grounds of disqualification in its articles.

Director shall inform the company about his disqualification in **Form DIR-8** before he is appointed or reappointed.

If a company fails to file the financial statement or annual returns or fails to repay any deposit, interest, dividend or fails to redeem its debentures, the company shall immediately file in Form DIR-9 to the Registrar, the name and address of all the directors of the company during the relevant financial years.

If the company fails to file **Form DIR-9** within 30 days of the failure, officers of the company specified in clause 60 of section 2 of the Act shall be officers in default.

Any application for removal of disqualification of directors shall be made in Form DIR-10.

VACATION OF OFFICE BY DIRECTORS (SECTION 167)

(1) The office of a director shall become vacant in case :

(a) he incurs any of the disqualifications specified in section 164 ;

(b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;

(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunals;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months :

Provided that the office shall be vacated by the director even if he has field an appeal against the order of such court;

hold these shares in his own right. Until the required number of shares are registered in the name of the director, he is not qualified. Lodging of shares transfer form is not the holding of shares.[1]

Liabilities in respect of qualification shares

If the company is wound up during this period of two months, such director cannot be placed on the list of contributories in as much as there is no express or implied contract under which he would be bound to take the qualification shares.

Consequences of failure to hold qualification shares

(i) If a director fails to obtain within 2 months or at anytime thereafter ceases to hold the qualification shares, he automatically varates office after the expiry of said 2 months and cannot act as a director and no notice of the director is required.

(ii) If a person acts as a director when he knows that the office of director held by him has become vacant, he shall be punishable with fine upto ₹ 5000 per day for the period he acts as a director [Section 283 (2A)]

(iii) If a person acts as a director of a company without holding the qualification shares, he will be punishable with fine which may extend to ₹ 500 for every day for the period he acts as a director (Section 272)

In a nut shell, if a person acts as a director after the expiry of said 2 months without taking qualification shares, he shall be liable to a cumulative fine upto ₹ 5,500 (₹ 5,000 + ₹ 500) for everyday for the period he acts as a director (Section 272 read with section 283).

Directors not required to hold qualification shares

The following directors are not required to hold qualification shares

(i) Technical Director, unless articles so provide

(ii) Directors representing special interest

(iii) Directors appointed by the central government

(iv) The directors of an independent private company.

DISQUALIFICATIONS OF DIRECTORS (SEC. 164)

The circumstances in which a person cannot be appointed as a director of a company are enumerated in Section 164. According to this section, a person cannot be appointed as a director of a company, if

(I) U/S 164(1) :

(a) he has been found to **be of unsound mind** by a competent court and the finding is in force ;

(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 of an offence** involving moral turpitude and sentenced to imprisonment for not less than 6 months and a period of 5 years has not elapsed since the expiry of his sentence ;

(e) he **has not paid any call** in respect of shares of the company held by him for a period of six months from the last day fixed for the payment;

1. Coal Products Pvt. Ltd. v. Ram Avtar Jalan (1969) 39 Comp. 223.

(f) he **has been disqualified by an order of the court or Tribunal** of an offence in relation to promotion, formation or management of the company of fraud or misfeasance in relation to the company.

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

(h) he has not complied with provisions u/s 152(3) **(*i.e* he has not obtained DIN)**

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(B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more :

In addition to the disqualification mentioned above there is another disqualification namely, the person should not be a minor or under any disability but should be competent to contract.

An independent private company may provide for additional grounds of disqualification in its articles.

Director shall inform the company about his disqualification in **Form DIR-8** before he is appointed or reappointed.

If a company fails to file the financial statement or annual returns or fails to repay any deposit, interest, dividend or fails to redeem its debentures, the company shall immediately file in Form DIR-9 to the Registrar, the name and address of all the directors of the company during the relevant financial years.

If the company fails to file **Form DIR-9** within 30 days of the failure, officers of the company specified in clause 60 of section 2 of the Act shall be officers in default.

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(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunals;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months :

Provided that the office shall be vacated by the director even if he has field an appeal against the order of such court;

(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

(2) If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications u/s 167(1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

(3) Where all the directors of a company vacate their offices under any of the disqualifications specified U/s 167(1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

The grounds laid down above for vacating the office of director apply to all companies—public and private. On the happening of any of the events, the director vacates the office automatically. The provisions of this section apply to all directors by whomsoever appointed and for whatsoever period appointed. The board has no power to waive the event or condone the act.

REMOVAL OF DIRECTORS

A director may be removed from his office ;

(1) By the Shareholders (Sec. 169) ; (2) By the Tribunal [Sec. 242].

(1) Removal by Shareholders. Section 169 empowers the company to remove a director by ordinary resolution before the expiry of his period of office except in the following cases ;

The following categories of directors cannot be removed by a company under section 169 of the Act :

(a) a director appointed by the Tribunal under section 242;

(b) a nominee director of a public financial institution which is by its charter empowered to nominate a person as a director or to remove him notwithstanding any power contained in any other Act;

(c) a director coming within the purview of directors appointed according to the principle of proportional representation under section 163 of the Act.

While the shareholders have no power, apart from that given in the statute or the Articles, to intervene in the management of the company's affairs, this section is designed to enable them to control the directors by their removal.

Special notice. Special notice is required of any resolution to remove a director or to appoint somebody in his place at the meeting at which he is removed.

On receipt of such notice, the company will immediately send a copy thereof to the director concerned and the director (whether or not he is a member of the company) shall be entitled to be heard on the resolution at the meeting.

Reasons for Removal—Not Necessary

It is not necessary to give reasons in the special notice given to the company or in the company notice to the members or in the resolution proposed by the Board itself, for removal of a director.

The explanatory statement u/s 102 are also not necessary in respect of the resolution for removal of directors, because the company is acting in pursuance of a special notice received by it to move the resolution. It is in fact, not resolution proposed by the company.

Director's right to make representation (Sec. 169(4)). The director concerned may also make any representation in writing and the copy of such representation may be sent by the company to every member. Where the copy of the representation is not sent to the members, in that case the director concerned may require the representation to be read at the meeting. Copies of such representations need not be sent to members nor the same be read out at the meeting if the Central Government is satisfied on an application being made by the company or the aggrieved person that the right as to representation is being abused to secure publicity for defamatory matter. In such a case the director concerned may have to pay costs, though not a party to the proceedings.

Filling of vacancy (Sec. 169(5), (6) & (7)). A vacancy created by the removal of a director as aforesaid can be filled up at the meeting at which he is removed provided special notice of the proposed appointment was also given. The director so appointed shall hold office till the date the director removed would otherwise have held office. If the vacancy is not filled, it shall be filled up as casual vacancy except that the director removed shall not be re-appointed.

Compensation (Sec. 169(8)). A director so removed shall not be deprived of any compensation or damages payable to him in respect of the termination of his appointment as director or of any appointment terminating with that as director.

Section 169 is general and applies to all directors including permanent and life directors (subject to the exceptions above). The right under this section is a statutory right given to a company and the company can exercise this power wherever it finds a director unsatisfactory or otherwise undesirable. The articles need not specify the circumstances in which the power can be exercised.

(2) Removal by the Tribunal. On an application to the Tribunal for prevention of oppression and mismanagement, the Tribunal may terminate, or set aside or modify any agreement between the company and the managing director or any other director or manager. (Sec. 242). On such termination, the director cannot serve the company in a managerial capacity for a period of five years from the date of the order of termination, without the permission of the Tribunal. The director on removal cannot sue the company for damages or compensation for loss of office. [Consequences of termination u/s 243].

Assignment of office. A director cannot assign his office to anybody. If such assignment is made it shall be void. (Sec. 166).

Removal of a non-rotational director of a Government company

Directors appointed by the State Government as a nominee director can be removed by such Government. The Government is entitled to revoke the nomination as a matter of right, which flows from the Articles of Association. Revoking of the appointment by the Government under the Articles is not the same thing as removal of a director by the company under section 169 of the Act. Hence, if the Government revokes the nomination, there is no circumvention of section 169.

(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

(2) If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications u/s 167(1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

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Civil Court cannot interfere in the matters of removal of a director

The right to remove a director of the company is provided in the Companies Act and it itself provides a procedure for enforcement of such right. Civil Courts cannot interfere with such matters of internal management of the companies. [*Khetan Industries Pvt. Ltd. v Manju Ravindra Prasad Khetan* (1995) 16 CLA 169 (Bom)]

The Court should not be a party to removal of permanent directors (or of any director) of a company by exercising its discretion under section 98 and dispensing with the special notice as required in section 169, in the absence of concrete, precise and specific charges against these directors.

RESIGNATION OF DIRECTORS

Earlier neither the Companies Act, 1956 nor the Table A was containing provision regarding resignation by a director. Moreover, section 283 of the Companies Act, 1956 also did not include resignation as one of the grounds for the vacation of office of a director. However, now section 168 provides for resignation of a director of a company.

1. A director may resign by giving notice in writing to the Company and Board of directors

Rule 15 provides that in terms of Section 168(1) a director may resign from his office by giving a notice in writing to the company and the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar within 30 days in Form DIR-12 along with the fee as per the companies (Registration Offices and Fees) Rules, 2014 and post the information on its website, if any. Further that the company shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company.

2. The resigning director may also forward a copy of the resignation to the Registrar alongwith the reasons for resignation

Rule 16 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that where a director resigns from his office, he shall also within thirty days from the date of resignation, forward to the Registrar a copy of his resignation along with reasons for the resignation in Form DIR-11 along with the fees prescribed under the Companies (Registration Offices and Fees) Rules, 2014.

3. Effective date of resignation by the Director

Section 168(2) provides that the resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

4. Director shall be liable after his resignation for offences which occurred during his tenure

It has been provided that the director who has resigned shall be liable even his resignation for the offences which occurred during his tenure.

5. Powers to appoint directors in case where all the directors resign from the company

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

6. Duty of the after resignation

After the resignation is received and the chairman of the Board has noted it, a letter informing of the receipt of the resignation should be sent to the director concerned. The Registrar of Companies shall be informed of the resignation of the director from the directorship by way of filing Form DIR-12 with the Registrar of Companies and the entry of the date of cessation will be made in the Register of directors.

At the next Board meeting, the letter of resignation will be placed before the Board and that fact will be recorded in the minutes of the meeting. It is common to place on record appreciation of the services of the concerned director. General notice of resignation of director is to be given to the public.

POWERS OF BOARD

A company being an artificial person, acts through its directors. The directors represent the directing mind or will of the company and control what it does. All the powers of management of the affairs of the company are vested in the board of directors. The board thus becomes the working organ of the company. In their domain of power, there can be no interference, not even by shareholders. The directors enjoy such powers as are given to them by the Act, memorandum or articles. Sections 179 & 180 deal with the powers of the board and the restrictions thereon.

The powers which vest in the board can be classified under three different heads :

I. General Powers : Powers which can be exercised in accordance with the articles.

II. Powers : u/s 179(3). Powers which can be exercised only at board meetings.

III. Powers under Rule 8.

IV. Other Matters

Let us understand them one by one :

I. General powers. The general powers of the Board of directors have been laid down in section 179 of the Companies Act, 1956. It empowers the board to exercise all such powers and do all such acts and things, as the company is authorised to exercise and do. In other words, the directors can do what the company is authorised to do unless there is any express restriction on their powers.

There are, however, two limitations upon their powers.

1. The Board shall not exercise those powers which under the Companies Act, 2013, or the memorandum of association or otherwise, are required to be exercised by the company in general meeting.
2. In exercising all such powers or doing of any such act, the Board will be subject to the provisions of this or any other Act, the memorandum or the articles.

Do shareholders have right to intervene/Powers cannot be usurped. The directors shall exercise their powers bonafide and in the interests of the company. But once specific powers of control and management have been granted by the company to its directors, the company cannot without justification impose its will at a general meeting. The shareholders cannot dictate to the directors the manner in which their executive authority is to be employed. Thus where the power to sell the assets of a company is vested in the board and the board thinks that it is not in the interests of the company to sell its assets, it is not bound to do so, notwithstanding a resolution to the contrary in general meeting.[1] Similarly where the shareholders by resolution pressed the directors to forego a debt, it was held that the directors were entitled to enforce the payment of the debt.[2]

"If powers of management are vested in the directors they and they alone can exercise those powers. The only way in which the general body of shareholders can control the exercise of the powers vested by articles in directors is by altering the articles, or, by refusing to re-elect the directors of whose action they disapprove. They cannot themselves usurp the powers, which by articles are vested in the directors, any more than the directors can usurp the powers vested by articles in the general body of shareholders."[3]

Exceptions. A company is an institution owned and controlled by its shareholders. As such the shareholders have an inherent and a residual executive power greater than the powers conferred upon directors. The powers of the directors are subject to the control by the shareholders at the general meeting. In the following exceptional cases the general meeting is competent to intervene in a matter delegated to board.

1. Directors acting malafide. The general body of shareholders can interfere where it is proved that the directors have acted from some improper motive or arbitrarily or capriciously. When the directors are themselves the wrongdoers against the company and have acted malafide or beyond their powers, and their personal interest is in conflict with their duty in such a way that they cannot or will not take steps to seek redress for the wrong done to the company, the majority of the shareholders must in such a case be entitled to take steps to redress the wrong.

Example : A and three other persons were the four directors of M company and they had a majority of shares. A controlled the majority of shares but less than three fourth. Another company known as N company was committing an infringement of M company's trade mark and the other three directors were interested in that company. At a meeting of the board A proposed a suit against the N company but the other three directors overruled his proposition. A at a general meeting of the shareholders resolved and commenced an action to restrain the alleged infringement. The other directors applied for the dismissal of the suit on the ground that as the articles had left the power of management with the board, the shareholders could not interfere by a simple resolution. It was held that the majority of the shareholders had the right to control the action of the directors.

[Marshall's Valve Gear Co. Ltd. v. Manning Wardle & Co. Ltd. (1909) 1 Ch. 267].

2. Board incompetent. The general body of shareholders may exercise the powers vested in the board when there is no legally constituted Board which could function or if there is a board but that is unable or unwilling to act. The shareholders have to step in where all the directors are interested in a transaction.

1. Pothan v. Hindustan Trading Corporation P. Ltd. (1967) 37. Com. Cas. 226
2. Shaw & Sons Ltd. v. Shaw (1935) 2 K.B. 113.
3. Ibid.

Example : The articles of the company authorised the board to fill casual vacancies. Some casual vacancies occurred and they were filled by the shareholders in general meeting because at that time there was no director validly in office. The appointment was challenged. It was held that the appointment was valid. **[Vishwanathan v. Tiffins B.A. and P. Ltd. AIR. 1953 Mad. 520].**

3. Deadlock in the Board. Where the directors are unable to act on account of a deadlock and the administration was at a stand still, the shareholders have the inherent power to take necessary steps to ensure the working of the company.

Example : There were only two directors on the Board of a company and one refused to act with another. Further they were unwilling to appoint additional directors under the powers conferred on them by the articles. Thus there was a dead lock. The shareholders in the general meeting appointed an additional director. The appointment was held valid. **[Barran v. Potter (1974) 1 Ch. 895].**

4. Residuary powers. The residuary powers of a company reside in the general meeting of shareholders and the shareholders can always exercise such residuary powers.

II. Powers under section 179(3) : Matters which shall always be considered at the meeting of the Board

There are specific provisions in the Act which require that certain matters, which are of importance to the company, shall always be considered at a meeting of the Board and accorded approval by resolution as per provisions of section 179(3) of the Companies Act, 2013, as given below :

(a) to make calls on shareholders in respect of money unpaid on their shares;
(b) to authorise buy-back of securities under section 68;
(c) to issue securities, including debentures, whether in or outside India;
(d) to borrow monies;
(e) to invest the funds of the company;
(f) to grant loans or give guarantee or provide security in respect of loans;
(g) to approve financial statement and the Board's report;
(h) to diversify the business of the company;
(i) to approve amalgamation, merger or reconstruction;
(j) to take over a company or acquire a controlling or substantial stake in another company;
(k) any other matter which may be prescribed.

It is also provided in the section that the Board may delegate by a resolution to a committee of directors, the managing director, manager or a principal officer of the company, any of the powers at items (d), (e) and (f).

III. Powers under Rule 8

Rule 8 of the Companies (Meeting of the Board and its powers) Rules, 2014 provides that in additions to be matters specified under section 179(3) the following powers shall be exercised only by means of resolutions passed at meeting of the Board, namely :

(i) to make political contributions;
(ii) to appoint or remove key managerial personnel (KMP)
(iii) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;

(iv) to appoint internal auditors and secretarial auditors;

(v) to take note of the disclosure of director's interest and shareholding;

(vi) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid – up share capital and free reserves of the investee company;

(vii) to accept or accept or renew public deposits and related matters;

(viii) to review or change the terms and conditions of public deposits;

(ix) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

IV. Other matters

In addition to the items referred to above, there are various other matters, as illustrated below in the routine working of a company which are considered by the Board at Board meetings :

(a) Issuance of shares.

(b) Allotment of shares and debentures.

(c) Appointment of directors and Managing Director/Whole-time Director.

(d) Consideration of Annual Accounts.

(e) Approval of interim dividend and recommendation of final dividend.

(f) Appointment of sole selling/buying agents.

(g) Merger and amalgamation of companies.

(h) Capitalisation of reserves and issuance of bonus shares.

(i) Appointment of auditors in casual vacancy caused otherwise than by resignation.

(j) Appointment of whole time secretary for issuance of compliance certificate.

(k) Further, where proposals are initiated by the Board and recommended for the consideration of the company in general meeting, all these matters are first considered at a meeting of the Board.

POWERS OF BOARD EXERCISEABLE WITH THE CONSENT OF GENERAL MEETING OR RESTRICTIONS ON POWERS OF BOARD (SECTION 180)

The Board of directors of a public company or of a private company which is a subsidiary of a public company shall not exercise the following powers except with the consent of the company in general meeting :

(a) Power to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company. In case of an improper sale or lease by the director the title of the purchaser or lessee will not be affected provided he buys or takes it in good faith and with due care and caution; i.e. the title of a bonafide buyer or lessee shall be free from any defect.

No approval of general meeting is required if the ordinary business of the company consists of selling or leasing of properties.

(b) Power to remit or give time for repayment of any debt due to the company by a director. However, no such consent is required for renewal or continuance of an advance made by a banking company to its director in the ordinary course of its business;

(c) Power to invest otherwise than in trust securities, the amount of compensation received by the company in respect of the compulsory acquisition

(i) of any undertaking

(ii) or premises or properties of the company ;

It is worth mentioning that no consent of the shareholders is required if compensation received by the company is invested in trust securities specified under section 20 the Indian Trust Act.

(d) Power to borrow money, where the money to be borrowed together with the moneys already borrowed by the company will exceed the aggregate of the paid-up capital of the company and its free reserves. This however, will not include temporary loans obtained from the company's bankers in the ordinary course of business ;

The resolution passed in the general meeting shall specify the total amount upto which moneys, may be borrowed by the Board otherwise the resolution shall be void.

(e) Power to contribute to (Sec. 181) :

(i) charitable funds

(ii) any other fund not directly relating to the business of the company

(iii) any other fund not directly relating to welfare of the employees

If the amount contributed in a financial year exceeds 5% of average net profit during 3 immediately preceding financial years, then a prior permission in the General Meeting is required.

DUTIES OF DIRECTORS

As directors possess immense powers they hold a key position in the company management. Law imposes certain duties upon them, in the interest of the public good and for the protection of those who invest money in the company. The duties of a director vary from company to company and within any one company the directors may and frequently do have different responsibilities. Breach of these duties or negligence in performing them on the part of a director entitles the company to sue him for any damage which has been suffered by the company as a result of the breach or negligence.

The duties of directors may be discussed under the following heads :

1. Fiduciary duties,
2. Duty of care and skill,
3. Duty to attend board meetings,
4. Duty not to delegate,
5. Duty to disclose interest, and
6. Statutory duties.

1. Fiduciary duties. The directors occupy a fiduciary position and must therefore, exercise their powers in good faith and for the benefit of the company as a whole. Directors should not enter into engagements in which there is a possibility that the directors personal interest could conflict with those of the company which they are bound to protect.

Example : The directors of a company carrying on the business of railway construction contractors obtained a contract in their own name to the exclusion of the company. The directors also procured a resolution of the company ratifying their conduct. On an action brought by a shareholder the Privy Council held that it was a breach of trust on the part of the directors and that the benefit of the contract belonged to the company and they were bound to account to the company for it.

[Cook v. Deeks (1916) A.C. 554 (P.C.)].

Another consequence of the fiduciary position of a director is that he cannot make a secret profit by reason of opportunities acquired as a result of his position. Where a director makes profits by the use of confidential information, he is not entitled to retain it unless these profits are disclosed to and approved by the company.

Example : R Co. Ltd. owned a cinema, and its directors wished to acquire two other cinemas in the town with a view to sell the three together. For this purpose a subsidiary company H was formed in which 3,000 shares were taken by the directors and R company's solicitors. The cinemas were acquired. Ultimately it was decided not to sell the property of company, but to sell the shares in R and H. The shares of the H company which the directors had purchased at par were sold at a profit. It was held that the directors were in a fiduciary relationship to the company and having obtained these shares by reason and only by reason of the fact that they were directors of R company, and in the course of the execution of their office, they must account for the profit they had made.

[Regal (Hastings) Ltd.v. Gulliver (1942) 1. All E.R. 378].

The fiduciary duty so owed is owed to the company as a whole and not to any individual member of it.

Where a director is instructed to purchase some property for the company, and he purchases the same for himself and then sells it to the company at a profit, he is clearly liable to account for the profit so made.

Examples : (1) One Burland was a director of the plaintiff company. He was also a shareholder and creditor of another company known as Burland Lithographic company, which was being wound up. At a public sale by the liquidator, Burland purchased all the assets of the company in four lots. The price paid by him for Lot I was 21, 564. and he shortly afterwards sold it to the plaintiff company for 60,000. In these circumstances he was ordered by the lower court to pay to the company the sum of 38,436 being the amount of profit made by him on the resale.

(2) Directors bought shares from a shareholder while they were negotiating for the sale of the company at a very high price. The directors did not disclose the fact to the shareholder. It was held that the directors do not owe fiduciary duties to any individual shareholder. Accordingly they were not under a duty to inform the shareholder of the negotiations. **[Percival v. Wright (1902) 2, Ch. 421].**

2. Duty of care and skill. Honesty alone is not enough. A director must perform his duties with reasonable care and skill *i.e. with that amount of care which an ordinary man will be expected to take, if the business of the company was his own. A director will be liable for negligence in the carrying out of his duties, where a dividend was paid by directors after the company traded only for eight months without any investigation of company's trading position, such payment was improper and the directors must refund.*[1] However, a director cannot be held liable for mere error of judgment, if he acts honestly and with reasonable care.

The duty of care and skill will depend upon the nature and size of the company's business and the manner in which the work of the company is distributed between the directors and other officials of

1. Rance's case (1870) L.R. 66 Ch. App. 104.

the company. The nature of the duties of a director to the company were discussed by Romer J. in the famous case of *Re. City Equitable Fire Insurance Co. Ltd.*[1] *wherein he observed :*

"As a general proposition a director will not be held liable for negligence unless guilty of ...gross or culpable negligence in a business sense."

The learned judge laid down the following propositions relating to the duty of care and skill.

1. "A director need not exhibit in the performance of his duties a *greater degree of skill* than may reasonably by expected from a person of his knowledge and experience. A director of a life insurance company, for instance does not guarantee that he has the skill of an actuary or a physician.
2. A director is not bound to give *continuous attention* to the affairs of the company. His duties are of an intermittent nature to be performed at periodic board meetings and the meetings of any committee to which he is appointed. He is not bound to attend all such meetings though he ought to attend whenever he is reasonably able to do so.
3. In respect of all duties, that having regard to the exigencies of business and the articles of association, may properly *be left to some other* official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

To conclude in the words of Lindley M.R. "If directors act within their powers, if they act with such care as is to be reasonably expected of them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as legal duty to the company.[2]

3. Duty to attend board meetings. Reasonable care requires that a director should give a reasonable amount of attention to the affairs of the company. A director should attend the board meetings whenever he is able to do so, but he is not bound to attend all board meetings. Continuous non-attendance may render a director liable for the acts of his co-directors. Section 164 provides that the office of director becomes vacant if he absents himself from (*i*) three consecutive meetings of the board or (*ii*) from all meetings of the board, for a continuous period of three months, whichever is longer, without obtaining leave of absence from the board.

4. Duty not to delegate. As a rule directors must perform their duties personally and should not delegate their office. The directors are bound by the maxim, *"delegates nonpotest delegare.' The rule is, however, subject to certain exceptions. The directors may delegate their duties if the Act or the articles specifically authorise them to do so. Secondly, having regard to the exigencies of the business, the directors may distribute the work among themselves and other officials of the company.*

5. Duty to disclose interest. As a director is an agent of the company, he must see that his interest and duty do not conflict. "For the proper exercise of the functions of a director, it is essential that he should be disinterested that is to say, he should be free from any conflicting interest." It follows that the company can avoid a contract in which the director has an interest unless the prior sanction of the board has been taken.

According to section 184 of the Companies Act, a director who is interested in any transaction of the company, he is bound to disclose his interest to the board. The disclosure shall be made at the first

1. (1925). ch. 407. (CA)
2. Lagunas Nitrate Co. v. Lagunas SYndicate, (1899) 2, Ch. 392.

meeting of the board held after he has become so interested. An interested director cannot take part in the discussion or vote on any contract in which he is directly or indirectly interested [Sec, 2(49)].

6. Statutory duties. Apart from the duties explained above, the directors have some specific duties laid down by the Companies Act.

Some of the important duties are enumerated below :

1. Duty not to allot shares until minimum subscription is raised. (Sections 39).
2. Duty to sign annual returns and the certificate attached thereto. (Sec. 92).
3. Duty to forward the statutory report to every member of the company.
4. Duty to call an annual general meeting every year within the proper time. (Sec. 96).
5. Duty to call an extraordinary general meeting on a valid requisition. (Sec. 100).
6. Duty to prepare profit and loss account and balance sheet and lay before the company with the director's report as to the state of the company's affairs. (Sections 128, 129 and 134).
7. Duty to take share qualification.

The list of duties given above is illustrative and not exhaustive.

7. Duty to prepare Director's Responsibility Statement and send to the Registrar alongwith Board's Report

Section 134(1) (c) of the Companies Act, 2013 provides that the Board's Report will also include a Director's Responsibility statement which shall that —

(a) directors had followed, in the preparation of annual accounts, the applicable accounting standards and given proper explanation relating to material departures, if any;

(b) they had selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true an fair picture of the state of affairs of the company at the end of the financial year and of profit or loss of the company for that period;

(c) they had taken sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Act so as to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

LIABILITY OF DIRECTORS

The liabilities of directors can be classified into :

1. Civil liability. 2. Criminal liability.

1. Civil liability. The directors may render themselves liable to *(a) the company; and (b) to the third parties.*

Liability towards the company. Directors are agents and trustees of the company as such they owe certain duties to the company. Breach of these duties or negligence in performing them may make them liable to the company and its shareholders. They may become liable for :

(i) Negligence, (i) Misfeasance, (iii) Breach of trust, and (iv) Ultra vires acts.

(i) Negligence. A director must exercise due care and diligence in the performance of his duties. When the directors acting within their powers fail to use such reasonable skill and diligence as may be expected from persons with their knowledge and experience in the management of the company's

affairs, they can be held liable for negligence. However, they will not be liable for mere errors of judgment resulting in a loss to the company provided they acted bonafide for the benefit of the company.

Example : P owed some money to a company. The directors in exercise of their discretion decide not to sue to recover the debt and consequently, the money was ultimately lost on account of the delay in action. It was held though technically it would amount to a breach of duty, it would neither be an actionable breach nor amount to negligence if they exercise their discretion bonafide and in the best interest of the company. **[Re. Forest of Dean Coal Mining Co. (1878) 10 Ch. D. 450].**

A director is not necessarily negligent if he fails to attend a board meeting but continuous non-attendance may be treated as a negligence on his part. Further, a director is justified in trusting officials of the company to carry out honestly any duty which in the absence of grounds for suspicion, may properly be left to him. Consequently, he shall not be held liable for negligence if such officer causes some loss or damage to the company by misconduct.

But, where a director had reason for suspecting an officer of the company for fraud, failure to investigate would amount to negligence in the performance of his duties. However, a director would not be liable for negligence if the company has not suffered any damage.

Section 197 of the Companies Act provides that any provisions in the articles of a company or in any agreement with the company, exempting any officer of the company from any liability arising from any negligence, default or misfeasance shall be void.

Relief against such liability may be granted under section 633 by a court if it is satisfied that he had acted honestly and reasonably, and that having regard to all the circumstances of the case, he ought fairly be excused. The court may relieve him, either wholly or partly from his liability on such terms as it may think fit.

(ii) Misfeasance. Misfeasance is defined as any breach of duty in the conduct of the company's affairs which causes loss to the company. It is something more than negligence. Any fraud or underhand dealing by the director will render him liable to the company for any loss suffered by the company as a result.

In order to take action against a director on the ground of misfeasance, two conditions must be fulfilled :

(a) there must be misconduct or negligence on the part of a director, and

(b) such act must be wilful.

Misfeasance proceedings may be taken up against a director by the court if the company is in the course of winding up. Application to the court may be made by the liquidator, or any creditor or contributory. The court may require the directors who are guilty of misfeasance to make good the loss to the company. (Sec. 340). In case of misfeasance proceedings also, the directors may apply for relief under Sec. 463.

(iii) Breach of trust. The directors are further liable for a breach of trust. It means any misapplication of the funds of the company. As directors are trustees of the company, they must exercise their powers bonafide and in the interest of the company as a whole. The assets of the company are entrusted to the directors to be applied to certain defined objects and they are responsible for a breach of trust if they apply them to other objects. Thus, paying dividend out of capital or using the funds of the company for ultra vires purposes amounts to a breach of trust. Similarly, where a director had caused shares to be allotted to his infant children, he was made personally liable for the unpaid liability of the shares.

(iv) Ultra vires act. Where directors do any acts which are in excess of their powers, or which are ultra vires and the company suffers a loss, the directors shall be personally liable to the company to make good the loss. It is not necessary to prove fraud in such cases. Thus where directors pay dividend out of their capital, they would be compelled to pay back the amount to the company. Similarly, where the directors have used their powers to part with moneys of the company for a purpose which the law forbids, they shall be personally liable to the company.

Liability to Third Parties

(1) As to contracts. Directors being agents of the company are not liable to third parties on contracts which they make on behalf of the company. They will be liable only when ordinary agents will be liable under those circumstances. This was pointed out by Lord Cairns in Ferguson v. Wilson.[1]

"Wherever an agent is liable, those directors would be liable, where liability would attach to the principal and the principal only, the liability is the liability of the company."

Where the directors have no authority to make the contracts, they are still not personally liable on the contract because every person contracting with the company is bound to read its memorandum and know the powers of the company. But where such ultra vires transaction amounts to a breach of an implied warranty of authority held out by the directors they may be liable for damages.

Example : A railway company had fully exercised its borrowing powers. Mr. Weeks lent 500 to the company and received a debenture which was subsequently declared void because the company had exhausted all its borrowing powers. It was held that the directors were liable in damages because they have warranted that they had authority to act on behalf of the company and the company had power to issue such debentures. **[Weeks v. Property (1873), 8 C.P. 427].**

Where directors contract in their own names, without disclosing that they are acting for the company, they are personally liable on the contract. Further, if they contract, disclosing the fact that they are directors, but without using words, sufficient to bind the company, they may render themselves personally liable on the contract.

(2) ***As to frauds and torts.*** *A director who is a party to a fraud, or to the commission of any other tort is personally liable to the injured party. For example, if by the order of the directors a patent is infringed or another wrongful act is committed, the directors who are parties to it are personally liable. But a director is not liable for the fraud of his co-directors unless it is authorised by him or he has participated therein.*

(3) ***Liability under the provisions of the Act. The directors are personally liable to third parties under the provisions of the Act in the following cases:***

(a) mis-statement in a prospectus (Sec. 35). Directors will be liable in respect of any fraudulent statement in a prospectus which has induced a person to subscribe for shares in the company.

(b) failure to repay the application money for shares. Where the minimum subscription as stated in the prospectus has not been subscribed, no allotment of shares can be made by the company. Section 39 read along with SEBI guidelines

(c) Where the directors knowingly contravene the provisions as to allotment, they are liable to compensate the company and the allottee for any loss or damage suffered thereby. Proceedings against the directors must be commenced within two years of allotment.

1. (1866) L.R. 2, Ch. App. 77.

(d) failure to repay application money for shares if application for these to be dealt in on the stock exchange is not made or refused (Sec. 40).

(e) In case of fraudulent trading by the company, the directors may be held personally liable by an order of the court under Section 339 of the Companies Act.

2. Criminal liability. Companies Act, 2013, imposes certain duties upon the directors and they may be liable to penalties by way of fine or imprisonment if they fail to perform them. These penal provisions are incorporated to create a sense of awareness in the directors in discharging their obligations.

Under the Companies Act criminal proceedings against directors may be instituted in pursuance of the following sections, among others, resulting in imprisonment :

(a) Section 34-Filing of prospectus containing untrue statements.

(b) Section 74-Inviting deposits in contravention of the rules, or manner or conditions-seven years imprisonment and fine not less non ₹ 25 lakh.

(c) Section 26-Issuing false advertisement inviting deposits–three years imprisonment, and/or ₹ 50000 fine.

(d) Section 36-Fraudulently inducing persons to invest money- imprisonment upto ten years, or fine.

(e) Section 40-Failure to repay excess application money- imprisonment upto one year and fine not less than 5 lakh & maximum 50 lakh.

(f) Section 66-Concealing name of creditor-imprisonment upto 10 year or fine or both.

(g) Section 164-Undischarged insolvent acting as director-imprisonment or fine or both.

(h) Section 127-Default in distributing dividends-2 years imprisonment and fine not less than 1000 per day of default.

(i) Section 207, 208 A-Failure to assist Registrar in inspection of books of account, etc.- imprisonment upto one year and fine not less than ₹ 25,000 which may extend to 1 lakh.

(j) Section 129-Failure to lay balance sheet etc. at annual general meeting-imprisonment upto one year or fine upto ₹ 50,000 or both.

(k) Section 134-Failure to attach to balance sheet a report of the board-imprisonment upto 3 years for each offence or fine not less than 50,000 and maximum 25 lakhs.

(l) Section 222-Improper issue of shares-imprisonment upto six months or fine of one lakhs and maximum 25 lakhs.

(m) Section 185-Grant of loan to directors-Simple imprisonment upto six months or fine of five lakhs and maximum 25 lakhs.

(n) Section 243-Acting as director after removal by court- imprisonment upto six months, or fine upto ₹ 5 lakhs or both.

(o) False declaration of company's solvency- imprisonment or fine or both.

(p) Section 336 to 339 and, 347-Offences regarding companies- imprisonment ranges between 3 years and 5 years and fine from ₹ 1,00,000 to ₹ 3,00,000.

MANAGERIAL REMUNERATION

As directors are not servants of the company, they have no right for payment unless it is provided in the articles. In the absence of an express agreement regarding remuneration, the directors render services to the company gratuitously and not for reward. The remuneration payable to the directors is determined by the articles of the company or by a resolution or if the articles so require by a special resolution passed by the company in a general meeting. The directors cannot themselves fix the remuneration of all or any one of themselves. Once the articles provide for remuneration it becomes a debt due from the company to the director and may be sued for and may be paid out of capital if there are no profits, and like ordinary creditors can prove their claim in winding up of the company. But a director cannot claim preferential payment of fees owing to him as he is not a servant of the company.

The expression managerial remuneration refers to the remuneration payable to the

(a) Managing director; (b) Whole Time Director; or

(c) Manager

It does not include executives who are not members of the board of directors irrespective of the salary paid to them.

Maximum Managerial Remuneration

Section 197 fixes an overall limit of managerial remuneration payable by a public company and a private company which is a subsidiary of public company. It provides that a company may pay to its directors and manager in respect of any financial year remuneration not exceeding eleven per cent of its net profits of that year.

Net profit for the purposes of determining directors remuneration shall be calculated u/s 198. In such calculation the remuneration of the directors shall not be deducted from the gross profit but income tax paid or payable should be deducted. A director may receive remuneration by way of a fee for attending board or committee meetings and fees so received are excluded in computing the over all limit of eleven per cent.

Minimum Remuneration in Case of Inadequate Profits

Section 197(3), prohibits the payment of any sum by way of minimum remuneration where company has no profit or its profits are inadequate, except with the previous approval of the central government. However there is one exception to this rule. Where the appointment and remuneration of the managerial personnel is subject to the provisions of section 203 the Company can pay minimum remuneration (inspite of losses or inadequacy of profits) without the approval of the Central Government.

PRESCRIBED SITTING FEE

Sitting fees payable to directors. According to Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 the amount of remuneration by way of fee for each meeting of the Board of directors or a committee thereof shall be payable as under :

A company may pay a sitting fee to a director for attending meetings of the Board or committees thereof such sum as may be decided by the Board of directors thereof which shall not exceed one lakh rupees per meeting of the Board committee therefore :

Provided that for Independent Directors and Women Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

Meaning of the Term 'Remuneration'

In order to make this limit meaningful and to prevent directors from drawing more money in the guise of collateral benefits, the explanation to section 197 provides that the word 'remuneration' shall include the following:

(i) Any expenditure incurred by the company for providing rent-free accommodation or any other benefit or amenity in respect of accommodation or otherwise free of charge.

(ii) any expenditure incurred by a company in providing any other benefit or amenity either free of charge or at a concessional rate.

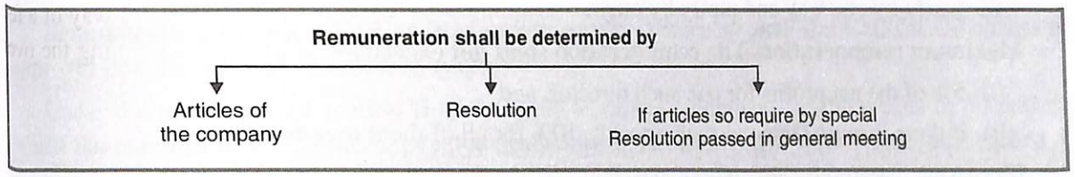
(iii) any expenditure incurred by the company in respect of any obligation or service which otherwise would have been incurred by the directors or manager.

(iv) any expenditure incurred by the company to effect any insurance on the life of the person, or his spouse or in providing any pension, annuity or gratuity.

RULES REGARDING DIRECTORS' REMUNERATION

Director's Remuneration to be fixed by Articles or Resolution in General Meeting

The remuneration payable to the directors of a company, including any managing director, shall be determined in accordance with the provisions of section 197 either by articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting.



The remuneration payable to any director shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity *except where,*

(a) the services rendered are of professional nature, and

(b) in the opinion of the central government, the director possesses requisite qualifications for the practice of the profession.

A. COMPANY HAVING ADEQUATE PROFITS :

[Section I of Part II of Schedule V of Companies Act, 2013]

1. Payment of remuneration to Ordinary or Non Executive Directors

Mode of payment. A director who is neither in the wholetime employment of company nor a managing director may be paid remuneration either

(a) by way of a monthly, quarterly or annual payment with the approval of the central government ; or

(b) by way of commission if the company by special resolution authorises such payment.

Maximum remuneration to such director. Non-executive directors are those on the Board of a company who are other than a managing or whole-time director. These non-executive directors normally receive only sitting fees for every meeting of the Board and Committee attended by them. Therefore a director who is neither in the whole time employment of company nor a managing director is called an ordinary director or non-executive director.

Quantum of commission that may be paid to non-executive directors. Section 197(1)(ii) provides that a director or directors who is/are not managing or whole-time directors may be paid remuneration periodically with the approval of the Central Government or may be paid commission, provided the said remuneration shall not exceed 1% of the net profits if the company has a managing or whole-time director or manager and 3% in other cases. The net profits shall be computed in terms of section 198, of the Act.

Excess payment. If any director receives, directly or indirectly, any remuneration in excess of the permissible limit or without requisite approval, he will have to refund such sums to the company and until such sum is refunded, he shall hold it in trust for the company. Even the company cannot waive the recovery of such sum unless permitted by the central government.

2. Payment of Remuneration to Managing or Wholetime Director

Mode of payment u/s 197(1). A director who is either in the whole-time employment of the company or a managing director may be paid remuneration either :–

(i) by way of monthly payment, or

(ii) at a specified percentage of the net profits of the company , or

(iii) partly by one way and partly by other.

Maximum remuneration. The remuneration shall not exceed—

(i) 5% of the net profits for one such director, and

(ii) if there is more than one such director, 10% for all of them together.

Increased remuneration when possible. With the approval of the central government remuneration may be paid in excess of 5% or 10% as the case may be.

Total Ceiling on Managerial Remunerations

Section 197(1) provides that the total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

Section 197 not Applicable to a Private Company

The provisions of Section 197 shall not apply to a private company unless it a subsidiary of a public company.

Chart showing the overall picture of managerial remuneration

Different categories of managerial personnel entitled to remuneration		*Maximum percentage of net-profits*
(1)	All directors when there is a manager or managing director or a whole-time director.	1%
(2)	All directors when there is no manager or managing director or whole-time director.	3%
(3)	Managing director (when there is one managing director).	5%
(4)	Manager (there is no provision of having more than one manager).	5%
(5)	Whole-time directors (when there is one such director).	5%
(6)	Managing directors and whole-time directors taken together.	10%
(7)	Total managerial remuneration to all directors, managing director(s) or manager and/or whole time director(s)	11%

New Ceiling Limits now Applicable

(a) If a company is laving adequate net profit, it can pay remunelation within the limits prescribed under Section 309(3).

(b) If a company not laving adequate net profits or it is Laving loss, it can pay remuneration, subject to fulfillment of other conditions of Schedule XIII.

B. COMPANY HAVING INADEQUATE OR NO PROFITS

[Section II of Part II of Schedule V of Companies Act, 2013]

Situation 1

Remuneration in case of nil or inadequate profits, where neither the Central Government approval nor the Special Resolution required :

Under the provisions of section II of Schedule V, where a company has no profits or inadequate profits the maximum remuneration payable depending upon the effective capital shall not exceed ₹ 5 lakhs per month or ₹ 60 lakhs per annum calculated on the following scale based on the effective capital of the company :

Effective Capital of the Company is	Monthly Remuneration payable shall not exceed Rupees
Less than ₹ 5 Crore	2,50,000
₹ 5 Crore or more but less than ₹ 100 Crore	3,50,000
₹ 100 Crore or more but less than ₹ 250 Crore	5,00,000
₹ 250 Crore or more	5,00,000 + 0.01% of the Effective capital in excess of ₹ 250 crores.

Eligible perquisite—A managerial person shall also be eligible to the following perquisites which shall not included in the computation of the ceiling on remuneration specified above :

(a) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income Tax Act, 1961,

(b) gratuity payable at a rate not exceeding half a month's salary for each completed year of service, and

(c) encashment of leave at the end of the tenure.

Situation 2

Cases where Special Resolution is required but Government approval is not required.

The notification has introduced a new situation where an eligible company can fix remuneration at higher ceiling limits.

Effective Capital of the Company	Monthly remuneration payable shall not exceed
Less than Rupees 5 Crore	5,00,000
Rupees 5 Crore or more but less than Rupees 100 Crore	7,00,000
Rupees 100 Crore or more but less than Rupees 250 Crore	10,00,000
Rupees 250 Crore or more	10,00,000 + 0.02% of the Effective Capital in excess of 250 crores

On one hand the Department of Company Affairs allows payment of remuneration at enhanced limits and on the other, to ensure stringent control over Corporate Governance, it imposes certain additional condition are in addition to conditions (a) and (b) discussed in situation 1, i.e., (1) Approved by Remuneration Committee, (2) Repayment of Debts.

(a) Approved by Special Resolution. A special resolution has to be passed at the General Meeting for the payment of remuneration for a period not exceeding three years.

(b) Notice of General Meeting should have a statement containing the prescribed information. A statement containing the following information should be given along with the notice calling for the General Meeting to every shareholder.

(i) General information about the industry and the company on prescribed lines,

(ii) Information about the appointee, including background, past remuneration etc.,

(iii) Other information, pertaining to reasons for loss or inadequate profit, steps taken or proposed to be taken for improvement expected increase in productivity and profits in measurable terms, etc.,

(iv) Disclosure requirement in the Director's report under the heading 'Corporate Governance', if any, attached to the annual report regarding all elements of remuneration packages such as salary, benefits, bonuses, stock options, pension etc.

Situation 3 : Section III of Part II of Schedule V of Companies Act, 2013

Remuneration payable by a company having no profit or inadequate profit without Central Government approval in certain special circumstances —by other foreign company, newly incorporated company and sick company

Section III of the Part II of Schedule V provides that in the following circumstances a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above :

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has go the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

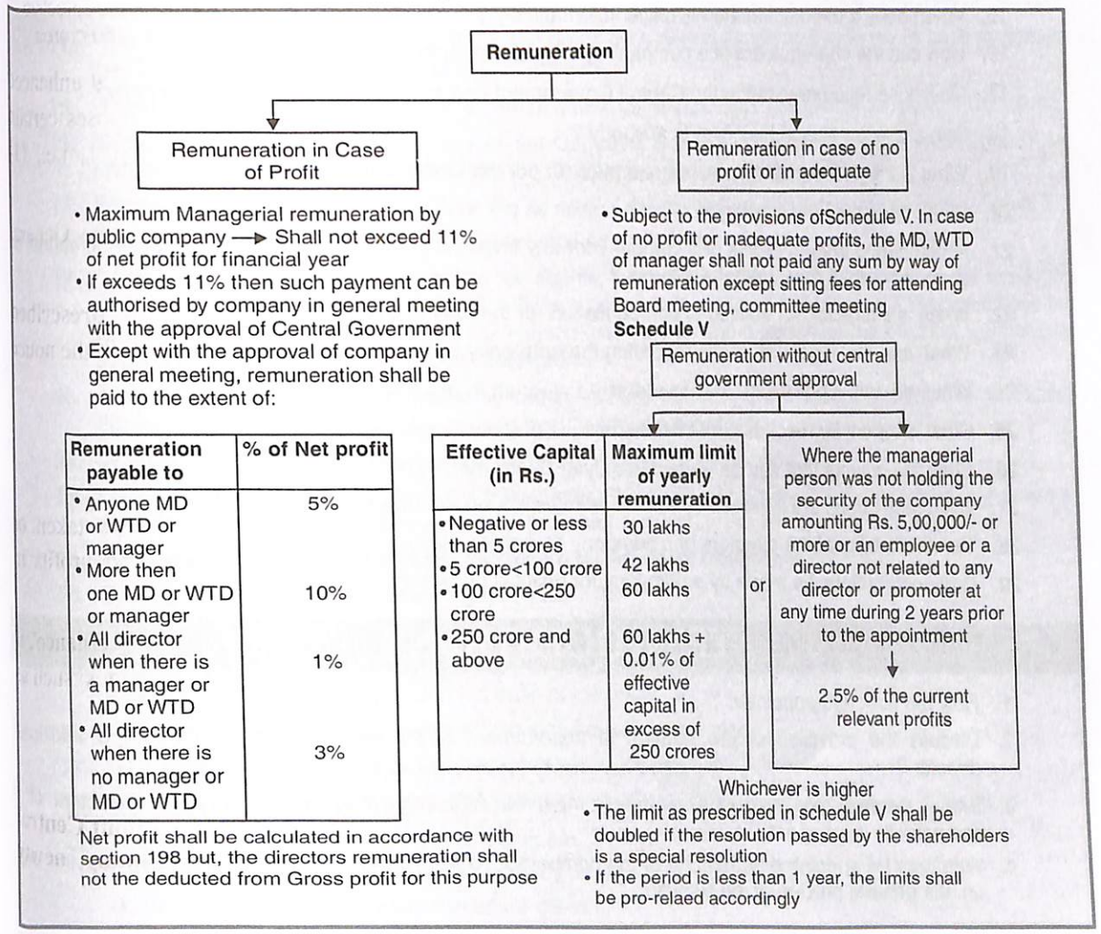
(b) where the company —

(i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the BIFR or NCLT, for a period of 5 years from the date of sanction of scheme of revival,

it may pay remuneration up to two times the amount permissible under Section II.

(c) Where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the BIFR or the NCLT.



SHORT ANSWER QUETIONS

1. Who is a director ?
2. Is it necessary for a company to have directors ?
3. Who can be appointed as a director ?
4. Can a firm or body corporate act as a director of a company ?
5. What is meant by share qualification of a director ?
6. When is a person disqualified for appointment as a director of a company ?
7. What is the minimum and the maximum number of director of a private and a public company ?
8. How are the first directors of a company appointed ?
9. When are subscribers to the memorandum deemed to be the directors of a company?
10. Can additional directors be appointed by a company ?
11. Can the Central Government appoint directors of a company ?
12. What is the penalty for acting as a director of a company without acquiring share qualification ?
13. What is the maximum number of companies of which a person can act as a director at a time ?
14. Which types of companies are exclded in calculating the number of companies of which a person may be a director ?
15. When does a director vacate his office automatically ?
16. How can the shareholders of a company remove the directors ?
17. On whose recommendation the Central Government can remove a director of a company?
18. Can a director assign his office to anybody ?
19. What is the limit of managerial remuneration as per the Companies Act ?
20. What does the term 'managerial remuneration as per the Companies Act include ?
21. In computing the net profits of a company for any financial year (i) credit has to be given (ii) cannot be given for certain items. What are these ?
22. When is a director not entitled to compensation for the loss of office ?
23. What are the legal provisions regarding the frequency of holding Board meetings ?
24. What do you understand by disinterested quorum in relation to Board meetings ?
25. What is meant by resolution by circulation ?
26. State the powers that can be tranacted only at Board meetings.
27. What restrictions are imposed by the Companies Act on the powers of the Board of directors ?
28. Can the liability of the directors of a company be made unlimited ?
29. Can contributions be made by a company for political purposes.

TEST QUESTIONS

1. How the directors appointed ?
2. Discuss the provision of law relating to appointment & tenure of alternate director & additional director ?
3. Briefly discuss the provisions of the Companies Act, regarding appointment of directors of a company ?
4. Who may be appointed as director of the company. What are the restrictions imposed by the Act, on the general powers of the Board ?

5. What are the restrictions on appointment of directors ?
6. How are directors of a public limited company appointed ? In case of resignation tendered by director elucidate :—
   (a) The date of which resignation takes effect &
   (b) Whether the resignation relieves the director from liabilities & obligations already incurred ?
7. State in relation to a public company :—
   (a) When Additional Director can be appointed & for what period ?
   (b) When an alternate director can be appointed & for what period ?
   (c) How the office of director is filled in case of casual vacancy & for what period?
   (d) Can director be appointed by proportional representation ?
8. Explain the powers of Tribunal to prevent changes in Board of Directors of a Company?
9. "A director can't enter into a contract with the Company." Examine statment.
10. "The powers of directors are co-extensive with those of company itself." Discuss.
11. The BOD of a Company shall be entitled to excerise such powers & do all such acts & things as the Company is authorised to exercise & do in general meeting." Critically discuss.
12. Discuss with reference to Company Law the powers of Government to fix or vary the managerial remuneration.
13. "The BOD is an agency through which the Company functions, as such it has unrestricted powers under the Companies Act." Comment.
14. "The Board of Directors of a Company can do all such acts & things and exercise all such powers as the Company itself may do & exercise." Comment.
15. "The directors of the Company are a seat of power as well as locus of legal responsibility." Comment.
16. "Director shall have all the powers of the Co. save & except those which either by Articles or by statute are requised to be exercised by the Company in general meeting." Discuss.
17. What are the statutory restrictions on the powers of director ? Can a director hold an office of profit ?
18. "Directors are not only agents but also in some sense trustees of the Company." Discuss.
19. "Directors are described sometimes as agents, sometimes a trustees & sometimes as managing partners. But each of these expression is used not as exhaustive of their powers & responsibilities but as indicating useful points of view from which they may for the moment for the particular purpose be considered." Elucidate with suitable illustrations.
20. How can directors of a Company be removed from office before the expiry of their term. Explain procedure for filling the vacancy caused by removal of a director ?
21. When is the office of a director of the Company deemed to be vacated ?
22. Can a director be removed from his office before the expiry of his term ? If the director is aggrieved by such removal, what remedies are available to him ?
23. What are the powers of the Govt. with regard to removal of directors by it ?
24. What is the procedure for removing a director :
    (a) by shareholders. (b) *by Tribunal.*
25. State the provisions of the Companies Act about the remuneration of directors. Under what conditions a director can be remunerated in the case of the public Co. ?
26. What are qualification of a director ? State the qualifications also.
27. "The right of hire or fire rests with shareholders." Discuss.
28. Is it necessary that all the directors of newly incorporated Company must retire at first AGM ?
29. Total strength of the B.O.D. of your Co. is ten :—
    (*i*) How many directors are liable to retire by rotation at the next AGM ?
    (*ii*) What will be the quorum of the board meeting ?

30. Explain the law of appointment of an additional director.
31. Discuss the liabilities of a director
    (i) to the company &
    (ii) to outsiders for their acts.

PRACTICAL PROBLEMS

Q. 1. X Co. Ltd. has 15 directors, 5 of whom are not subject to retire by rotation. Is it a validly constituted Board ?

Ans. Not less than 2/3rd of the total number of directors of a public company or of a private company which is subsidiary of a public company must be subject to retirement by rotation. In other words, not more than one third of the total number of directors can act as non retiring directors. Here 1/3rd of directors are non retiring directors. It is a validly constituted Board.

Q. 2. P was a director of a public limited company. The shareholders of the company by altering its Articles of Association with immediate effect, made it a compulsory qualification for directors to be at least graduate. P who was not a graduate was asked to quit. Advise P.

Ans. The Companies Act does not lay down any specific academic qualification for appointment as a company director, not even qualification shares.

However the circumstances in which a person can't be appointed as a director of a company. But it does not specify any educational qualification. Compulsory qualification fixed by the company in the A.O.A is violative. A public company can't provide for additional qualifications & hence P need not quit.

Q. 3. The Articles of a company incorporated in 1992 provided that a director should hold 200 shares of the value of `10 each as a qualification. At the annual general meeting of the company held in September 2011 an ordinary resolution was passed increasing there share qualification to be held by directors to 600 shares. The company then issued notice to the directors who did not hold 600 shares to acquire additional shares within one month.M, a director, who was asked to acquire additional qualification shares, received the notice. He seeks your advice. What advice would you give him ?

Ans. The alteration is invalid because :

(a) Special resolution required to alter the articles is not passed.

(b) It violates the provisions.

It provides that the nominal value of these shares must not exceed `5000 or nominal value of one share where it exceeds ` 5000. Any provision requiring a director to hold as qualification shares more than the amount will be invalid. Hence Mr. M should not purchase additional qualification shares.

Q. 4. P and Q have been appointed as directors of Zoom Electricals Ltd. on the same day. P is aged 58 years and Q is aged 63 years. At the next annual general meeting, one director is liable for retirement by rotation under Section 256 of the Companies Act, 1956. P and Q holding offices of directors for longest period, the legal advisor has advised Q to retire as he is senior to P in age.

Ans. In case of between persons who became director on the same day, those who are to retire shall be determined by mutual agreement or, in default by lot. In the instant case, age is considered for this purpose. Hence the advise of the legal advisor is not correct.

Q. 5. Discuss the validity of the following :

The Board filled up a casual vacancy by appointing S as a director. S expired within a few days of his becoming director. The Board wishes to fill up the casual vacancy by appointing A in the forthcoming meeting of the Board.

Ans. The Board of Directors is authorised to fill up casual vacancy in the Board in place of directors appointed in the general meeting.

In the given case, the present vacancy has arisen owing to death of Mr. S who was appointed by the

Board to fill up the casual vacancy. Since Mr. S was appointed by the Board, the present vacancy cannot be considered as casual vacancy and therefore the Board cannot fill up the same.

The Board may, however, appoint Mr. A as an Additional Director of the Act provided the articles of association authorise the Board accordingly. Mr. A as an Additional Director can hold office until the conclusion of the next annual general meeting.

Q. 6. With reference to the provisions of the Companies Act, 2013 examine the validity of the following :

D, who is a director already in 14 public limited companies accepts the directorships of the following companies :

(i) BC Private Limited, which is the holding company of a public limited company.

(ii) RM company which is an unlimited company.

(iii) MJ & Company Ltd., as an alternate director.

Ans. The following companies shall be excluded in calculating the number of companies of which a person may be a director :

(a) a private company which is neither a subsidiary nor a holding company of a public company;

(b) an unlimited company;

(c) an association not carrying on business for profit or which prohibits the payment of dividend;

(d) a company in which such person is only alternate director.

(i) D who is a director already in 14 public limited companies can accept directorship in BC Private Ltd. as the number has not exceeded 20.

Directorship in BC Ltd. will be counted within 20 as the company in question is the holding company of a public limited company.

(*ii*) *Since RM Company is an unlimited company D can accept the directorship* in the company, as directorship of an unlimited company is not counted in the said 20.

(iii) Alternate directorship is also not counted in the 20. Therefore, D can accept directorship in MJ Co. Ltd. also.

Thus he can accept the directorships in all these cases.

Q. 7. Explain whether it is in order for a Director liable to retire by rotation at the next Annual General Meeting to continue to function as a Director in the following cases :—

(*i*) *The company defaulted in holding the Annual General Meeting.*

(*ii*) *The Annual General Meeting was held in time but the vacancy caused by his retirement was* not filled up.

Ans. The directors cannot prolong their tenure by not holding an annual general meeting in time. They would automatically retire from office on expiry of the maximum permissible period within which such meeting ought to have been held. To call annual general meeting is the duty of directors and by omitting to convene such meeting, they cannot take advantage of their own default.

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

If the place of the retiring director is not so filled, and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned. If at the adjourned meeting also the vacancy is not filled, and the meeting 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 :

1. at the meeting or at the previous meeting a resolution for the re-appointment of such director has been put to the meeting and lost;
2. he has, by a notice in writing, addressed to the company or to Board, expressed his unwillingness to be re-appointed;
3. he is not qualified for appointment;
4. a special or ordinary resolution is necessary for his appointment or re-appointment.

Q. 8. ABC Ltd. is a deemed public company, the present strength of the Board of Directors of ABC Ltd. is 12. The company wishes to increase the strength beyond 15.

(a) Advise ABC Ltd. the procedure to be followed for increasing the strength of Board of directors beyond 12.

(b) What will be the procedure to be adopted by a private limited company which is not a subsidiary of public limited company ?

Ans. (a) If AOA does not permit the maximum number of directors to be in excess of 15, it should be amended to provide for the maximum number in excess of 15. Any increase beyond the limited fixed by the articles must be approved by the Central Government except where the increase in the number of directors does not make the total number of directors more than 15. Such an increase will become void if disapproved by the Central Government.

For getting approval of the Central Government for increasing the number of directors, an application shall be made in Prescribed Form.

(b) If AOA permits an increase of directors beyond 15, the company can increase the number of directors subject to maximum by an ordinary resolution. This is not applicable to a private company which is not a subsidiary of a public company, Central Government's approval is not required for increase of directors beyond 15.

Q. 9. Mr. X is named as a director for life in the articles of association of M/s XYZ Private Limited which was incorporated on 1st April, 1977. The articles of association of the company also provide that he cannot be removed by the members in general meeting. Some of the members want to remove 'X' by passing an ordinary resolution in general meeting. State with reference to the relevant provisions of the Companies Act, 1956 whether the proposed action is valid.

Ans. A company may be ordinary resolution passed in general meeting after due receipt of a special notice, remove a director before the expiry of his term of office. A private company can have permanent directors or life directors. Even such a permanent or life director can be removed.

Further, a private company may by its articles provide that the office of directors shall be vacated on any additional ground as may be specified in Articles of Association. The articles can't provide that director for life shall not be liable to be removed. Hence the proposed action of removal of X by passing an ordinary resolution in general meeting is valid.

Q. 10. XYZ Company Limited calls a meeting of the Board of Directors without giving notice to directors as required under the Companies Act, 1956. The meeting is attended by all the directors. None of the directors of the company objected to the absence of notice. The proceedings of the meeting are ratified later by the Board of Directors at a regulary constituted meeting.

Decide giving reasons for your answer whether :

(i) the meeting and the proceeding are valid ?

(ii) the Board of Directors are competent to ratify at a later meeting the above proceedings ?

Ans. (i) Notice of every meeting of the Board of Directors of a company shall be given to every directors for the time being in India and at his usual address in India to every other director. However, where notice so required is not given but all directors attend the meeting and don't object to the absence of notice, the proceedings at the meeting will not be invalid, especially, if they are ratified at a subsequent meeting at which the absentee directors are present. Hence the meeting and proceedings both are quite valid.

(ii) Further, the Board of Directors is quite competent to ratify at a later meeting the above proceedings.

Q. 11. 3 persons were appointed as directors of a company by a single resolution. A member who did not object to this in the meeting later filed a complaint to Magistrate under Sec. 629-A of the Companies Act, who sentenced them to a fine of ₹ 250 each and in default 15 days simple imprisonment. The directors appealed against the conviction. Decide.

Ans. 629-A provides for penalty in case of certain offences where no specific remedy is provided elsewhere in the Act. The appointment of 2 or more persons as directors by a single resolution is void. The

decision of magistrate is correct and the appeal of the directors against conviction is liable to be set aside.

Q. 12. The usual powers of management of a company are vested in the Board of directors, which also include a provision that the powers shall be "subject to such regulations not inconsistent with the Articles, as may be prescribed by the company in general meeting." In exercise of their powers the directors filed a suit against an employee of the company for recovery of a loan advanced to him. The general body of shareholders thereupon passed an ordinary resolution to the effect that the loan should be written off in consideration of the employee's meritorious services to the company. Are the directors bound to withdraw the suit or are they at liberty to proceed with the suit ? Give reasons for your answer.

Ans. The Board of Directors are not bound to withdraw the suit because it is laid that when powers are vested in the Board of Directors by the Articles of the Co., they alone can exercise those powers. In fact, the shareholders cannot themselves usurp the powers, which by Articles are vested in the directors. Further, the shareholders cannot dictate to the directors the manner in which their executive authority is to be employed. Hence, directors are at liberty to proceed with the suit.

Q. 13. P is one of the 5 directors of Z Co. Limited, a public company. At a meeting of the Board of directors a resolution with all the 5 in favour is passed approving a proposal to enter into a building contract with Y Limited in which P has the majority shareholding. Comment on the above.

Ans. Although P should have disclosed his interest in the contract and although he is debarred from voting on such contract and although his presence is not counted towards quorum, yet the requisite quorum (1/3 of the total strength or two whichever higher) was present and the resolution passed in the meeting is valid.

Q. 14. The directors of X Co. Ltd. bought some of its shares from a shareholder while they were negotiating for a transaction financially advantageous to the company and which, if successful, would have substantially raised the market value of its shares. They did not disclose this information to the shareholder when buying his shares. This erstwhile shareholder sued the directors for rescission of sale on the ground of fraud. State, giving reasons, whether he will succeed.

Ans. Directors are trustees for the company and not for the third persons who have made contracts with the company or for the individual shareholder. The purchase of the shares was good.

[Percival V. Wright (1902) 2 CH. 421]

Q. 15. The Board of directors of P Ltd. met only 3 times in the previous year. A fourth meeting was adjourned twice for lack of quorum. Does this constitute a violation of the Companies Act ?

Ans. No, this does not constitute the contravention because where a meeting is called but could not be held for want for quorum it will not be treated as a contravention of provision which requires atleast one meeting in every 3 months and atleast 4 such meetings in a year to be held.

Q. 16. M/s International Carrier Limited purchased a flat in Mumbai to give residential accommodation to Shri Ravi Mehta, the Managing Director. At the time of purchase of flat, the Managing Director was given an option to buy the flat during the course of his employment. The Managing Director exercised his option and paid the company half of the purchase price and requested for time to pay the balance amount in three equal half-yearly instalments at 10% interest per annum. Examine whether the arrangement would amount to a loan to the Managing Director and if so, whether the loan was in order.

Ans. This is applicable to both direct and indirect loans to directors. The Bombay High court, came to the conclusion that a company selling one of its flats to one of its directors on receiving half price in cash and agreeing to accept the balance in instalments is not a loan to the director. It is a credit sale. It cannot be described even as an indirect loan. Hence, it can be concluded that credit sale of a flat may not amount to loan attracting provisions of section 295.

Q. 17. Director of ABC Limited are not holding any shares in MDJ Company Limited. Similarly directors of MDJ Company Limited are not holding any shares in ABC Limited. But wife of director 'A' of ABC Limited holds 40% of the paid up share capital of MDJ Company

Limited. Board of directors of ABC Limited entered into contract with MDJ Company Limited for purchase of goods and director 'A' did not disclose his indirect interest in MDJ Company Limited. Examine whether 'A' has violated any of the provisions of the Companies Act and also the validity of the contract.

Ans. A director to disclose any direct or indirect interest at a meeting of the Board of Directors of the company. Here A is indirectly interested in MDJ Ltd. as his wife is holding substantial shares in that company. Also a director occupies a fiducialy position in relation to a company and he must act bona fide in the interests of the company and must disclose his interest. It is therefore, a clear violation of Section 299 by not disclosing his 'indirect interest' in the contract for purchase of goods.

Q. 18. A was appointed director of the company in its Annual General Meeting. He took over the office and started acting on behalf of the company as its director. Subsequently, it was found that the appointment of the director was not valid because in the meeting where he was appointed, certain members who had voted were not qualified to vote and certain members had voted twice by mistake. There were also certain mistakes in the counting of votes. As such, the appointment of the director was held to be invalid. Would the acts of A, done by him as director, be valid and binding upon the company ?

Ans. All acts of the director are valid notwithstanding the fact that his appointment is afterwards discovered to be invalid, the reason of any defect in his appointment. This is to protect outsiders as well as members dealing with the company. In this case the defects in the appointment of the director were found out subsequent to his appointment. The director had no knowledge of the defects until he had started acting as a director. The validity of the acts of the director cannot be questioned just on the basis of irrigularities subsequently discovered in the appointment of the director.

Q. 19. A is the managing director of a public limited company with a paid up capital of ` 12 crores. He is also a partner of firm of which the other partners are his wife and two sons. The company proposes to enter into a contract with the firm for the sale of its own products of the value of ` 10 lacs, on credit.

(i) When can such a contract be entered into ? (ii) What are the duties of A in such a case ?

(iii) Will it make any difference if the contract is entered into with a private limited company in which the wife of the managing director and his two sons are members ?

Ans. *(i)* In the instant case, a Public Limited Company having paid up capital of more than ` one crore proposed to enter into a contract of sale of goods worth ` 10 lacs on credit with a firm in which its managing director is interested, his wife, two sons and he himself being the partners of the firm.

The contract can be entered into only when following conditions are fulfilled :—

1. The consent of the Board of Directors is obtained. 2. The approval of the Central Govt. is taken.

(ii) Duties of A in the given case are as follows :

(a) He should disclose the nature of his concern or interest at a meeting of the Board of Directors.

(b) For the above purpose a general notice be given to the Board by him and he should take reasonable steps to secure that it is brought upon and read at the first meeting of the Board after it is given.

(c) He is not to participate in the discussion of, or vote on the proposed contract, nor his presence to be counted for the purpose of forming a quorum at the time of any such discussion or vote.

(iii) The situation will be quite different when the Contract is entered into with a Private Limited Company in which the wife of Managing Director and his two sons are members. Only those Private Companies in which the director of the concerned company is a member or director. Consequently the restrictions imposed shall not apply in the present case even though the Managing Director 'A' may be vitally interested in the contract.

Q. 20. J holds the office of managing director of a private company for life. The company's articles empower him to appoint a person to be the managing director in succession to him. J, therefore, in the exercise of his powers appoints by will D as the managing director to hold office after the former's death. Some members of the company challenge the provisions of the

Articles and question the validity of the appointment of D. Examine the validity of the contention of the members.

Ans. A director cannot assign his office. This applies also to a private company. Though the office to the Director is not assignable, a director, if so empowered by the Articles of the company, can appoint his successor by will or otherwise and such appointment of the successor will not be an 'assignment' of office by Director [*Oriental Metal Pressing Works Pvt. Ltd. v. Bhasker Kashinath Thakoor (1961)]. In view of the above circumstances, the appointment of 'D' as a Managing Director is valid.*

Q. 21. 'X' was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 2011. The articles also empowered 'X' to appoint a successor. 'X' appointed by will 'G' to succeed him after him death.

Answer the following :

(i) Can 'G' succeed 'X' as Managing Director after the death of 'X' ?

(ii) Is it possible for the company in general meeting to remove 'X' from his office of directorship during his life time ?

Ans. (i) The Act prohibits assignment of his office by a director and such assignment shall be void. However, in case of Oriental Metal Pressing Works Pvt. Ltd. v. Bhasker Kashinath Thakoor (1961), the Supreme Court held that the appointment of the successor did not come within the prohibition. Hence X has not made any assignment of his office prohibited and 'G' can succeed X as managing director after the death of X.

(ii) Any director can be removed i.e. by passing in an ordinary resolution before the expiry of his period of office. This section applies to permanent directors or life directors. However, in case of private companies, director appointed for life. As the private company in this case was incorporated on 1st June, 2001, it is not entitled to this exemption. Hence X can be removed as a director even though he is a permanent director and once he is removed as a director, he also ceases to be a managing director.

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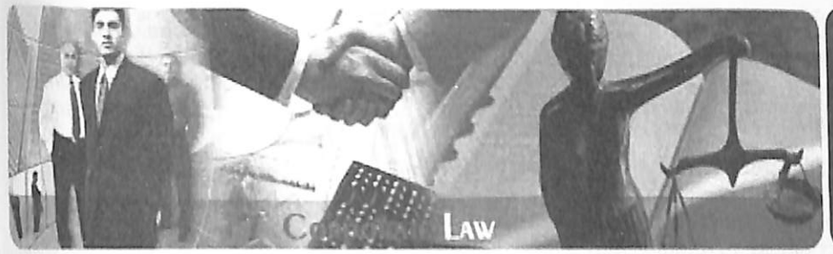

13

OTHER MANAGERIAL PERSONNEL

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
Appointment of Managing Directors, whole time director or manager	No Company shall re-appoint any person as its managing director, whole time director or manager **earlier than one year** before the expiry of his term.	In Companies Act, 1956 any re-appointment was not done earlier **than two years from the** date on which it comes into force.
Appointment of Key Managerial Personnel (KMP)	Under Rule 8 compulsory for every listed company and every other public company having paid up share capital of ten crores or more to have KMP : (i) MD or CEO or manager and in their absence a WTD (Whole Time Director) (ii) Company Secretary (iii) CFO	Compulsory for every public company and every private company (which is a subsidiary of public company) having paid up capital to appoint : (i) MD ; or (ii) WTD ; or (iii) Manager (iv) Whole time secretary
Whole-Time KMP in only one company	A whole-time KMP not to hold office in more than one company except in its subsidiary company at the same time.	No such provision.
If office of KMP vacated	Resulting vacancy to be filled up by Board at a Board meeting within 6 months.	No provisions in this regard.
Disqualification for appointment as MD/WTD/Manager	Schedule V of 2013 Act adds one more enactment to the list of 1956 Act : • The Prevention of Money Laundering Act, 2002. Convic-tion for this enactment is also a disqualification for appointment as MD/WTD/ Manager.	Schedule XIII of 1956 Act contained a list of 15 enactments under which conviction of an offence resul-ted into a fine not exceeding ₹ 1,000 and imprisonment. This was a disqualification for appointment as MD/WTD/ Manager.
Replacement of Enactments	Schedule V has replaced some of enactments of the original list of 1956 Act : • FERA, 1973 with FEMA 1999. • 1956 Act with 2013 Act. • MRTP Act, 1973 with the Competition Act, 2002.	–

Minimum age for appointment as MD/ WTD/Manager	Minimum age has been lowered by schedule V of 2013 **Act to 21 years.**	Minimum age **was 25 years** in Schedule XIII. However any one below this age could be appointed if company passed a special resolution.

Managerial Personnel

As per Section 196, managerial personnel means—

(*a*) Managing director (s)

(*b*) Manager

According to Section 196 a company cannot have simultaneously two managerial personnel at the same time *i.e. both a managing director and a manager because it is needless and expen5sive.*

However, the Companies Act, 1956, does not prohibit the simultaneous employment of :

(*i*) more than one managing director; or

(*ii*) one or more whole time director alongwith the managing director or manager.

MANAGING DIRECTOR

Definition. Section 2(54) defines a managing director as **"a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called."**

The important features revealed by above definition are as follows :

(i) A managing director must be an individual as no body but an individual can be appointed as a director. A person, who is not a director cannot be appointed as a managing director. His appointment is automatically terminated if he ceases to act as director.

Hence, the managing director has necessarily to be a director. He, like any other director, has no powers of management except when acting as one of the members of the Board.

(ii) A managing director is entrusted with substantial (not the whole) powers of management which would not otherwise be execisable by him.

But the power to do administrative acts of the routine nature when so authorised by the Board such as

(a) affixing the common seal of the company to any document or

(b) drawing and endorsing a cheque on the account of the company in any bank or any negotiable instrument or

(c) signing any certificate of share or directing registration of transfer of any share, will not make a director a managing director. In order to make a director a managing director, it is necessary that the powers exercisable by him constitute substantial powers of management which consists of laying down broad policies and objectives of the company.

(iii) A person who occupies the position of a managing director without being designated as such would also be a managing director i.e. he may be called technical director or technical advisor.

(iv) Managing director exercises his powers subject to the superintendence, control and direction of Board [Section 2(54)] Hence, a managing director is subordinate to the Board of directors.

(v) A managing director is generally a whole-time employee of the company. Of courses a director who is not in employment of the company, may also be appointed as a managing director.

Alteration of Managing Director's Powers of Management

The 'substantial powers of management' that are conferred upon a managing director may be revoked, withdrawn, reduced or otherwise altered.

Example : The service agreement of a managing director provided that "he shall perform the duties and exercise the powers in relation to the business of the company and the business of its subsidiaries which may from time to time, be assigned or vested in him by the directors." Subsequently, the directors resolved that he should confine his attention to a particular subsidiary. Managing Director brought an action for damages for breach of contract. It was held that the managing director's action must fail and no action lay for breach of contract as the board of directors was entitled to do what it had done.

[Harold Holds Worth & Co. v. Caddies (1955) I All E.R. 725]

Further, a managing director occupies the position of a trustee for the company and he has to safeguard the interest of the shareholder and the company.

Appointment of Managing Director

According to the definition given by the Act, the appointment of a managing director can be made either by

(a) an agreement with the company, or

(b) a resolution passed by the company in general meeting; or

(c) a resolution passed by its Board of directors; or

Every such appointment shall be made either :

(i) With be approval of Central Government or

(ii) In accordance with schedule V.

Managing Director—a Director First

A managing director is not usually subject to retirement of directors by rotation.

If the managing director is subject to rotation or resigns or dismissed, he shall *ipso facto* and immediately cease to be the managing director if he ceases to hold the office of director from any cause.

The word having a 'paid up share capital' includes preference share capital also and therefore both equity and preference share capital must be taken into consideration for compliance of the provision.

CASES IN WHICH APPROVAL OF THE CENTRAL GOVERNMENT IS NOT REQUIRED

Managing Director can now be appointed without approval of the Central Government if the conditions laid down in Part I of Schedule V are fulfilled.

It means, if the appointee does not fullfil any of the said conditions, the appointment cannot be made except with the approval of the central government under section 196.

Such condition where the approval of the central government would not be required are :

(a) No conviction : He has not been sentenced to imprisonment for any period or to fine exceeding rupees one thousand for conviction of an offence under any of the Acts mentioned in Schedule XIII.

These Acts are

1. the Indian Stamp Act, 1899.
2. The Central Excise Act, 1944.
3. The Industries (Development and Regulation) Act. 1951.
4. The Prevention of Food Adulteration Act, 1954.
5. The Essential Commodities Act, 1955.
6. The Companies Act, 2013.
7. The Income Tax Act; 1961.
8. The Wealth Tax Act, 1957.
9. The Customs Act, 1962.
10. The FEMA 1999.
11. The Foreign Trade (Development & Regulation) Act, 1992.
12. The Securities Contracts (Regulation) Act, 1956.
13. The Sick Industrial Companies (Special Provisions) Act.
14. The Securities and Exchange Board of India Act, 1992.
15. The Prevention of Money-Laundering Act, 2002.
16. The Competition Act, 2002.

(b) No Detention under COFEPOSA

He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

(c) Age. The appointee must be in the age group of 21 to 70 years or age of retirement as might have been specified by the company, whichever is earlier.

Now, a company will have full freedom to appoint a managerial person (*i*) who has not completed the age of 21 years but has attained the age of majority or (*ii*) he has attained the age of 70 years *without the approval of the Central Government* provided his appointment is approved *by special resolution* passed by the company in general meeting.

(Note. Age limit has been lowered to 21 yrs. from 25 yrs. in 2013 Act.)

(d) Remuneration. Where he is a managerial person in more than one company he draws remuneration from one or more companies subject to the ceiling provided in section V of Part II.

(e) Resident. He is resident in India

Resident in India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India—

(*i*) for taking up employment in India or

(*ii*) for carrying on a business or vocation in India.

PROVISIONS IF CENTRAL GOVERNMENT APPROVAL IS REQUIRED

Section 200, 203 read with Rule 6, 7 and 8 of Companies (Appointment & Remuneration of Managerial Personnel], Rules 2014.

(1) Application for approval to be made within 90 days [Rule 7(3)]

Every application seeking approval to the appointment of a managing or whole time director or a manager shall be made to the Central Government within a period of 90 days from the date of such appointment. It is required when conditions of schedule V are not complied with.

Approval need not be prior approval

Even if Rule 7(3) requires the approval of the Central Government, yet this requirement is not the requirement of prior approval as this section requires application for approval can be submitted within 90 days.

2. Application to Central Govt. shall have regard to following matters [Rule 6]

(1) the Financial and operating performance of the company during the three preceding financial years.

(2) the relationship between remuneration and performance.

(3) the principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the Board who receives remuneration and employees or executives of the company.

(4) whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.

(5) the securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

3. Form of Application & Fees [Rule 7]

Every application made to the Central Government under the provisions of Chapter XIII shall be made in Form No. **MR 2** and shall be accompanied by fee as may be specified for the purpose.

4. Filing of Return of Appointment [Rule 3]

A company shall file a return of appointment of a Managing Director, Whole Time Director or Manager, Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer (CFO) within sixty days *of the appointment*, with the Registrar in Form No. **MR. 1** along with such fee as may be specified for this purpose.

5. Companies that must appoint key managerial personnel [Rule 8 read with Section 203]

Every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have the following whole-time key managerial personnel :

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) company secretary ; and

(iii) Chief Financial Officer ;

6. Restriction on appointment & re-appointment [Sec. 203]

In pursuance of the Articles of Association of the company, an individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act.

However, such appointment or re-appointment can be done when :

(a) the Articles of such a company provide otherwise, or

(b) the company does not carry multiple businesses.

7. Other Restrictions [Sec. 203 (2, 3, 4)]

(a) Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

(b) A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

(c) A key managerial personnel shall not be disentitled from being a director of any company with the permission of the Board.

(d) A whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one.

(e) If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

8. Penalty for Contravention [Sec. 203(5)]

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Every director and key managerial personnel of the company who is in default shall be punishable with fine which may extend to fifty thousand rupees. Where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues.

Disqualifications for a Managing Director (Sec. 196)

A person cannot be appointed as the managing director or whole-time director of a company if he suffers from any of the following disqualifications:

(i) He is below the age of 21 years or has attained the age of 70 years.

(ii) He is an undischarged insolvent or has at any time being adjudged an insolvent; or

(iii) He suspends or has at any time suspended payment to its creditors; or

(iv) He makes or has at any time made a composition with his creditors. A composition is an agreement made between a debtor and his creditors by which the creditors accept a part of their claim in satisfaction of the whole. In other words, it amounts to paying less than the full amount of the debts in discharge thereof ; or

(v) He is or has been convicted by the court of an offence and sentenced for a period of more than 6 months.

It may be noted, that since managing director has necessarily to be a director, any one who is disqualified to be a director u/s 164, cannot be appointed as managing director or whole-time director.

Similarly, a person who does not satisfy the conditions of Schedule V cannot be appointed as a managing director of a company without the approval of the central government.

A person is disqualified from being appointed as managing director if he is convicted for whatever term of imprisonment or fine by any court in India or abroad of an offence involving moral turpitude. Even a day's imprisonment or a fine of rupee one will do. Moral turpitude means anything done contrary to justice, honesty or good moral, and includes a violation or breach of duties which a man owes to his fellow men or society in general. Even embezzlement and fraud also constitute moral turpitude. It also includes black marketing, profiteering, hoarding, adulteration and antisocial acts. Drunkenness at a public place leading to criminal conviction may in certain cases amount to moral turpitude. The term is vague and it may have different meanings in different contexts.

Number of Managing Directorship (Section 203)

A whole time key managerial personnel shall be appointed by passing a resolution of the Board and shall not hold office in more than one company except in its subsidiary company at the same time where :

(1) Where he is the managing director or manager of one and not more than one other company and his appointment is approved by a resolution passed at a Board meeting with the *unanimous consent of all* the directors present thereat and (*ii*) a special notice of this meeting and the resolution must have given to all the directors then in India. [Sec. 203 (2, 3)].

Thus, a person can be a managing director for more than two companies simultaneously.

Term of Office

No individual can be appointed as a managing director for more than five years at a time. He may be re-appointed or the term of office may be extended by successive periods of five years each. The appointment or extension shall not be sanctioned earlier than one year from the date on which it is to take effect. **(Note : The 2013 Act changed period to one year from two years).**

> **Example :** The managing director of AB Co. Ltd. is appointed for a period of 5 years w.e.f. 1st April 2012. He will hold this office upto 31st March 2017. The Company shall not sanction his reappointment earlier than 2 years from the date on which it is to take effect i.e. not eariler than 31st March 2013. He can be reappointed for a further period of 5 years with effect from 1st April 2017 to 31st March 2022.

No approval of the Central Government is required for appointment or reappointment of managerial personnel, if made in terms of Section 203 of the Act.

Remuneration to Managerial Personnel

A managing director may be remunerated either by way of a (*i*) monthly payment or (*ii*) as a specified percentage of the net profit of the company [illegible] a managing director or WTD or Manager, but not any other [illegible]. However such

- compensation for loss of office
- consideration for retirement from office
- in connection with such loss or retirement

The Maximum Remuneration an MD or WTD or manager would have earned if he had been in office

- For remainder of his term
- For tree years

Whichever is shorter.

Calculation of remuneration under section 202 for loss of office *i.e.* only for above mentioned purpose

Average Remuneration

Actually earned by him during a period of 3 years immediately preceding the date on which he ceased to hold office	or	Where he held the office for a lesser period then 3 years during such period.

Exception : Compensation shall not been given in case of winding up, whether before or at any time within 12 months after the date on which he ceased to hold office, if the assets on the winding up, after deducting the expenses, are not sufficient to repay to the shareholders the share capital, including the premium, if any contributed by them.

The company is not prohibited to make the payment to MD, WTD or manager of any remuneration for services rendered by him to the company in any other capacity.

Payment not to be made in following cases :

1. Where the director resigns from his office :
   - as a result of reconstruction or
   - of its amalgamation with any body(ies) corporate and
   - is appointed as the MD or WTD, manager or other officer of the restructured company or of the body corporate resulting from the amalgamation
   - otherwise than on the reconstruction of the company or its amalgamation.
2. Where the office of the director is vacated u/s 167(1)
3. Where the company is being wound up either by an order of the tribunal or voluntarily due to the negligence or default of the director.
4. Where the director has been guilty of fraud or breach of trust in relation to or of gross negligence or mismanagement of the affairs of the company or any subsidiary or holding company.

winding up [illegible] director has instigated or has taken [illegible] mation of his office.

Difference between a Managing Director and a Whole Time Director

Basis of Distinction	Managing Director	Whole-time Director
1. Meaning and Powers	A MD is entrusted with substantial powers of management which are not otherwise exercisable by a director.	A Whole time director includes a director in the whole time employment of to company as per terms of employment.
2. Appointment	The appointment of a Managing director need not necessarily be made with the consent of the members. It can be made by virtue of the following.	Appointment of a whole-time director requires the sanction of the shareholders, by means of a special resolution.
	(*i*) Agreement with the company.	
	(*ii*) Resolution of the Board.	
	(*iii*) Provision in the MOA or AOA	
3. Term of office	A managing director of a company can be appointed for a maximum period of 5 years.	There is no such restriction regarding the term of appointment of a whole-time director.
4. Numbers of Companies	A person can be a managing director of 2 companies. However, the Central Government may permit any person to be appointed as a managing director of more than 2 companies if it is satisfied that it is necessary that companies should have common managing director for their proper functioning as a single unit.	A whole-time director, being a whole-time employee of the company, cannot be a whole-time director in more than one company.
5. Simultaneous appointment with manager	A MD and Manager can't exist simultaneously (Section 196)	A whole time director can be appointed alongwith a managing director or a manager

MANAGER

Definition

As per Section 2(53) "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not."

The important features of a manager, emerging out of the above definition, are as follows :

(i) Only an individual can be appointed as a manager of a company. Section 196 of the Companies Act states that a company (whether public or private) must not appoint any firm, body corporate or association of persons as its manager.

(ii) A manager shall have the management of the *whole or substantially the whole of the affairs of a company. Further, manager is not an agent who is to do a particular thing, or a servant who is to obey orders, but a person who is entrusted with power to transact the*

Compensation for loss of officer of Managing Director or Whole Time Director or Manager [Sec. 202]

A company may make payment to a managing director or WTD or Manager, but not any other director by way of

– compensation for loss of office

– consideration for retirement from office

– in connection with such loss or retirement

The Maximum Remuneration an MD or WTD or manager would have earned if he had been in office

– For remainder of his term

– For tree years

Whichever is shorter.

Calculation of remuneration under section 202 for loss of office *i.e.* only for above mentioned purpose

Average Remuneration

Actually earned by him during a period of 3 years immediately preceding the date on which he ceased to hold office	or	Where he held the office for a lesser period then 3 years during such period.

Exception : Compensation shall not been given in case of winding up, whether before or at any time within 12 months after the date on which he ceased to hold office, if the assets on the winding up, after deducting the expenses, are not sufficient to repay to the shareholders the share capital, including the premium, if any contributed by them.

The company is not prohibited to make the payment to MD, WTD or manager of any remuneration for services rendered by him to the company in any other capacity.

Payment not to be made in following cases :

1. Where the director resigns from his office :
   - as a result of reconstruction or
   - of its amalgamation with any body(ies) corporate and
   - is appointed as the MD or WTD, manager or other officer of the restructured company or of the body corporate resulting from the amalgamation
   - otherwise than on the reconstruction of the company or its amalgamation.
2. Where the office of the director is vacated u/s 167(1)
3. Where the company is being wound up either by an order of the tribunal or voluntarily due to the negligence or default of the director.
4. Where the director has been guilty of fraud or breach of trust in relation to or of gross negligence or mismanagement of the affairs of the company or any subsidiary or holding company.

Where the director has instigated or has taken part directly or indirectly in bringing the termination of his office.

Difference between a Managing Director and a Whole Time Director

Basis of Distinction	Managing Director	Whole-time Director
1. Meaning and Powers	A MD is entrusted with substantial powers of management which are not otherwise exercisable by a director.	A Whole time director includes a director in the whole time employment of to company as per terms of employment.
2. Appointment	The appointment of a Managing director need not necessarily be made with the consent of the members. It can be made by virtue of the following.	Appointment of a whole-time director requires the sanction of the shareholders, by means of a special resolution.
	(*i*) Agreement with the company.	
	(*ii*) Resolution of the Board.	
	(*iii*) Provision in the MOA or AOA	
3. Term of office	A managing director of a company can be appointed for a maximum period of 5 years.	There is no such restriction regarding the term of appointment of a whole-time director.
4. Numbers of Companies	A person can be a managing director of 2 companies. However, the Central Government may permit any person to be appointed as a managing director of more than 2 companies if it is satisfied that it is necessary that companies should have common managing director for their proper functioning as a single unit.	A whole-time director, being a whole-time employee of the company, cannot be a whole-time director in more than one company.
5. Simultaneous appointment with manager	A MD and Manager can't exist simultaneously (Section 196)	A whole time director can be appointed alongwith a managing director or a manager

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As per Section 2(53) "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company and includes a director or any other person occupying the position of a manager, by whatever name called, and whether under a contract of service or not."

The important features of a manager, emerging out of the above definition, are as follows :

(i) Only an individual can be appointed as a manager of a company. Section 196 of the Companies Act states that a company (whether public or private) must not appoint any firm, body corporate or association of persons as its manager.

(ii) A manager shall have the management of the *whole or substantially the whole of the affairs of a company. Further, manager is not an agent who is to do a particular thing, or a servant who is to obey orders, but a person who is entrusted with power to transact the*

whole of the affairs of the company. Accordingly, a mere head of a department or a branch manager would not be a manager.

(iii) A manager is subject to the superintendence, control and directions of the Board of directors.

(iv) Manager includes a director or any other person occupying the position of a manager, by whatever name called i.e. all de-facto managers.

(v) A manager may be appointed under a contract of service or otherwise.

(vi) A director may be a manager and in such a case if for any reason his office of director is vacated, the office of manager held by him is not affected but it is not so in case of managing director.

1. Disqualification for the office of manager (Sec. 196). A person will not be appointed manager of a company if he—

(i) Is below age of 21 yrs. or has attained the age of 70 yrs.

(ii) is an undischarged insolvent or has at time with in the preceding five years been adjudged insolvent ; or

(iii) suspends or has at any time within the preceding five years suspended payment to his creditors or makes or has made within the above period a composition with them; or

(iv) is or has at any time been convicted by a court in India of an offence and sentenced a period of more 6 months.

Further where a director is appointed as a manager, he will be a managing director or whole time director for all purposes and therefore, will be governed by Section 196 and not by this section.

The Central Government may, however, remove the above mentioned disqualifications either generally or in relation to any company or companies. It may be noted that Central Government has no such power to remove the disqualification of a managing director or whole time director.

2. Appointment of manager. Provisions which are applicable to the managing director regarding appointment or re-appointment, term of office and number of companies also apply to a manager. (Sec. 196).

(i) Appointment or re-appointment of a manager. The appointment or reappointment can be made by the company without approval of Central Government if the same is made in accordance with the conditions specified in Schedule V.

(ii) Term of office. Individual can be appointed as a manager for more than five years at a time. He may be reappointed or the term of office may be extended by successive periods of five years each. The appointment or extension shall not be sanctioned earlier than one year from the date on which it is to take effect. **(Note : Time period shortened from two year to one year by 2013 Act).**

(iii) Number of managerships. No company shall appoint or employ any person as manager if he is either the manager or the managing director of any other company. A person already holding such an office can also be appointed provided the appointment is made or approved by a resolution passed at the meeting of the Board with the consent of all the directors present at the meeting and in respect of which a specific notice has been given to all the directors in India.

The Central Government may permit any person to be appointed as a manager of more than two companies if it is satisfied that it is necessary that the companies should, for proper working, function as a single unit and have a common manager. (Sec. 203).

3. Remuneration. The manager of a company may receive remuneration either by way of a monthly payment, or by way of specified percentage of the net profits of the company. The remuneration payable to a manager shall not exceed five per cent of the net profits of the company. However, this limit can be exceeded only with the approval of the Central Government. (Sec. 197).

4. Compensation for loss of office of a manager to director only. Section 202 enables a company to pay compensation for loss of office or as Section 202 enables a company to pay compensation for loss of office or as consideration for retirement from office to a director holding the office of manager.[1]

5. Office of manager cannot be assigned. Any assignment of office made by a manager of a company shall be void.

Private Companies

A private company which is not a subsidiary of a public company is outside the purview of Sec. 197 which provides for compulsory appointment of managing director or whole-time director or manager.

No other provision of the Act relating to appointment and remuneration are applicable to such a private company. Therefore, if any such private company makes for appointment of MD or WTD or Manager, the appointment or remuneration will not be governed by the provision of the of the Act or Schedule V. They will be governed by the provisions of the articles, if any. In such cases, the appointment and remuneration may be determined by a boards resolution, unless articles provide otherwise.

Difference between a Manager and a Managing Director

A manager and a managing director have one common feature, that they have the management of whole or substantially the whole of the affairs of the company.

But there are important differences between the position of a managing director and that of a manager, which are as under :

Basis of Distinction	Manager	Managing Director
1. Directorship is a pre-condition	Manager may not be a director.	Managing director must be a director of the Company.
2. Number	There cannot be more than one manager in a Company.	There may be more than one managing director in a Company.
3. Manner of Appointment	A manager may be appointed under a contract of service or otherwise.	Managing director may be appointed by virture of an agreement with the Company or resolution passed by the Company in general meeting or by the board of directors or the Memorandum or the Articles of Association of company.
4. Grounds of Disqualification	Grounds of disqualifications remain effective only for 5 years.	Grounds of disqulification remain effective for the whole of life.

1. Ref. to compensation for loss of office of Managing Director.

5. Conviction for Moral Turpitude	Conviction for moral turpitude by a foreign court is not a disqualification	Conviction for moral turpitude by any Court in India or abroad is a disqualification.
6. Central Government power to remove dis-qualification	The Central Government may remove the disqualifications either generally or in relation to any Company or Companies by notification in the official gazette. (Sec. 196).	The Central Government has no such power to remove the disqualifications under Section 196.
7. Power	The manager has management over whole or substantially the whole of the affairs of the Company. Hence, the powers of a manager are wider than the powers of a managing director.	Managing director has substantial powers of management which would not otherwise be exercisable by him.
8. Remuneration	The maximum remuneration payable to a manager cannot exceed 5% of net profits.	Where more than one managing director is working in the same Company, the maximum limit is fixed at 10% of the net profits.

APPOINTMENT OF KEY MANAGERIAL PERSONNEL SEC. 203, RULE 8, 8A OF COMPANIES (APPOINTMENT AND REMUNERATION OF MANGERIAL PERSONNEL) RULES, 2014

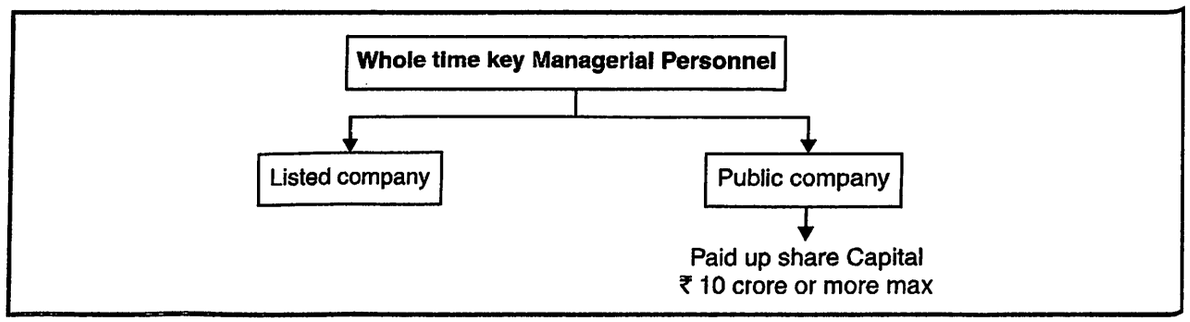
Every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel :

(i) managing director or Chief Executive Office or manager and in their absence, a whole-time director.

(ii) Company secretary and

(iii) Chief Financial officer

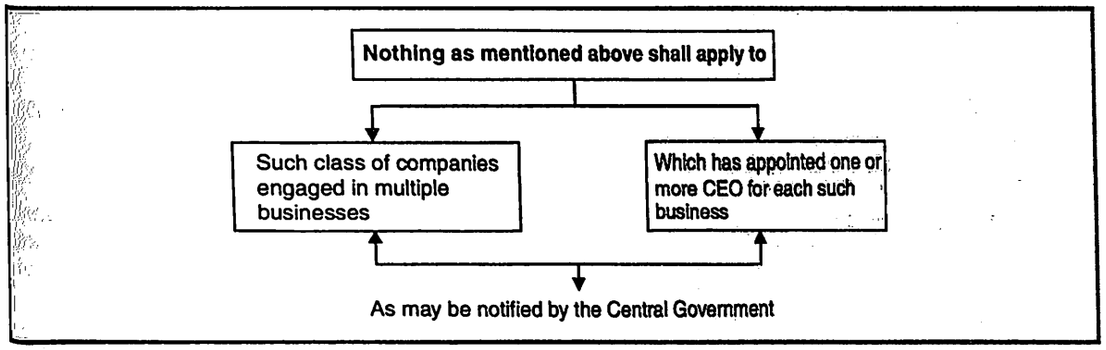
Rule 8 of companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that every listed company and every other public company having a paid up share capital of ₹ 10 crores or more shall have whole-time key managerial personnel.



Further rule 8A provides that a company, other than a company covered under Rule 8 which has a paid up share capital of ₹ 5 crore or more shall have a whole time company secretary.

An individual shall not be appointed as chairperson in pursuance of the articles of the company, as well as the MD or CEO at the same time after the date of commencement of this Act unless :

- ✓ the articles of the company provides otherwise or
- ✓ the company does not carry multiple business

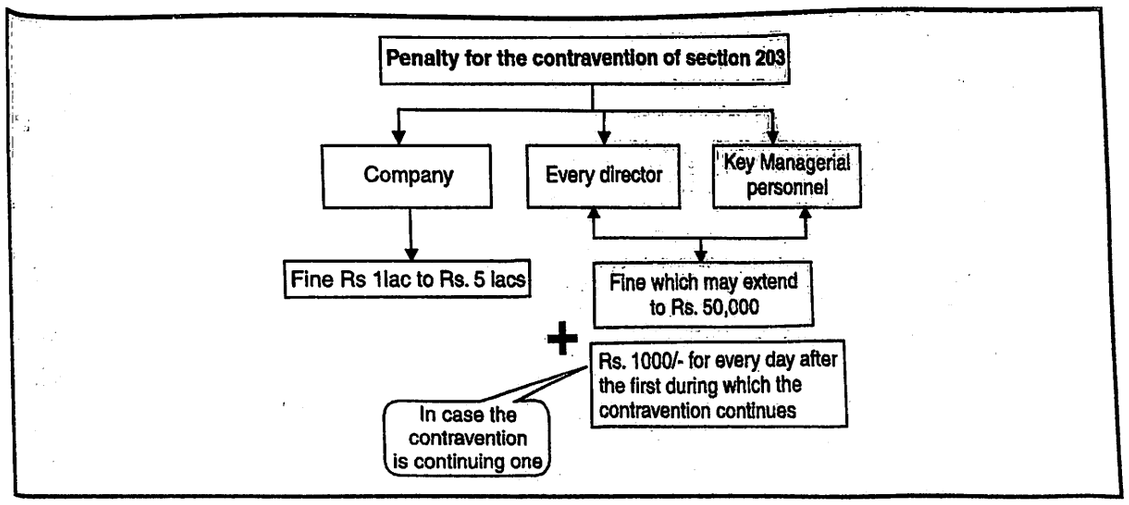


- Every whole time KMP shall be appointed by the board resolution containing the terms and conditions of the appointment and remuneration.
- A whole-time KMP cannot hold office in more than one company except in its subsidiary company at the same time.
- A whole time KMP can be a director of any company with the permission of the Board of the existing company in which he is a director.
- A whole- time KMP holding office in more than one company on the date of commencement of this Act *i.e.* April 1, 2014 shall within 6 months from such commencement choose one company in which he wishes to continue.

A person can be appointed or employed as a MD of a company if he is already a MD or Manager l any other company but such appointment and employment shall be made and proved in the board meeting by the numinous consent of the directors present at the meeting and for which the specific notice ahs been given to all the directors then in India.

Vacancy of office of whole time KMP shall be field up by the Board at its meeting within a period of 6 months from the date of such vacancy.

Penalty : Section 203(5)



SHORT ANSWER QUETIONS

1. Who is a managing director ?
2. How is the managing director of a company appointed ?
3. What are the disqualifications of a managing director?
4. What is the term of office of a managing director ?
5. What is the maximum number of companies of which a person can be appointed as the managing director ?
6. What considerations are taken into account by the Central Government before granting its approval to the appointment of a managing director ?
7. Distinguish between a managing director and a whole time director.
8. Define 'Manager' according to Companies Act, 2013.
9. Who is disqualified from being appointed as the manager of a company.
10. What is the number of companies of which a person can be appointed as the manager?
11. Can the manager of a company receive remuneration either by way of monthly payment or by way of specified percentage of the net profits of the company ?
12. Can the office of a manager be assigned ?
13. Distinguish between a manager and a managing director.
14. Can Managing Director be removed.
15. Can the members remove a managing director before the expiry of his tenure.
16. 'No one below the age of twenty-five years can be appointed as managing director of a company' Comment.
17. Sole selling Agents.
18. Re–appointment of sole selling agents.
19. Remuneration of sole selling agents.
20. The Central Government cannot always investigate into the terms of appointment of Sole-selling agent.
21. Can compensation be paid to a sole selling agent for the loss of office ?
22. Under what cases the appointment of a sole selling agent has been prohibited by the Central Government ?
23. Write short note on appointment of sole buying or purchasing agent. ?

TEST QUESTIONS

1. Explain the provisions of the Act in regard to appointment and remuneration to the Managing Director. Can a person be appointed managing director of more than one company ?
2. Discuss the restrictions imposed on the appointment and payment of remuneration to Managing Director.
3. How is a managing Director appointment ? What are his duties and responsibilities ? Discuss the role and powers, if any, of the Government in regard to the appointment of Managing Director.
4. State the factors the Central Government is required to take into consideration in according its approval to the appointment of a managing or whole time director and the remuneration payable to him.
5. State the procedure for the appointment of a managing director of a public limited company.

6. What is the position of the managing director vis-a-vis the board of directors ?
7. Discuss the statutory provising relating to the appointment, re-appointment and payment of remuneration to the managing director of a public limited company.
8. What is the legal positions ?

   (i) If Director ceases to be a M.D. *(ii) If M.D. ceases to be a Director.*

   (iii) State whether Managing Director is an employee of the Company.
9. Can the members remove a managing director before the expiry of his tenure.' If not, who can remove the managing director. When does the resignation of a Managing Director becomes effective.
10. Discuss the provision of the Companies Act 2013 relating to appointment of a manager. What are the disqualification for the office of a manager.
11. Discuss the statutory provisions relating to the appointment, re-appointment and payment of remuneration to the manager of a public limited company. Who can remove the manager of a Company. When does the resignation of a Manager becomes effective.
12. Distinguish between

    (i) Managing Director and Whole Time Director.

    (ii) Managing Director and Manager
13. Is it obligatory on the part of the companies to have managing director or manager ? When does the appointment of managing or whole time director require the approved of the central government ? What are the Consequences, if such approval is not obtained or Central government refuses approval.
14. State the provisions of the Companies Act, 2013 relating to the appointment of 'sole selling agents'. Explain how they protect the interests of the shareholders of the company and the consumers ?
15. State the provisions of the Companies Act regarding appointment of 'sole-selling agents' and payment of compensation to them for loss of office. What are the powers of the Central Government in controlling the appointment of such agents.
16. What are the restrictions laid down in the Companies Act in regard to appointment of sole-selling agents by a public limited Company ? Can the Central Government investigate into the terms of appointment of sole-selling agents ?
17. What do you mean by sole selling agents ? State the circumstances under which approval of the Central Government is required for the appointment of sole selling agents. When may the Central Government prohibit the appointment of a sole selling agent.

PRACTICAL PROBLEMS

Q. 1. Mr. Y the managing director who has completed 72 years of age, is to be re-appointed for five years. The remuneration will be within the limits prescribed under Schedule V.

Ans. In terms of amended Schedule V a person who is otherwise qualified but has attained the age of 70 years can be appointed Managing Director without Central Government approval if his appointment is approved by a special resolution passed by, the company in general meeting. So, Mr. Y can be reappointed for a period of 5 years & the procedure for re-appointment is as under :

(1) Ensure that Y fulfils conditions contained in Part I of Schedule V.

(2) Ensure that the remuneration to be paid to him shall be within the limits specified in Schedule V.

(3) Hold the Board Meeting and pass the resolution for reappointment of 'Y' as Managing Director and fixation of his remuneration.

(4) Call and hold the General Meeting and get the Special Resolution passed.

(5) File a return in the prescribed Form with the concerned Registrar of Companies within 90 days of the appointment. Also file copy of the special resolution and terms and conditions with the Registrar as per Section 117 and send extracts to members as per Section 190.

Q. 2. Mr. P, the managing director of M/s XYZ Ltd., is proposed to be appointed as managing director of M/s ABC Ltd. State the procedure for such an appointment and whether Mr. P can draw remuneration from both the companies.

Ans. Mr. P can be appointed as managing director by complying with the provisions of Section 203 of the Companies Act, 2013. Appointment can be made or approved by a resolution passed at the meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and if the resolution to be moved thereat, specific notice should be given to all the directors in India.

If the appointee is managerial person of more than one company, he shall draw remuneration from one or both companies provided that the total remuneration drawn from both the companies does not exceed the maximum limit admissible from any one of the companies of which he is the Managing Director. Accordingly, Mr. P can draw remuneration from both the companies provided the same is within the overall ceiling as stated above.

Q. 3. The Managing director of the company withdrew a sum of money from the company's bank account and used it to pay bribes for obtaining contracts in favour of the company. The company sued the managing director. The managing director contends that the company has benefited substantially on account of the contract obtained. Decide whether company will succeed.

Ans. The Managing Director of the company has no authority to use the fund of the company for illegal purposes like giving bribes. Even if the company has benefitted from the contract, he has no right to charge the company for his illigal activities. The company can recover the money.

[*Hannibal (E) & Co. v. Frost 1988 4 BCC 3 (CA)*]

Q. 4. Mr. X managing director of a company is convicted of an offence involving moral turpitude. He prefers an appeal against conviction. Can he continue as managing director pending disposal of the appeal. Can the appellate court remove the disqualification or stay the same pending the disposal of the appeal.

Ans. u/s 196, a person is disqualified from being appointed or continued in employment as managing director if he is convicted for whatever term of imprisonment or fine by any court in India or abroad of an offence involving moral turpitude. Under Criminal Procedure Code, an appeal against the order of conviction may either be dismissed summarily or heard by an appellate court. However, order of conviction does not on the mere filing of an appeal disappear and it is difficult to hold that section 196 of the Companies Act must be read to apply over to final order of conviction as such interpretation may defeat the very object and purpose for which it came to be enacted. In view of this, operation of Section 196 shall not be stayed pending disposal of appeal. [*Rama Narang v. Ramesh Narang (1995)*]

Q. 5. Shri Prakash Chand was appointed as a Managing Director of M/s Sun Fabrics Limited for a period of 5 years with effect from 1.4.2001 on a remuneration of ₹ 50,000 per month with other perquisites which are in excess of the limits laid down in Schedule V to the Companies Act. The Central Government has received a complaint in this regard, as the company has not sought the approval of the Central Government for the said appointment. Examine the powers of the Central Government in such a situation. Also examine the validity of acts of Shri Prakash Chand as Managing Director. [*C.A. (Final) May, 1997*]

Ans. Since the appointment of Shri Prakash Chand is not in accordance with the conditions laid down in Schedule V, the appointment cannot be made except with the approval of the Central Government. Since here appointment has been made without the approval of the Central Government, it shall be competent for the Central Government to refer the matter to the Tribunal for decision.

The Tribunal shall decide whether appointment has been made in contravation of the requirements of Schedule V. If so, it shall pass an order in this regard. The appointment of Shri Prakash Chand shall be deemed to have come to an end in addition to being liable to pay a fine u/s 197.

All acts done by a managing or whole time director or a manager, as the case may be purporting to act in such capacity and whose appointment has been found to be in contravention of Schedule V, shall, if the acts so done are valid otherwise, be valid notwithstanding any order made by the Tribunal.

Q. 6. J, having substantial interest in XYZ Ltd. is appointed as a Sole Selling Agent by the Board of Directors of the company for a period of 5 years. The company's paid-up share capital is ₹ 49 crores. The Board of Directors did not place the matter in the AGM, for paucity of time and communicated to J about his appointment, who in turn accepted the appointment.

Explaining the provisions of the Companies Act, 2013 decide :

(i) Whether the appointment of J is in order ?

(ii) What course of action would you take as the Secretary of the company in case J does not have substantial interest ?

Ans. (i) The appointment of J is not in order. Appointment without the approval of the general meeting and without the approval of the Central Government is not valid since the company's paid up share capital is more than ₹ 50 lakhs in this case. Moreover, since J has substantial interest in the company, approval of Central Government in Form I is must. Thus the appointment of J is not in order.

(ii) In this case, J does not have substantial interest, but the company's paid-up share capital is more than 50 lakhs, consent of the company in general meeting by special resolution and the approval of the Central Government is required.

□□□

14

COMPANY SECRETARY AND COMPANY SECRETARY IN PRACTICE

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
Appointment of Key Managerial Personnel (KMP)	Compulsory for every company belonging to such class or classes of companies to have the following whole-time key managerial personnel (i) MD or CEO or manager and in their absence a WTD, (ii) **Company Secretary** and (iii) CFO. Rule 8 of the companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that every listed company and every other public company having a paid up share capital of ten crore rupees or more shall have whole-time key managerial personnel. (i.e. (i) MD or CEO or Manager or in their absence a WTD (ii) Company Secretary (iii) CFO)	Compulsory for every public company and every private company which is a subsidiary of public company having paid up capital of prescribed sum to appoint a managing director or whole-time director or manager. Also, it made it compulsory for every company having a paid up capital of such sum as may be prescribed to appoint a whole-time secretary.
COMPANY SECRETARY/ SECRETARIAL AUDIT		
Secretarial audit for bigger companies	Mandatory secretarial audit by a company secretary in practice for listed companies and every public company having a paid up share capital of ` 50 crores or more or turnover of ` 200 crore or more. [See Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014] Secretarial audit report in Form No. MR. 3 to be annexed to BOD's report.	No such requirement.

Functions of Company Secretary	*New provisions introduced by the 2013 Act. [See also rule 10 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014]*	*No provisions on functions of Company Secretary in the 1956 Act.*

WHO IS SECRETARY ?

Every association of persons, from the smallest sports club to right upto the Government itself, has at least one person—the 'Secretary'. The profession of a secretary is one of the oldest in the world.

In order to understand the meaning, importance and position of a secretary, it would be useful to study the definition of the term 'secretary'. Secretary means 'one entrusted with secrets'. The word 'secretary is derived from the Latin word 'secretarius' which means a confidential writer or notary. In its early use, the term was applied only to the officer who conducted the correspondence of a king. In modern times the duties and functions of a secretary have become so wide and varied that a modern secretary does no longer resemble his ancient counterpart. His duties are no longer confined to conducting confidential correspondence for kings and other important persons. Today his duties and functions range from conducting of correspondence, keeping of records and accounts, writing of minutes, reports etc., to acting as public relations officer of the employer.

IMPORTANCE

The secretary has come to occupy a very important place in society. In fact he is an indispensable person in industry, commerce and other social institutions. The governing body of an organisation may change from time to time *e.g. the directors or chairman of a company, or ministers in a cabinet may come and go but it is the work of the secretariat that "runs the show" and promotes the growth of the organisation.*

The importance of a secretary is especially felt in the business world. The reasons are two-fold. With the growth in the size and complexities of business operations it is impossible for a business executive to cope single handed with the day-to-day problems. As such he has to depend more and more on his secretary. By entrusting the secretary with the supervision of routine matters, he is free to concentrate on matters requiring his personal attention. Further, legal requirements relating to joint stock companies have become so elaborate and complex that compliance with the various provisions is now quite a difficult job. The secretary fulfils the functions of a whole time officer who looks after the routine business matters as well as ensures compliance with the legal provisions.

TYPES OF SECRETARIES

Of secretaries there is no end. Secretaries may be classified into several categories which are discussed as under.

(i) Private secretary. A private secretary is a person employed by another for his personal work and correspondence. He is the right hand man of his employer. Persons holding top positions in business houses, public bodies and government ; the professional people like doctors, lawyers, accountants etc. whose work requires close attention and specialisation cannot afford to spare time for routine activities. For such activities they employ secretaries.

The duties of a private secretary vary according to the nature of the work of the employer. However, there are certain routine duties which have to be performed by all private secretaries.

These are as follows :

(a) taking dictation; (b) handling mail;
(c) filing and indexing; (d) keeping financial and personal records;
(e) attending to callers : (f) making appointments
(g) handling the telephone; and (h) collecting information.

(ii) Secretary of an association or club. An association or a club is formed to serve some common cause of its members, such as promoting art, science, music, sports etc. These associations, unions or clubs require the services of a whole time secretary. They usually appoint a paid secretary to conduct the day to day activities of the association and act as the agent and adviser of the managing committee.

(iii) Secretary of a government department. Secretary of a government department is the executive head who manages a particular department of the government. Usually an I.A.S. officer is appointed as the secretary of a particular department, such as Secretary, Ministry of Home Affairs ; Secretary, Ministry of Foreign Affairs. The secretary of a government department acts under the direct control of the minister in charge of that department. He is not only the executive or administrative head of the department but also the chief adviser to the Minister. The ultimate policy decisions are taken by the minister himself, but he has to remain so much busy with political and parliamentary matters that he finds very little time to keep in touch with day to day development relating to the functioning of his ministry. Consequently, he has to depend heavily on the aid and advise of his secretary.

(iv) Secretary of a co-operative society. A co-operative society is a body corporate with a common seal and with powers to own property, to enter into contracts and to do all that is necessary to achieve the objectives for which it is formed.

The secretary of a co-opeative society, like that of a company is an officer of the society. He may be appointed either as a paid secretary or elected from among the members of the managing committee. A secretary may be appointed on part time or full time basis depending on the size or volume of work of the society.

The main function of the secretary of a co-operative society is to manage the affairs of the society under the control and direction of the managing committee. He is required to maintain proper records and registers in accordance with the rules framed by the government and submit periodical statements and returns to the Registrar of co-operative societies.

(v) Secretary of a local body. Local self governing bodies such and municipal committees, improvement trusts, zila parishads etc. usually provide for the appointment of a whole time secretary to look after their day to day affairs. The secretarial duties include office management, assisting in the conduct of meetings, recording proceedings at the meetings of the body concerned, ensuring that the legal requirements are duly complied with and doing scores of other functions.

(vi) Company secretary. The largest and most important group of secretaries in the business sector comprise those appointed by joint stock companies. In recent times there has been an increasing appreciation of the role of company secretaries in the administration of companies. It is with this class of secretaries that we are concerned with in this book.

DEFINITION OF A COMPANY SECRETARY

Section 2(24) of the Act defines a secretary as follows :

"Secretary means a Company Secretary within the meaning of Section 2(1) (c) of the Company Secretaries Act, 1980, and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties."

The definition reveals the following characteristics of a Comapny Secretary.

(1) Only an individual may be appointed a company secretary. A firm or a body corporate cannot be a company secretary.

(2) A company secretary should possess the *requisite qualifications to be prescribed by the Central Government.*

The company secretary performs the duties which may be performed by a secretary under Companies Act including any other ministerial or administrative duties. In other words the duties of the secretary are *ministerial or administrative and not managerial. Thus, the secretary is an officer in a ministerial and administrative capacity, who is charged with the duty of ensuring that the affairs of the company are conducted in accordance with the provisions of the Companies Act, the company's Articles and generally in accordance with the law. The omission of word 'purely' before the words 'ministerial or administrative duties is intended to enlarge the scope of the Secretary's function. Accordingly, he may also be given managerial responsibilities. In general managerial powers are given to him and they extend to the whole affairs of the company. The secretary though called by that name will really be the manager or if he is also a director, the managing director or whole time director for purpose of this Act.*

COMPULSORY APPOINTMENT OF KMP (KEY MANAGERIAL PERSONNEL) UNDER SECTION 203 OF COMPANIES ACT, 2013 READ WITH RULE 8 OF THE COMPANIES (APPOINTMENT AND REMUNERATION OF MANAGERIAL PERSONNEL) RULES, 2014

Every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have the following whole-time key managerial personnel :

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director,

(ii) **Company secretary** and

(iii) Chief Financial Officer :

An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director of Chief Executive Officer of the company at the same time after the date of commencement of this Act.

(a) Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of Board containing the terms and conditions of the appointment including the remuneration.

(b) A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

(c) A key managerial personnel shall not be disentitled from being a director of any company with the permission of the Board

(d) A whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one.

(e) If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Penalty : If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Every director and key managerial personnel of the company who is in default shall be punishable with fine which may extend to fifty thousand rupees. Where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues.

Note : Under the 1956 Act, it was compulsory for every company having a specified paid up share capital to appoint a whole-time secretary. But under the 2013 Act, it is compulsory for every listed company and every other public company having paid up share capital of ₹ 10 crore or more to appoint KMP.

PARTICULARS OF SECRETARY [SECTION 170]

Section 170 of the Companies Act, 2013 provides that every company shall keep in its registered office a register of its directors, managing director, manager and secretary containing particulars about them. Thus the name, father's name, surname, usual residential address, nationality, date of birth etc. of the Secretary must be entered in the register. If there is a change of secretary, notice must be sent to the Registrar of Companies in the prescribed form with thirty days. Failure to comply with this provision shall render the company and its every officer who is in default liable to punishment with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

QUALIFICATIONS OF A COMPANY SECRETARY

Qualification prescribed for appointment of a Company Secretary

The whole-time company secretary as a KMP shall be a member of the Institute of Company Secretaries of India. A listed company or any other public company having a paid up share capital of ₹ 10 crores or more shall appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 as a whole-time secretary to perform the duties of a Key Managerial Person and Secretary under the Companies Act, 2013.

Appointment of a director as Secretary

Where the Board of directors of a listed company or any other public company having a paid up capital of Rupees Ten Crores or more consisting of only two directors, neither of them shall be appointed as a secretary of the company.

DEFINITION OF A COMPANY SECRETARY

Section 2(24) of the Act defines a secretary as follows :

"Secretary means a Company Secretary within the meaning of Section 2(1) (c) of the Company Secretaries Act, 1980, and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties."

The definition reveals the following characteristics of a Comapny Secretary.

(1) Only an individual may be appointed a company secretary. A firm or a body corporate cannot be a company secretary.

(2) A company secretary should possess the *requisite qualifications to be prescribed by the Central Government.*

The company secretary performs the duties which may be performed by a secretary under Companies Act including any other ministerial or administrative duties. In other words the duties of the secretary are *ministerial or administrative and not managerial. Thus, the secretary is an officer in a ministerial and administrative capacity, who is charged with the duty of ensuring that the affairs of the company are conducted in accordance with the provisions of the Companies Act, the company's Articles and generally in accordance with the law. The omission of word 'purely' before the words 'ministerial or administrative duties is intended to enlarge the scope of the Secretary's function. Accordingly, he may also be given managerial responsibilities. In general managerial powers are given to him and they extend to the whole affairs of the company. The secretary though called by that name will really be the manager or if he is also a director, the managing director or whole time director for purpose of this Act.*

COMPULSORY APPOINTMENT OF KMP (KEY MANAGERIAL PERSONNEL) UNDER SECTION 203 OF COMPANIES ACT, 2013 READ WITH RULE 8 OF THE COMPANIES (APPOINTMENT AND REMUNERATION OF MANAGERIAL PERSONNEL) RULES, 2014

Every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have the following whole-time key managerial personnel :

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director,

(ii) **Company secretary** and

(iii) Chief Financial Officer :

An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director of Chief Executive Officer of the company at the same time after the date of commencement of this Act.

(a) Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of Board containing the terms and conditions of the appointment including the remuneration.

(b) A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

(c) A key managerial personnel shall not be disentitled from being a director of any company with the permission of the Board

(d) A whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one.

(e) If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Penalty : If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Every director and key managerial personnel of the company who is in default shall be punishable with fine which may extend to fifty thousand rupees. Where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues.

Note : Under the 1956 Act, it was compulsory for every company having a specified paid up share capital to appoint a whole-time secretary. But under the 2013 Act, it is compulsory for every listed company and every other public company having paid up share capital of ₹ 10 crore or more to appoint KMP.

PARTICULARS OF SECRETARY [SECTION 170]

Section 170 of the Companies Act, 2013 provides that every company shall keep in its registered office a register of its directors, managing director, manager and secretary containing particulars about them. Thus the name, father's name, surname, usual residential address, nationality, date of birth etc. of the Secretary must be entered in the register. If there is a change of secretary, notice must be sent to the Registrar of Companies in the prescribed form with thirty days. Failure to comply with this provision shall render the company and its every officer who is in default liable to punishment with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

QUALIFICATIONS OF A COMPANY SECRETARY

Qualification prescribed for appointment of a Company Secretary

The whole-time company secretary as a KMP shall be a member of the Institute of Company Secretaries of India. A listed company or any other public company having a paid up share capital of ₹ 10 crores or more shall appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 as a whole-time secretary to perform the duties of a Key Managerial Person and Secretary under the Companies Act, 2013.

Appointment of a director as Secretary

Where the Board of directors of a listed company or any other public company having a paid up capital of Rupees Ten Crores or more consisting of only two directors, neither of them shall be appointed as a secretary of the company.

However, if a public company has more than three directors on the Board, one of them can act as a secretary subject to that such director is a member of the Institute of Company Secretaries of India and subject to the compliance of the provisions of section 188 of the Companies Act, 2013.

Secretary is not responsible under sections 138 and 141 of the Negotiable Instruments Act, 1881

It has been held that the role of Company Secretary is distinguishable and he is merely an employee of the company. If he is neither director nor signatory to the cheque, in view of that the secretary has no active role in the passing of resolution and policy decision of the company or seeking financial assistance or issuing cheques and he is rather an outsider and mere employee of the company, therefore, the proceeding under section 138 and 141 of the Negotiable Instruments Act, 1881 against the company secretary has been dropped.

OTHER QUALIFICATIONS

In view of the qualifications prescribed under the above rules, it is apparent that a company secretary must be a well qualified man.

The professional qualifications which enable a company secretary to discharge his multifarious obligations efficiently may be summed up as follows :

1. Sound education. The secretary should possess high standard of academic qualification. Since a company secretary has to perform multifarious duties, it is desirable that he should be very well qualified.

2. Proficiency in language. Proficiency in language is an indispensable qualification of a secretary. A person who can write forceful, logical, persuasive letters, and so maintain friendly relations with the company's correspondents is very valuable to the company he serves. The writing of precis, the drafting of reports, the writing of minutes, the preparation of agenda and the framing of resolutions require a somewhat specialized knowledge of the English language. Hence, it is necesssary that the secretary should command that knowledge.

It would be useful if he has working knowledge of one or more foreign languages particularly where the company has foreign connections.

3. Knowledge of office organisation and business methods. It is essential that the secretary should posses sound practical knowledge of the different systems of filing, indexing, duplicating. He should have practical knowledge of office routine and methods. He should be familiar with the modern trend of office mechanisation and automation.

He must also know the methods of selecting, remunerating and controlling the staff and apportioning the work among the members in the manner that would ensure smooth and efficient working of the office.

4. Knowledge of accountancy and taxation. As an executive officer, the company secretary must have a basic knowledge of book keeping and accountancy as well as the law and practice of income-tax, sales-tax, etc.

5. Knowledge of Mercantile Law. It is necessary that the secretary should be thoroughly conversant with the Acts like the Contract Act, and the laws of the country relating to the Sale of Goods, Insurance, Patents and Copyright, Trade Marks, Workmen's Compensation, etc. Above all he should possess an intimate knowledge of the Companies Act together with the leading cases that have

decided certain points of procedure or clarified the meanings of certain sections of the Act. Most of the sections of the Companies Act should be on the tips of his fingers.

6. Knowledge of economics, banking and finance. A company secretary should especially have a knowledge of the methods of modern banking and finance so far as it relates to the financing of his company. More particularly, he should know the law and practice of banking, working of the money and capital markets, methods of financing trade and industry and foreign exchange.

7. Impressive personality. A good and impressive personality is the aggregate of several qualities of head and heart, e.g., sincerity, orderliness, commonsense, tact, discretion, punctuality, enthusiasm, alertness, dependability, sense of responsibility, cheerful disposition, and the like. The secretary can get on well with everybody and secure willing co-operation from his subordinates and colleagues if he possesses an impressive personality.

In order to command respect from the staff, to gain confidence of the board and achieve the status of an executive secretary, he must have a high moral character which is based on four pillars of truth, justice, loyalty and honesty.

RIGHTS AND POWERS OF A COMPANY SECRETARY

A company secretary enjoys certain rights. Some of them are conferred by the Companies Act, while some other rights arise out of agreement between him and his employer :

1. A Company Secretary has the right to supervise & control the secretarial department of a company.
2. He has the right to sign documents as a principal officer of the company within the meaning of the Companies Act.
3. Secretary has a right to issue share certificate of the company.
4. The secretary of a company is empowered to perform all acts which he is required to perform under enactments like the Companies Act, the MRTP Act, the Income Tax Act etc.
5. Sometimes the Board of Directors may delegate some of their powers to the company secretary. Accordingly, he can enter into agreement on behalf of the directors and do all acts which the board of directors specifically directs him to perform.
6. Sometime, the general meeting also authorises him to perform an act. However, if the secretary performs an act without being so authorised the company may not ratify it and may not be bound by it.
7. He has a right to be indemnified by the company for any loss suffered by him while discharging his official duties.

Restrictions : There are some restrictions on the powers of Company Secretary :

1. He cannot participate in the management of company's affairs.[1]
2. He cannot enter into any contract on behalf of the company unless specifically authorised by the directors. However, he can enter into contracts necessary for carrying on the administration of the company's organisation such as contracts for the employment of staff,

1. Barnett v. The South London Transways Co. (1887) 18, BD 815.

the acquisition of official equipment or the hiring of transport for customers visiting company's factory.[1]

3. He can not borrow money in the Company's name.[2]
4. He cannot call meetings of members ; has no right to allot shares, has no right to register transfer of shares unless he is authorised by the directors.

DUTIES OF A COMPANY SECRETARY

The duties of a company secretary may be of two kinds :

(a) Statutory duties and

(b) General duties.

A. Statutory Duties

I. Under the Companies Act

(i) Secretary may sign any document or proceedings requiring authentication by the company. (Section 21).

(ii) He has to deliver for registration return of allotment to the Registrar. (Section 39).

(iii) He has to give notice of the increase in the share capital to the Registrar. (Section 64).

(iv) He has to deliver the share certificate within 3 months of allotment or within 2 months of registration of transfer. (Section 56).

(v) He has to make available trust deed for inspection to every member or debenture holder and to forward a copy of it to the members or debentureholders at their request within 7 days of request on payment of prescribed fee. (Section 71).

(vi) He has to deliver for registration particulars of mortgages and charges. (Section 77).

(vii) He has to make statutory declaration for attaining the certificate of commencement of business. (Sec. 11)

(viii) He has to sign the annual return. (Section 92).

(ix) He has to allow inspection of and to furnish copies of register of members. (Section 94).

(x) He has to send notice of general meetings to every member of the company. (Section 101).

(xi) He has to file certain resolutions and agreements requiring registration with the Registrer. (Section 117).

(xii) He has to prepare minutes of every general meeting and of every meeting of Board of directors or of every committee of the board within 30 days of the conclusion of every such meeting. (Sec. 118)

(xiii) He has to make available for inspection the books of general meetings. (Sections 119).

(xiv) He has to give notice of every meeting of the Board of directors in writing to every director for the time being in India, and at his usual address in India to every other director. (Sec. 173)

1. Panorama Development (Guide ford) Ltd. v Fidelis Furnishing Fabriccs Ltd. (1971) 3 ALL ER 16.

2. Re cleadon Trust Ltd. (1938) 4 ALL ER 518.

(xv) He has to make available register of directors for inspection. (Sec. 171).

(xvi) He has to sign every balance sheet and every profit and loss account in the case of non banking companies. (Sec. 134)

(xvii) He has to maintain the following statutory books :

(a) Register of investments (Sec. 187)
(b) Register of charges. (Section 85).
(c) Register of members. (Section 88).
(d) Register of debentureholders. (Section 88).
(e) Books containing the minutes of Directors' and Shareholdres meetings.
(f) Register of contracts, companies and firms in which directors are interested. (Sec. 189)
(g) Register of directors (Sec. 170)
(h) Register of director's shareholding etc. (Sec. 170).

(2) **Under Income-tax Act..** *The Income tax Act also considers the secretary as the principal officer of the company and imposes certain obligations upon him :*

(i) He is required to see that proper income tax is deducted from the salaries of the employees.

(ii) Similarly, he is required to see that proper income tax is deduced from dividend and interest payable to shareholders and debentureholders respectively.

(iii) He is also to see that a certificate of income tax deducted at source is furnished to every shareholder or to every debenture holder.

(iv) He is to see that tax so deducted has been deposited in Government treasury and the Income-tax Return as required by law is filed with the Income-tax Department.

(v) He is to file the Income-Tax Return of the company and deposit the tax payable on the basis of such return.

(3) **Under Stamp Act.** The secretary of a company is required to see that every document like share certificate, share warrant, debenture certificate and transfer forms, are properly stamped as per the requirements of the Indian Stamp Act.

(4) **Under other Acts.** In addition, the secretary is also required to comply with the provisions of the various Acts e.g. The Factories Act, 1949, The Industrial Disputes Act, 1947. The Employees State Insurance Act, 1948, The Minimum Wages Act, 1948, The Payment of Wages Act, 1936, The Provident Fund Act, 1952, Foreign Exchange Management Act (FEMA) 1999, Monopolies and Restrictive Trade Practices (MRTP) Act, 1969.

B. General Duties

1. Duties to the directors. The duties of the company secretary in relation to the directors may be stated briefly as follows :

(i) To work in accordance with the instructions of the Directors.

(ii) To deal with that correspondence in which directors are interested.

(iii) To issue notice and prepare agenda for the Board of directors meetings, arrange for these meetings, and, at the meeting to attend the same and to prepare minutes of it later on.

(iv) To maintain all important correspondence, files and records for the perusal of directors.

(v) To draft the director's report.

(2) Duties to the shareholders and the public. The important duties of the secretary in relation to the shareholders and creditors, etc. are as follows:

(i) To do all the necessary things relating to shares and debentures; to issue a prospectus, to invite applications for the subscription of shares and debentures and arranging for their allotment, to issue share certificates and debentures, to handle transfer and transmission of such shares and debentures, to arrange for the payment of dividend and interest thereon respectively.

(ii) To deal with all corresondence between the company and the shareholders, creditors, public and look into their complaints.

(iii) To intimate them about the date of a general meeting, about its agenda, about closure of transfer books, etc.

(iv) To attend all the meetings of shareholders, creditors and debenture holders and record their proceedings.

(v) Not to disclose any confidential or secret information relating to the affairs of the company.

(vi) Not to make secret profits by virtue of his position as secretary of the company.

LIABILITIES OF A COMPANY SECRETARY

A. Statutory Liabilities

If a company secretary fails to perform his statutory duties, he becomes liable to punishment or penalty prescribed under the Act.

He may be held liable for :

(i) default in filing a return of allotment—fine upto ₹ 1,000 for every day which may extend to 1 lac if the default continues. (Sec. 39),

(ii) default in keeping ready for delivery share certificates, debenture certificates etc., within 3 months after allotment and within 2 months of the application for registration of a transfer—fine upto ₹ 5,000 which may extend to 5 lac for every day during which the default continues (Sec. 56),

(iii) default in filing particulars of charges on properties acquired subject to charge—fine upto ₹ 5,000. (Sec. 79),

(iv) failure to comply with the requirements of section 12 of the Act regarding exhibiting the name of the company—fine upto ₹ 1,000 (it may extend to 1 lac if default continue),

(v) default in filing annual return—fine upto ₹ 50,000 and if default continues ₹ 5 lac (Sec. 92),

(vi) default in holding the annual general meeting of the company—fine upto ₹ 1 lac plus fine upto ₹ 5,000 for every day after the first during which such default continues. (Sec. 99),

(vii) default in the circulation of the member's resolution—fine upto ₹ 25,000 (Sec. 111),

(viii) default in registering certain resolutions and agreements requiring registration—fine upto ₹ 1 lac, which may extend to 5 lacs (Sec. 117),

(ix) Failure to record the minutes of the board and general meetings—*(i) fine upto ₹5,000 (Sec. 118),*

(x) Refusal in allowing inspection of minutes of general meeting or failure to furnish a copy of such minutes on request by any member within 7 days of such request—fine upto ₹ 5,000 in respect of each offence. (Sec. 119),

(xi) default in laying down Profit and Loss Account and Balance Sheet at the annual general meeting—fine upto ₹ 50,000 (which may extend to 5 lacs) or imprisonment upto 1 year or both, (Sec. 129),

(xii) failure to give the due notice of board meeting—fine upto ₹ 25,000 (Sec. 173),

(xiii) failure to maintain the following statutory books :

(a) Register of members—fine upto ₹ 50,000 upto 3 lacs, (Sec. 88),

(b) Index of register of members—fine upto 3 lacs, (Sec. 88),

(c) Register and index of debenture holders—fine upto ₹ 500, (Sec. 88),

(d) Register of directors—fine per day of default. (Sec. 170),

(e) Register of directors shareholdings—fine (Sec. 170),

B. Contractual Liabilities

A company secretary has certain contractual liabilities arising out of his contract of service with the company :

(i) A company secretary is expected to perform his duties with reasonable care and skill. He is liable to the company for damages caused by his wilful misconduct or neglect of duties. On this ground, he may be dismissed summarily and without notice.

(ii) He should not do anything beyond his authority. If he acts beyond his authority he will be personally liable for any damage or loss suffered by the company or any third party as a result of his action.

(iii) He is under an obligation not to disclose any confidential or secret information relating to the affairs of the company. Otherwise, he may be restrained by injuction from disclosing trade secrets.

(iv) He stands in a fiduciary position to the company and if he makes a secret profit on account of his position as secretary of the company, he will be liable to account for it to the company.

(v) If he commits fraud or does any wrong within course of his employment, he is liable to indemnify the company or any third party for the loss suffered on account of his action. But, he is not liable for any fraud on the part of any of his assistants unless he is party to it.

COMPANY SECRETARY'S LIABILITY FOR OFFENCES COMMITTED BY THE COMPANY

Company Secretary can't be held liable for offences committed by the company to which he has remote relation and the company secretary has been arrayed simply because he is a Company Secretary.

Example : A complaint was lodged against the petitioner alleging that a sample of insecticides drawn from a lot manufactured by the company showed that it was misbranded and was not in conformity with the Ist specification and that since the petitioner was working as secretary of the company and was responsible for the secretarial function of the company, he was liable to be proceeded against & punished. The

prosecution maintained that the secretary was a responsible officer of the company and by virtue of the provisions of Section 33(2) of Insecticides Act, 1968, he must be deemed to be guilty of the offence. Quashing the complaint the High Court held; "....when an offence had been allegedly committed by a company then every person who was responsible shall be deemed to be guilty of the offence provided he was incharge. for the conduct of the business of the company at the time offence was committed." In the petition, it had only been stated that the pettioner was the Secretary of the company and was responsible for this offence. But the company secretary has nothing to do with production. Hence was not held liable and prosecution against him was an abuse of the process of the court. [B.B. Nagpur v. State of Haryana (1995) 18 CLA 83].

POSITION OF COMPANY SECRETARY

It is difficult to give a precise description of the legal position of a company secretary. The Companies Act, 2013, does not define the legal position of company secretary, yet his position may be assessed and described from the nature of the duties he is required to discharge, pursuant to his agreement with the company and in conformity with the statute.

The legal position of a secretary of a company is that of an agent and servant of the company acting under the directions of the Board. Accordingly he has no right to bind the company without authority from the Board. In 1887 Lord Esher while delivering his judgement in Barnett Hoares & Co. Vs. The South London Tramways Co. Ltd.[1] observed.

"A Secretary is a mere servant, his position is that he is to do what he is told and no person can assume that he has any authority to represent anything at all nor can any one assume that statements made by him are necessarily to be accepted as trustworthy without further enquiry any more than in the case of a merchant it can be assumed that one who is only a clerk has authority to make representation to induce persons to enter into contracts."

But the position of the Secretary has changed a great deal since Lord Esher's judgement in 1887. From the position of almost a clerk the company secretary has become an important figure in the corporate set up. He is an officer of the company charged with the duty of ensuring that the affairs of the company are conducted in accordance with the provisions of the Act and the company's articles.

Lord Danning describes the present position of the company secretary in the following words.

"But times have changed. A Company Secretary is a much more important person now-a-days than he was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Act but also by the role which he plays in the day-to-day business of the company. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day to day running of the company's business. So much so that he may be regarded as having been held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of the company's affairs, such as employing staff and ordering cars and so forth. All such matters now come within the ostensible authority of a Company Secretary."

The changing position and importance of a company secretary has been incorporated in the statutes over the years. The Companies Act, 2013 provides for the appointment of a company secretary as Key Managerial Personnel u/s 203 [Already explained in detail].

1. (1887) 18 QBD 815.

With growing industrialisation the task of company administration has become more and more complex. The enactment of various economic legislations like Companies Act, 1956, Industries (Development and Regulation) Act, 1951, and Foreign Exchange Regulation Act, 1973 and SEBI guidelines etc. to name a few has increased the importance of the role of a company secretary in a company. The complexities of company administration require comprehensive understanding of law, accountancy, management, labour law, industrial relations and a multitude of other aspects affecting the day to day functions of company secretaries.

The Company Secretaries Act, 1980 defines the term 'Company Secretary in Practice' as a person who is a member of the ICSI *i.e.*, Institute of Company Secretaries in India. Section 6 of this Act provides that only a member of the ICSI who has obtained a certificate of Practice from the Council shall be entitled to practice as a company secretary. A Company Secretary shall be deemed to be in practice when he individually or in partnership with one or more members of the Institute engages in practice of the profession of Company Secretaries in the specified areas. The 'areas of practice' prescribed by the Company Secretaries Act, 1980, are : –

(i) to engage in the practice of the profession of company secretaries to or in relation to any company ; or

(ii) to perform services in relation to the promotion, formation, incorporation, amalgamation, reconstruction, reorganisation or winding up of companies;

(iii) to perform such services as may be performed by an authorised representative of the company, a share-transfer agent, an Issue House, Share-stock Broker, a secretarial auditor or consultant, an adviser to a company etc.

(iv) to render such other services as, in the opinion of the Council, are or may be rendered by a company secretary in practice.

The Company Secretaries Regulations, 1982 framed under the Company Secretaries Act, 1980 contain provisions relating to practising company secretaries. Thus, Regulation 11 provides that a certificate of Practice issue to a practising member shall be cancelled when—

(a) the name of the holder is removed from the Register of members;

(b) when it is noticed that the certificate was issued on the basis of false, incorrect or misleading information;

(c) the member ceases to be in practice; or

(d) the member has not paid the annual certificate fee on or before 30th June of that year.

Before cancellation of certificate, under clause (b) above, the member shall be given a reasonable opportunity of being heard.

The procedure for restoration of the certificate of practice is contained in Regulation 14. The application for restoration has to be made by the member to the Council along with the restoration fee as prescribed. On being satisfied that the certificate be restored, the Council shall communicate the restoration to the member concerned and also publish the same in its Journal.

Regulation 167 makes it obligatory for every member in practice to have a place of business in India in his own charge or in charge of another member. The details of such place must be communicated to the Council. In case, there is a change of such place of business, it should be communicated to the Council within thirty days of such change.

A company secretary in practice shall not engage himself in any business or profession other

than the profession of company secretary unless he is otherwise permitted to do so by a general or specific resolution of the Council. However, the Council at its discretion, may permit a company secretary in practice to act as a secretary, trustee, executor, administrator, auditor, receiver, appraiser, valuer, internal auditor, management consultant or a taxation expert and may also take up appointment that may be made by Central or State Government, Court of Law, Labour Tribunal or any other statutory authority.

SECRETARIAL AUDIT

Section 204(1) read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that:–

(a) every listed company; or

(b) every public company having a paid-up share capital of ₹ 50 crore rupees or more; or

(c) every public company having a turnover of ₹ 250 crore rupees or more,

shall annex with its Board's report made in **terms of section 134(3)**, a secretarial audit report, given by a company secretary in practice, in the Form MR-3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

- Section 204(3) provides that the Board of Directors, in their report made in terms of section 134(3), shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under section 204(1).
- There is no specific provision which requires that the Secretarial Audit Report needs to be laid by the company in its annual general meeting, however as an annexure to the Board Report it needs to be laid before the meeting.

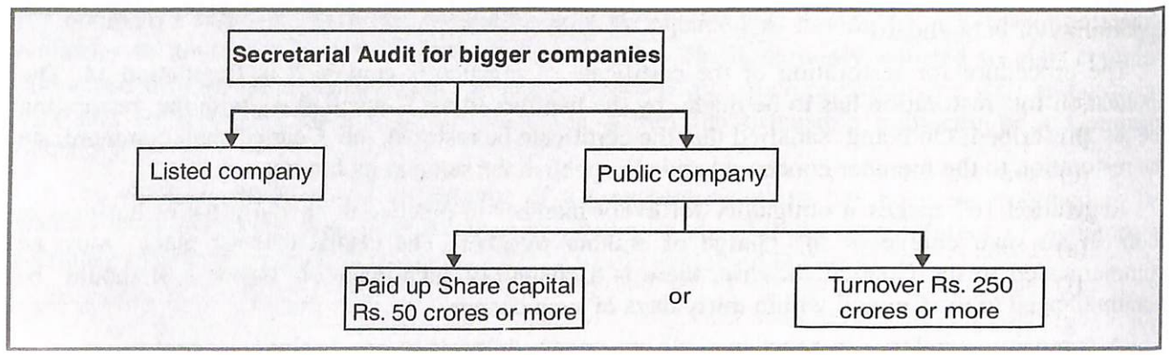
SECRETARIAL AUDIT FOR BIGGER COMPANIES SECTION 204, RULE 9

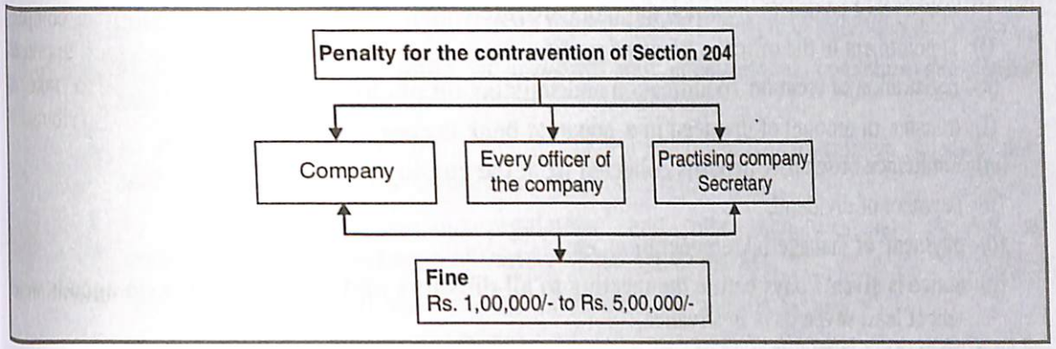
Every listed company and company belonging to other class of companies as may be prescribed shall annex with its Board's report made in terms of section 134(3) Secretarial audit report given by company secretary in practice in such form as may be prescribed such form as may be prescribed.

Such other class of companies are

– every public company having a paid up share capital of ₹ 50 crores or more or

– every public company having a turnover of ₹ 250 corres or more.





SCOPE OF SECRETARIAL AUDIT

The scope of Secretarial Audit would comprise of verification and report of compliance of various requirements under the Companies Act and the Rules there under. The CSP (Practising Company Secretary) should give his Security Audit Report only in respect of matters specified in the Form MR-3 prescribed under the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. If any matter is not applicable, it should also be specified accordingly.

Flexibility in the form of Compliance Certificate

As mentioned in rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 the Secretarial Audit Report shall be given in the Form MR-3 which means that if any information required to be given in the Report does not fit into the format, necessary modifications may be made accordingly in the format of Secretarial Audit Report by the CSP.

Verification of records and documents

For issuance of the first Secretarial Audit Report, CSP should verify the various statutory registers, forms and other relevant records and documents maintained by the company from the first day of the financial year as well as for the previous period for his satisfaction. In case of any doubt on compliance specially for filling of various forms and returns the CSP should also check the proof for filing and receipts obtained from the Registrar and other authorities.

Crucial area of the Secretarial Audit Report

There are certain clauses prescribed under the Secretarial Audit, in which probability for defaults that may be committed by the company and its director is more, due to various reasons, therefore proper care must be taken specifically in the matter of :

(1) Under the Companies Act, 2013 ;

(a) increase in the authorised, issued and paid up share capital,

(b) appointment and cessation of office of directors,

(c) appointment of the KMP,

(d) information filed with the RoC for change in the promoters and top 10 shareholders.

(e) issuance of share certificate for the shares allotted in the earlier years,

(f) acceptance of deposits from the members and general public,

(g) Usecured loans obtained from the various sources.

(h) loan, given or guarantee or security provides to directors and their related concerns,,
(i) approval of contracts in which directors are interested,
(j) appointment in the office or place of profit,
(k) registration of creation, modification and satisfaction of charges,
(l) transfer of amount of dividend in a separate bank account,
(m) remittance of security deposits collected from the employees,
(n) payment of dividend,
(o) payment of managerial remuneration, etc.
(p) notice is given 7 days before the meeting to all directors and detailed notes on agenda were sent at least seven days in advance,

(2) SEBI Rules and Regulations :

(a) the Depositories Act, 1996 and the Regulations and Bye-laws framed there under.
(b) the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011,
(c) the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulation, 1992) ;
(d) the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
(e) the Listing Agreements entered into by the Company with Stock Exchange(s), if applicable,

(3) Other Laws :

(a) Foreign Exchange Management Act, 1999 and the rules and regulations made there under to the extent of Foreign Direct Investment, Oversees Direct Investment and External Commercial Borrowings ;
(b) Other laws (depending upon the nature of industry in which company deals (Mention the other laws as may be applicable specifically to the company)

(4) All the Secretarial Standards issued by The Institute of Company Secretaries of India.

Period of the Secretarial Audit

The Secretarial Audit Report shall relate to the period pertaining to the financial year of the company. The Report should be on the basis of the financial year/accounting year of the company, it may be for a period of less than or more than one year, depending upon the period of financial statements.

FUNCTIONS OF COMPANY SECRETARY

Section 205(1) provides that the functions of the company secretary shall include—

(a) to report to the Board about compliance with the provisions of this Act, the rules made there under and other laws applicable to the company;
(b) to ensure that the company complies with the applicable secretarial standards;
(c) to discharge such other duties as prescribed under Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 as under :

1. to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
2. to facilitate the convening of meetings and attend Board, committee and general meetings, and maintain the minutes of these meetings;
3. to obtain approvals from the Board, general meetings, the Government and such other authorities as required under the provisions of the Act.
4. to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;
5. to assist the Board in the conduct of the affairs of the company;
6. to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
7. to discharge such other duties as have been specified under the Act or Rules, and
8. such other duties as may be assigned by the Board from time to time.

For the purpose of section 205, "Secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government.

SHORT ANSWER QUETIONS

1. Define a Company Secretary.
2. How is a Company Secretary appointed ?
3. State the qualification which a Company Secretary must possess.
4. State Company Secretary's liability for offence committed by the Company.
5. Can a director of a company act as a secretary ?
6. Who makes the Secretary's appointment ?
7. What is the position of a company secretary ?
8. Can a private company having only two directors appoint one of them as secretary of the company ?
9. Can a firm or a body corporate be appointed to hold the office of a company secretary ?
10. Who can use the designation of Company Secretary.
11. Define Company Secretary in Practice.
12. Give the Ceiling with regard to signing of Annual Return by Company Secretary in Practice.
13. What is 'Professional Misconduct' under the Company Secretaries Act, 1980.
14. Under what circumstances a certificate of practice issued can be cancelled ?

TEST QUESTIONS

1. Define the term "Company Secretary". State how and who may be appointed as Secretary of a company.
2. Discuss duties and responsibilities of a Company Secretary.
3. 'While the directors are the brains of a Company, the secretary is its ears, eyes and hands.' Explain.
4. (a) What qualification should a Company Secretary possess ?
   (b) Can a director of a company act as a Secretary ? Explain.
5. (a) Explain the term "Secretary" under the Companies Act, 2013. Is it necessary for every company to have a secretary ?
   (b) State the qualifications which a company secretary must possess.

6. "The post of the secretary is what the Company and the individual make of it." Explain and discuss the statutory duties of a Company Secretary.
7. Discuss the statutory and contractial liabilities of a Company Secretary.
8. Discuss the legal position of a Company Secretary and state his main function.
9. "Secretary is a pivot around which the whole corporate machinery revolves." Discuss this statement with reference to his duties and responsibilities.
10. Explain the provisions of the Company Secretaries Act, 1980 and the Company Secretaries Regulations, 1982 relating to the issue of certificate of practice.
11. Define Company Secretary in practice :

    State the areas of practice specified for a company secretary in practice under the company secretaries Act, 1980.
12. *(a)* Define professional misconduct in relation to practising company secretaries.

    (b) State briefly the procedure to be followed in making enquiries relating to misconduct of a company secretary in practice.
13. Outline and discuss the provisions of the Company Secretaries Regulation 1982 in regard to 'practising company secretary'.

□□□

15

SUPERMACY OF MAJORITY AND PROTECTION OF MINORITY

PRINCIPLE OF MAJORITY RULE

'Majority must prevail' is the fundamental principle of company law. Except the powers vested in the Board of directors, the overall powers are exercised through general meetings and questions relating to management are decided either by a simple majority or by a special majority of the votes of share holders. It is only the majority of the members who can control the directors. If the directors are supported by the majority of the shareholders in what they do, the minority shareholders can, in general, do nothing about it. In other words, once a decision is taken by a majority of votes in a duly convened and constituted general meeting, it becomes binding on all the shareholders including the minority shareholders and the company. Thus it is an accepted principle of the Company Law that in the matter of controlling in general the affairs of the company, the majority rule will prevail.

The Leading case on this point is ***Foss V Harbottle***

Foss V. Harbottle (1843)

Points decided are

(1) The court will not ordinarily intervene in the case of internal irregularity if the matter is one which the company can ratify or condone by its own internal procedure.

(2) Where it is alleged that a wrong has been done to a company, *primafacie*, the only proper plaintiff is the company itself.

Facts of the case are

An action was brought by two shareholders, 'F' and 'T' of a company against the directors and solicitors charging them quilty of fraudulent acts resulting in loss to the company. They prayed the court that the defendants might be decreed to make good to the company the losses. The company in general meeting had already resolved not to take any action against the directors. The court dismissed the action holding that the wrong done to the company was one which could be ratified by the majority of members. The conduct with which the defendants are charged is an injuiry not to the plaintiffs exclusively, it is an injury to the whole corporation and therefore, the corporation alone, and not the plaintiffs, could bring the action at law. It was upto the majority to decide whether an action should be brought against the director.

The case of Foss v. Harbottle, not only lays down the rule of the supermacy of the majority and the principle of non- interference by the court but it also establishes the theory of corporate personality.

The majority have a right to determine everything connected with the management of the company. Where a general meeting could confirm the action taken by the directors, the minority could not be permitted to bring an action which might nullify the wishes of the majority of shareholders. Mellislo, L.J. has affirmed the rule of supermacy in *Macdougall v Gardiner* in these words :

"In my opinion if the thing complained of is thing which in substance the majority of the company are enabled to do, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."

Example : A minority shareholders brought an action for damages against three directors and against the company itself on the ground that they had been negligent in selling a mine owned by the company for 1,82,000, where its real value was about 10,000,000. It was held that the action was not maintainable. The Judge observed, "It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement had sold the company's mine at an undervalue, proceedings should not be taken against the directors. [Pavlides v. Jensen (1956) (Ch. 563)].

The rule as laid down in *Foss v. Harbottle has been followed in numerous cases in India. The Supreme Court in Rajahmundry Electric Supply Corporation v. Nageshwar Rao observed, "The courts will not, in general, intervene at the instance of the shareholders in matters of internal administration, and will not interefere with the management of a company by its directors, so long as they are acting within the powers conferred on them under the articles of the company.*

WHO CAN BE CALLED A MINORITY

The group of shareholders who are not a part of the majority can be called the minority. It can be single dissident shareholder or a group of shareholders.

Basis of the Rule

1. The right of the majority to rule. The Courts have always stressed the principle of majority rule. Courts have taken the view that the ultimate power of control over the company rests with the general meeting which can dictate to the directors in matters of policy. The majority shareholders have the power to ratify the wrongful acts of the directors and they are competent to decide whether the action against the directors brought or not.

2. The company is a legal person. A company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person that corporate body is the proper plaintiff and the only proper plaintiff.[1]

3. The prevention of multiplicity of actions. One of the reasons for the rule in Foss v. Harbottle is the undesirability of a multiplicity of actions for the same wrong if every member of the minority

1. Gray v. Lewis (1873) 8 Ch. App. 1035.

could procure the aid of the Court, it will lead to endless litigation and the business of the company could not be carried on. This rule is a great protection to the directors of a company.

4. **The Court's order may be made ineffective leading to unproductive litigation.** Another reason for the rule is to inhibit futile litigation. Where an action is brought to redress a wrong which would cease to be a wrong if ratified by the majority in general meeting, there is no use in having a litigation about it.

EXCEPTIONS TO THE RULE IN FOSS V. HARBOTTLE

From the rule in Foss v. Harbottle it becomes crystal clear that a minority, even as great as 49%, has no voice in the control and management of the company's affiars. But in order to prevent the majority from misusing this privilege and at the same time to ensure justice to minority shareholders certain exceptions to Foss v. Harbottle have been admitted.

In the following circumstances the will of the majority shall not prevail and an individual shareholder or minority shareholders may bring an action to protect their interests.

(a) **Ultra vires and illegal acts**. Where the act is illegal or ultra vires the company, any individual member may sue becuase the act cannot be confirmed by the majority. He may sue to restrain the company from performing ultra vires or illegal activities.

Example : One of the objects of the company was: "To advance money at interest on the security of land, houses, machinery and other property situated in India...." A shareholder (Plaintiff) of the respondent company complained that "several investments have been made by the company, without adequate security and contrary to the provisions of the Memorandum and therefore, prayed for a perpetual injunction to restrain it from making such investments." The court (now Tribunal) granted the injunction and held that under these circumstances a single member could maintain the suit. [Bharat Insurance Co. Ltd. v. Kanahya Lal AIR 1935 Lah. 792].

(b) ***Fraud on the minority.*** *The decision of the majority shareholders can also be questioned in the court of law successfully if it constitutes a fraud on the minority. Generally speaking fraud on minority means a discriminatory action. "A special resolution would be liable to be impeached if the effects of it were of discriminate between the majority shareholders and minority shareholders so as to give to the former an advantage of which the latter were deprived.*[1]

Examples : (i) The majority of members of company A were also members of company B, and at a meeting of company A, they passed a resolution to compromise an action against company B, in a manner alleged to be favourable to company B, but unfavourable to company A. It was held that the minority of company B could bring an action to have the compromise set aside. "It would be shocking thing, "the court observed. "if that could be done ..... then the majority put something into their pockets at the expense of minority.... "[Meiner v. Hooper's telegraph Works (1874) 9 App, 350]

(ii) Three directors of a railway contruction company obtained a contract in their own name to construct a railway line. The directors had used their position as directors to obtain the contract and it amounted to breach of trust by them who then used their voting powers to pass a resolution of the company declaring that the company had no interest in the contract. It was held that the directors must account to the company for the profit they made, which was apparently at the expense of minority. [Cook v Deeks (1916) I.A.C. 554]

It may be noted that a resolution constitutes a fraud on the minority if it is not passed *bona fide for the benefit of company as a whole, even if it is to the detriment of an individual shareholder or minority shareholders. In other words, the general test which is applied to decide whether a case*

1. Greenhalgh c. Ardene Cinemas Ltd. (1945) 2 All E.R. 719.

falls in the category of fraud on the minority or not is whether a resolution passed by the majority is bonafide for the benefit of a company as a whole.

Examples : (i) The plaintiffs who were in minority in the defendant company carried on a competing business. The majority of the shares were held by the directors. The company's article were altered by passing a special resolution which authorised the directors to acquire the shares of any shareholder who competed with the company's business. The validity of the resolution was challenged on the ground that it was not for the benefit of the company as a whole, the court (now Tribunal) rejected the contention and held that it was very much for the benefit of the company to get rid of the members who were in competing business as such members have the unique opportunity of exploiting the company's business secrets against its very interest. [Sidebottom v. Kershaw, Leese & Co. (1920) 1 Ch. 154]

(c) *Acts requiring special resolution.* *Where the matter is one which must be decided by a special resolution, it cannot be validily done or sanctioned by a simple majority. The reason for this exception is that otherwise the company could, in breach of the articles, do by ordinary resolution that which according to its regulations, could only be done by an special resolution. Where the majority by a bare majority resolves a measure not authorised by the Act or Articles, an individual membership right of the minority shraeholder, is infringed. In such a case, the indidual member can sue notwithstanding the rule in Foss v. Harbottle.*

Example : The constitution of a trade union provided that alternations of the contributions of employed members could only be made by a ballot vote of the members and obtaining a two thirds majority. During the Second Word War a delegate meeting of the union, without takig a ballot of members and obtaining a two thirds majority, passed a resolution increasing the amount of the contributions. Two members of the union sued for a declaration that the alteration adoxted by the delegate meeting was invalid. The Court of Appeal held that the resolution was invalid and that the rights infringed were individual membership rights and for that reason, the rule is ***Foss V. Harbottle did not apply. [Edward v. Halliwel (1950) All E.R. 1064]***

Further, majority cannot dispense with the special resolution, if it is so required by law.

(d) *Wrong doers in Control.* *It is a general rule that for a wrong done to a company, the company itself must sue and must act through its majority shareholders. But if the wrong is alleged to have been committed by those who are controlling affairs of the company, such controlling shareholdres would not permit an action to be brought against themselves. In such cases, to safeguard the interest of the company, minority shareholders are within their rights to bring an action on behalf of the comapny.*

Example : A company was controlled equally by the two defendants and the two plaintiffs. The plantiffs brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court (now Tribunal) allowed the action and observed, "While the general principle was for the company itself to bring an action where it had an interest, it was appropriate for the two plaintiffs here to bring an action on behalf of company since the two defendants controlled the company in the sense that they would prevent the company from taking action. [Glass v. Atkin (1967) 65 D.L.R. (2d) 50].

(e) *Individual Membership Rights.* *As per the provisions of the Companies Act, every shareholder has certain personal rights against the company and co-shareholders. These rights have ben conferred upon the shareholders by the Act itself and some of them may also arise out of the Artilces of Association. The rule of majority does not operate as far as such individual membership rights are concerned. These rights include right to vote, right to receive dividend, right to stand as a director of a Company at an election etc.*[1] In the words of Palmer **"If such a rights is in question, a single shareholder can defy a majority consists of all the other shareholders."**

1. Nagappar Chettia v. Madras Race Club. (1949) I.L.R. (Madras) 808.

Examples : (i) At a company's meeting it was decided to elect some directors by separate elections. The plaintiff was a candidate who contested the election but was defeated, but he was proposed as a candidate again to fill up the second vacancy. The Chairman, on account of his previous defeat disqualified him. The Court (now Tribunal) held that the plaintiff was entitled to a declaration that the proceedings of the meetings as regards elections of the directors were null and void. [Josepth v. Jos, 1964 1 Comp. L.J. 105].

(i) A shareholder who had the right to vote, but whose vote was rejected, brought an action to compel the directors to record his vote. Elucidating the law, Justice Jessel observed :

"He is a member of the company and whether he votes with the majority or the minority, he is entitled to have his vote recorded—an individual right in respect of which he has a right to sue." [Pender v. Lushington, (1877) 6 Ch. D. 70]

Hence, it is crystal clear from the foregoing discussion that the rule in Foss v. Harbottle only applies where a corporate membership right is infringed and has no application where an individual right of membership is denied to a member.

(f) Breach of duty. The minority shareholder may bring an action against the company where, although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the comapny.

Example : The majority shareholders of a company brought an action against two directors of the company and the comapny itself. In their statement of claim, they alleged that company, on the instruction of the two directors, who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for 4250 and the directors knew or ought to have known that the sale was at an undervalue. Four years after the sale, she sold the same land for 1,20,000. It was held that the shareholders had a cause of action notwithistanding the rule in Foss v. Harbottle [Daniels v. Daniels (1978) 2 W.L.R. J3].

(g) Where there is Oppression and Mismanagement. Section 241 to 242 empower the court to make order remedying a situtation where there is oppression of minority shareholders or mismanagement of the affairs of the company. These provisions are also an exception to the Rule in Foss v. Harbottle.[1]

The exceptions to the rule in *Foss v. Harbottle are not limited to those covered above. Further exception may by admitted where the rule of justice require that an exception to the rule should be made.*

PROTECTION OF MINORITY RIGHTS

The minority shareholders should be protected from the unjust or unfair conduct of the majority shareholders. The restrictive character of the Rule in *Foss v. Harbottle has let to the creation of statutory remedies for minority shareholders. The most impressive of these is the power conferred on the court to prevent oppression and mismanagement. The Companies Act, 2013, together with the Common Law remedies attempts to maintain a balance between the rights of the majority and minority shareholders.*

The minority shareholders are protected under

(1) the Common Law, and (2) the Companies Act.

1. Protection under Common Law. The principle of the supermacy of majority of the Rule in

2. A detailed discussion follows in the next chapter.

Foss v. Harbottle is not absolute and is subject to a number of exceptions. These exceptions constitute restrictions on the powers of the majority shareholders. These have been recognised in England and in our country.

In a nutshell, the comapny cannot confirm ;

(*a*) any act which is *ultra vires the company ;*

(*b*) any act which is a fraud on the minority ;

(*c*) any act passed with simple majority which requires special majority ;

(*d*) any wrong act done by those who are in control ;

(*e*) any act which infringes the personal membership right ;

(*f*) any act which amounts to breach of duty by directors ;

(*g*) any act which amounts to oppression of minority or mismanagement of the company.

2. Protection under the Companies Act. Minority shareholders have been granted various rights under the Companies Act, 2013., These rights relate to

(*i*) the variation of class rights (Sec. 48) ;

(*ii*) schemes of reconstruction and amalgamation (Sec. 230, 231, 232, & 235);

1. Rights to apply to the Tribunal for the cancellation or the variation of class rights (Section 48)

Where the shares capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the written consent of three-fourth majority of the shareholders of that class. This may possibly lead to fraudulent variations of the rights to the prejudice of the remaining one-fourth minority. In such cases, the affected shareholders not less than 10% of the issued shares of that class may apply to the Tribunal for the cancellation of the variation of their right.

2. Right to apply to the Tribunal u/s 210 to have the affairs of the company investigated

If the shareholders feel that the affairs of the company are not properly managed, such specified (minority) members may apply to Tribunal for the investigation of company's affairs. After considering the application, the Tribunal may recommend that the affairs of the company should be investigated by one or more inspectors. On such recommendition, the Central Government shall appoint inspectors for the investigation of company's affairs.

The specified number of shareholders, who may apply for investigation of company's affairs is as under :—

(*a*) In case of a company having a share capital, at least 200 members.

or from members having not less than 1/10 of the total voting power therein.

(*b*) In case of a company not having a share capital, at least 1/5 of the total number of members.

3. Right to apply to the Tribunal if not satisfied with the scheme of reconstruction and amalgamation. Section 232 which provides for schemes of Amalgamation or reconstruction also gives protection to minority. Provison to Section 232 provides that no compromise or arrangement in connection with a scheme for the amalgamation of the company which is being wound up shall be sanctioned by the Tribunal unless the court has received a report from or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.

4. Right of dissenting shareholders under takeover bids. (Section 235) When an offer for the

purchase of all the shares is received and the offer is accepted by the holders of 90 per cent of the shares, the party making the offer may, on the same terms acquire the remaining shares also. But a notice is to be given to the dissenting shareholders, who may apply to the Tribunal praying that their shares should not be allowed to be acquired. Section 235 confers a very wide discretion on the Tribunal to sanction or disallow the attempt to acquire. The Tribunal will not make an order in favour of transferee where the transaction appears unjust or where the Tribunal is satisfied that the sanction of the majority has been obtained by fraud or by other improper means.

5. Oppression & Mismanagement. The principle of majority rule does not apply where the majority shareholders treat the company as their own property to the detriment of the minority shareholders. In such cases of oppression of minority or mismanagement of companies by majority, the minority may apply to Tribunal by petition under Section 241 of the Act for appropriate relief.

It has been stated by Sinha J. of the Calcutta High Court in Kanika Mukherji v. Rameshwar Dayal Rubey that the principle empodied in Section 241 and 242 of the Indian Companies Act which provide for prevention of oppression and mismanagement, is an exception to the rule in Foss v. Harbottle. which lays down the sanctites of the majority rule.

6. Winding up application. Section 271 permits an individual shareholder to make a winding up petition to the Tribunal.

SHORT ANSWER QUESTIONS

1. State the rule in Foss v. Harbottle.
2. Why should the will of majority in a company prevail ?
3. What is the basis of rule in *Foss v. Harbottle* ?
4. Mention the exception to the rule in *Foss v. Harbottle.*

TEST QUESTIONS

1. Explain the rule in Foss v. Harbottle. What are the exceptions to it ?
2. Explain clearly the meaning of 'majority rule' as applied in managing a company registered under the Companies Act, 2013. Are there any exceptions to this rule ? If so, explain.
3. It is a cardinal rule of company law that majority of the members is entitled to exercise all the powers of the company and generally to control its operation.' Discuss.
4. Explain the rule of supremacy of the majority of shareholders with all its exceptions.
5. "A proper balance of the rights of the majority and minority shareholders is essential for the smooth running of a company." Comment and discuss how the Companies Act, 2013, achieves this aim.
6. "The rule in Foss v. Harbottle presently has lost its importance because of adequate statutory provisions made in the Companies Act, 2013." Discuss how adequate the provisions in this respect are ?
7. Discus why the rule in Foss v. Harbottle is not relevant in the modern times?
8. "A company is a democratic institution in which the majority have a right to control the company." Do you support the statement ? Give arguments.
9. "Majority must prevail" is the principle of company management. Are there any exceptions ?

PRACTICAL PROBLEMS

Q. 1. **Mr. F a member brings an action against NK Ltd. in respect of wrongs done to the company notwithstanding the rule in Foss vs. Harbottle. Will the action succeed.**

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Ans. As per rule stated in Foss V. Harbottle the will of majority prevails. If any wrong is done to the company, it is only the company itself, acting through its majority that can seek to redress and not an individual shareholder. However, the rule is subject to certain exceptions laid down with a view to protect the minority rights.

An individual can bring an action against the company notwithstanding the Rule in Foss V. Harbottle, in the following cases :

1. Where the directors perform *ultra vires acts.*
2. Where there is any fraud on minority.
3. If wrong doers are in control of the company.
4. If a resolution requiring special majority is passed by a simple majority.
5. If there is denial of individual membership rights.
6. Where there is breach of duty by the directors.
7. For prevention of oppression and mismanagement.

Q. 2. The majority of the members of company A were also members of company B. At a meeting of company A, the majority passed a resolution to compromise. On action against company B, in a manner alleged to be favourable to company B but unfavourable to company A. The minority filed a case in the Tribunal for the declaration of the compromise as invalid. Will the company succeed ?

Ans. Yes, the Tribunal will declare the compromise invalid and grant an injunction to restrain further proceedings. The court (now Tribunal) held in Menir v. Hopper's Telegraphs works that "It would be a shocking thing if that could be done .... then the majority put something into their pockets at the expense of minority..."

Q. 3. The constitution of a trade union provided that contributions were not to be altered until a ballot vote of the members had been taken and a two third majority obtained. A delegate meeting of the union, without taking any ballot, passed a resolution increasing the contributions of the members. Two members of the union filed a suit against the union of the declaration that the resolution was invalid. Will, the action succeed ?

Ans. The resolution was invalid and that the rights infringed were individual membership rights and for that reason, the rule in Foss v Harbottle will not apply

Q. 4. A company is in need of further capital. The majority representing ninety eight (98) per cent of the shareholders are willing to provide this capital if they could buy up 2 per cent minority. The minority refuse to sell the shares, so the majority propose to alter the articles to provide for compulsory acquisition. Is the alteration valid ?

Ans. The alteration of the articles could be restrained as it is neither just nor equitable for the benefit of the company as a whole to purchase the shares of a minority compulsorily.

Q. 5. The majority of shareholders in a company passed a resolution whereby power was given to the directors to enable them to require any shareholder who carried on competing business or was a director of any company carrying on a competing business to transfer his shares at their full value to the nominees of the directors. The minority objected to it. Will it succeed ?

Ans. No, under the Act a resolution shall be perfectly valid and binding when it is for the benefit of the company as a whole, even though it is not favourable to an individual or minority shareholders.

Q. 6. At a company's meeting it was decided to elect some directors by separate elections. The plaintiff was a candiate who contested the election but was defeated, but he was proposed as a candidate again to fill up the second vacancy. The Chairman, on account of his previous defeat disqualified him. Decide whether proceeding of the meeting as regards election of the directors in valid.

Ans. No, the plainfill was entitled to a declaration that the proceedings of the meeting as regards elections of the directors are null and void.

□□□

16

PREVENTION OF OPPRESSION AND MISMANAGEMENT

Supremacy of the majority is the fundamental rule of Company Law. But sometimes a group of unscrupulous persons or a particular person gains control of the majority of the shares and runs the company to serve his own benefit and ignore minority interest. The majority shareholders treat the company as their own property to the detriment of the minority shareholders. Hence, a proper balance of the right of majority and minority shareholders is essential for the smooth functioning of the company.

In such cases of oppression of minority or mismanagement of companies by majority, the minority shareholders can adopt the following remedial measures.[1]

1. Apply to the Tribunal for the Winding up of the Company on the ground that it is 'just and equitable' to do so.
2. Apply to the Tribunal for appropriate orders giving relief without directing winding up, and
3. Apply to the Central Government for appropriate relief.

APPLICATION TO TRIBUNAL FOR PREVENTION OF OPPRESSION

Any Members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner opressive to any member or members (including any one or more of themselves) may apply to the Tribunal for an order under Section 241 provided such members have a right so to apply in virtue of section 244.

If, on any application Tribunal is of opinion :

(a) that the company's affairs are being conducted in a manner prejudicial to public interest or in a manner opressive to any member or members ; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up ;

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1. The first measure will be discussed in the chapter of winding up and the last two measures have been discussed in this chapter.

The tribunal may, with a view to bringing to an end the matters complained of make such order as it thinks fit.

Following requirements must be satisfied for seeking a relief under section 241 :

(i) That the affairs of the company are being conducted (a) in a manner prejudicial to public interest or (b) oppressive to any member or members;

(ii) That the fact justified the compulsory winding up order on the ground that it is just and equitable that the company should be wound up.

(iii) That to wind up the company would unfairly prejudice the petitioners.

(a) Meaning of Oppression

The word 'oppression' is not defined in the Companies Act. It is, therefore, left to the Tribunal to decide whether there is any oppression or not. Oppression, according to the dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. Oppression in the context of Section 241 exists where the majority shareholders by an abuse of their voting power treat the company and its affairs as their own property to the detriment of the minority shareholders. In other words, it means that the complaining shareholder is under an unbearable burden due to unjust, harsh or tyrannical treatment of the majority shareholders.

The scope of meaning of the expression 'oppression' has been very well defined by Lord Cooper in Elder v. Elder and Watson Ltd.

"The essence of matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a voilation of the conditions of fair play on which every shareholder ..... is entitled to rely.[1]

Oppression may take different forms and need not necessarily be for obtaining pecuniary benefit. It may be due to a desire to obtain power and control, or be merely vindictive. The oppression need not be by a controlling majority. Oppression by anyone in fact taking part in the affairs of the company in enough.

(b) Oppression qua Members

Section 241 gives no guidance as to the meaning of the word "oppressive" but it does indicate that the victim or victims of the oppressive conduct must be a member or members of the company as such. In other words, the oppression complained of must be upon members in their capacity as members and not in any other capacity. The harsh treatment of a member who is a director or other officer or employee, by the Board of Directos does not come within this section.

A shareholder was also the director of the company. He was removed from the office. His petition alleging that he has been oppressed by removal from office was dismissed by the Court (now Tribunal) holding that no wrong was done to him as a member and is, therfore, outside the scope of the Section 241. [Re Belladore Silk Ltd. (1965) 1 All E.R. 667].

It may be noted that the petitioners must be shown as members in the 'Register of Members' of the Company. If the persons who intend to file a petition u/s 241 are not shown as members in the register, rightly or wrongly, they must get the register of members rectified first and get their names entered therein before they can file a petition.

1. (1952) Scottish Cases 49.

(c) Facts must justify winding up

It is an essential condition for the maintenance of a petition under Section 241 that the facts alleged must justify a winding up order on "just and equitable" grounds, as required by Section 271 and must also amount to oppression. This is very difficult, though apparently simple condition which may not be satisfied in many cases. If a company is a sound concern director's misappropriation will not be a just and equitable for winding up. On the other hand, if the company is not a sound concern, it will be a just and equitable ground for winding up. So, the just and equitable ground is a varying factor depending on the facts of each case.

(d) Oppression of continuing nature

The facts alleged in the petition must reveal an oppression of continuing nature as is apparent from the phrase "the affairs of the company are being conducted." It means a persistent and persisting course of unjust conduct must be proved. In other words, there must be continuous acts on the part of the majority shareholders continuing upto the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. Hence, one single isolated act of oppression will not normally be sufficient to justify relief u/s 241.

In the case of an oppressive act, though it may itself be not continuous if the circumstances indicate that the effect is continuous the court (now Tribunal) will interfere.1 But mere past conduct, not in any way affecting the present state of affairs or course of conduct is not enough as the purpose of the sections is not so much to dig up the past as to redeem the future.[2]

(e) Event relied must be within Limitation Period

Article 137 of the Limitation Act, 1963, applies to application under Section 241 and 242 and the petitioner cannot rely upon events more than 3 years prior to the date of the filing of the petition.

SOME INSTANCES OF OPPRESSION

(a) An attempt to force new and more risky objects upon an unwilling minority may amount to oppression.

Example : The life insurance business of a company was taken over by the Life Insurance Corporation of India in 1956 and compensation thereof was paid to the company. The directors, who had the majority voting power, refused to distribute the amount of compensation and went ahead with a special resolution to undertake new and, more risky objects. This was held to be an 'oppression' as the minority had invested their money in a life insurance business with all its safeguards and statutory protections; but they were being forced to invest where there should be no such protections or safeguards. [Re Hindustan Co-operative Insurance Society Ltd. AIR Cal. 44]

(b) Where a majority controller persistently flouted the decision of the Board and made it impossible for the company to function, was held to be an oppression.

Example : Mr. H the father and sole proprietor of a business had formed a company to carry on the business with his two sons, to whom he gave shares, and who were appointed directors of the company. The father was appointed chairman and life director. He and his wife held such a majority of votes that they, together could secure the passing of any ordinary and special resolution. Mr. H. disregarded the resolutions of the board of directors, assumed powers which he did not possess and exercised them against the wishes of his sons who were shareholders as well as directors. On

1. Seth Mohan Lal Ganpartram v. Shri Sayajee Jubilee Cotton and Jute Mills Co. Ltd. (1964) 1 comp. L.J. 3326.
2. R.S. Mathur v. H.S. Mathur (1970) 1 comp. L.J. 35.

action brought by the two sons, the court (now Tribunal) held that the affairs of the company had been conducted in a manner oppressive to the sons. The Court (now Tribunal) removed the father from his office as director and demoted him to the position of an expert adviser at a fixed salary. [Re H.R. harmer Ltd. (1959) 1 W.L.R. 62].

However, minor acts of mismanagement are not to be regarded as oppression and shareholders should try to reconcile their differences by mutual adjustments.

Example : The plaintiff alleged that the income of the company was deliberately shown less by excessive expenditure, that petrol consumption was excessive; that passengers travelling without tickets on the company's buses were not checked ; that dividends were being declared at a very low rate. Held, even if each of these allegations were proved, there would have been no oppression as contemplated by the Act. [Lalita Rajya Lakshmi v. India Motor Co. A.I.R. 1962 Cal. 127]

Similarly, mere unwise, inefficient and careless conduct of a director in the performance of his duties cannot in itself be taken as oppressive so as to attract the provisions of Section 241.

Example : P had a small shareholding in a company. E, who was chairman of the Board of directors and managing director, had formely been the controlling shareholder, but at the date of action was no longer so. P alleged in the petition that E conducted the affairs of the company with complete disregard of the interests of any shareholders other than his wife and himself. P also alleged that E had unwise, inefficient and careless in the performance of his duties as managing director and chairman of the board of directors. Petition was dismissed as it disclosed no ground for relief under Section 397. [Re Five Mnuse Car Wash Service Ltd. (1966) 1 W.L.R. 745]

(c) An attempt to deprive a member of his ordinary membership right is an oppression.

Example : A public company doing forward business contracts altered its Articles under statutory direction in such a manner as to deprive the non-trading members of the company of their right to call meeting, to attend meeting, to elect directors and to declare dividends. The court (now Tribunal) held it oppression within Section 397, Mahajan J. observed : "I cannot conceive of a worst oppression than the denial of a voting right to a shareholder .... To take away the right of partaking in dividends is not merely oppressive but even confiscatory." [Mohan lal Chandumal v. The Punjab Co. Ltd., A.I.R. (1961) Punj. 485]

(d) An unreasonable refusal to accept a transfer or transmission of shares has been held to be oppressive.

Example : A shareholder of a private company bequeathed under a will some of his shares to the directors of company and some to the second wife. The directors transferred shares in favour of themselves as provided under the will but refused to register the shares in the name of the shareholder's widow, on acount of a private dispute with the petitioners. It was held that the conduct of the directors amounted to oppression and the court (now Tribunal) directed the directors to transfer the shares to the petitioners as provided under the will. [Mrs. Gajarabai v. Ptny Transport Co. A.I.R. (1966) A.P. 226]

The Leading case on this point is

Shanti Parasad Jain V. Kalinga Tubes Ltd. (1965)

Point decided is

The private agreement between the parties to maintain the equilibrium is not binding on the company.

Facts of the case are

There were three shareholders in a private company holding shares in equal proportions and with equal representation on the Board. They had agreed in writing to maintain this equilibrium though there was no such provision in the articles. Subsequently, the company was convered into a public

company so as to avail of loan facilities and it was proposed to issue 39,000 shares. Two shareholders who constituted majority resolved both in a board meeting and in a general meeting to offer these shares to outsiders, which was accordingly done. One of the shareholders filed a petition contending that the allottees were friends of the majority group and that the allotment was made to them with mala fide intention of increasing their own voting strength and to squeeze him out, thus amounting to oppression.But, the Supreme Court held that there was no oppression.[1]

The following instances of oppression based on law cases, are also pertinent to note in connection with the registration or allotment of shares :-

(a) The registration of transfer of shares may amount to oppression if the shares are registered in violation of company's articles of association and with an ulterior motive of weakening the minority and strengthening the majority. [Bhubenashwar Singh V. Kanthal India Lt. (1986) 59 Comp Cases 46 (Cal)]

(b) The transfer of shares, in violation of a pre-emptive (*i.e. existing share holders' right to buy) provision amounts to oppression.*[2]

(c) Even if the Company was in no need of further capital, the act and policy of materially reducing the voting strength of shareholders by making a new issue and alloting the same to the controlling shareholders may amount to oppression.[3]

ACTS HELD AS NOT OPPRESSIVE

Following are some of the instances in which there is no oppression :

1. Non-holding the meeting of the directors would not amount to an oppression of the minority shareholders.
2. Not declaring dividends when company is making losses is not an oppression.
3. Refusal to declare more than moderate rate of dividend even though the profits earned could justify a higher rate of dividend may not amount to oppression.
4. Denial of inspection of books to a shareholder is not an act of oppression.
5. In case notice of a meeting is not accompanied by an 'explanatory statement', it cannot be considered as an act of oppression in conducting the affairs of a company within the meaning of section 241.
6. The drawing of salary by the directors does not amount to oppression merely because the company is suffering losses.
7. The fresh issue of shares to outsiders by passing a resolution even if it does not suit the interest of minority.
8. Increasing the voting right of the shares held by the management.
9. The non-maintenance of records cannot amount to acts of oppression being committed on the minority shareholders. If proper records of the company are not maintained, it may mean that the management is not working properly.
10. An unwise, inefficient or careless conduct of a director does not amount to oppression.

1. (1965) 1 Comp. L.J. 193.
2. M.M. Dua V. Indian Dairy & Allied Services (P) Ltd. (1996) 85 Comp. Cases 657 (CLB)
3. Farhat Sheikh V. Detinners (P) Ltd., (1997) 87 Company Cases 290 CLB)

MAJORITY TOO ENTITLED FOR RELIEF U/S 241.

Section 241 of the Companies Act, 2013, provides that any members of a company who complain ..... may apply to the Tribunal for an order under this section provided such members have a right so to apply in virtue of Section 399. The words "such members have a right so to apply" is by way of minimum number of members necessaity requires as prescribed in the Act without reference to any upward limit. The provisions of Section 241 and allied section of the Act no where specifically mention that the oppression complained of must be of the minority shareholders by the majority shareholders and not vice versa. Moreover, the law fixes the lower limit with regard to the number of petitioners, yet no upper limit has been contemplated. Hence, the remedy u/s 241 is also available to the majority shareholders, if, in the circumstances of the case, they have been completely nullfied by the minority in control. In other words, opppression may be exercised by those in control even they lack in majority and section 241 provides protection in such cases too.

The Calcutta High Court (now Tribunal) observed that Section 241 and 242 no where prescribe that the application under the two sections can be made only by a minority group. Not these sections prescribe that a majority group can under no circumstances come to court for redress, whatever may be the nature and extent of the oppressive acts of the rival group and whatever may the extent of injury suffered by the company as a result of the activities of such a group. Further, the court had categorically rejected that the relief under Section 397 is available only to minority shareholder.

The court (now Tribunal) further held, that if the court (now Tribunal) finds that the company's interest is being seriously prejudiced by the activities one or the other group of shareholders, that two registered offices at two different addresses have been set up, that two rival boards are holding meetings, that the company's business, property and assets have passed into the hands of the unauthorised persons who have taken wrongful possession and who claim to be shareholders and directors, that the bank account of the company have been practically frozen, there is no reasons why the court should not make appropriate orders to put an end to such matters.

Similarly, the Kerla High Court[1] observed that "it is true that sections 241 and 242 are inended primarily to protect the minority interest. In ordinary cases, the majority will be able to protect itself by controlling the directors at general body meetings. But where the majority is prevented from doing so....., the majority becomes an artificial minority entitled to claim protection under sections 241 and 242."

PREVENTION OF MISMANAGEMENT

Section 242 provides for relief in case of mismanagement. Mismanagement means inefficient management. Where the company is run overriding the wishes and interests of the majority of shareholders, the management is not in the interest of the company.

Any member of a company may apply to the Tribunal for appropriate relief on the ground;

(a) that the affairs of the company are being conducted in a manner prejudicial to public interest, or in a manner prejudicial to the interests of company; or

(b) that by reason of a material change in the management or control of the company it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or to the interest of the company.

1. Dr. V. Sebastian V City Hospital (P) Ltd. [1985] 57 Comp. Cas 413.

The Tribunal may, if it is satisfied with the truth of the complaint, make such orders as it thinks fit in order to bring an end or preventing the matters complained of or apprehended.

Examples : (i) An action was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice chairman grossly mismanaged the affairs of the company and had drawn considerable amount for his personal purposes....that machinery was in a state of disrepair and that the shareholders outside the group of chairman were powerless to set matters right. This was a clear case of mismanagement. The Court (now Tribunal) accordingly appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate. [Rajahmudry Electric Supply Corporation v. A Nageshwara Rao, A.I.R. 1956 S.C. 213].

(ii) The Managing Directors of a company continued in office after their terms had expired, without a meeting being held to reappoint them prior to making a fresh application to the Central Government under section 269. It was held that continuation in office under these conditions was mismanagement within the purview of sections 397 and 398. [Shishu Ranjan Dutta v. Bhola Nath Paper House Ltd. (1983) 53 Com. Cases 883 Cal].

No such order will, however, be made where the change in management of the company has been brought about in the interest of the creditors including debentureholders or any class of shareholders of the company.

Examples : The arrangement was made with the creditors to become shareholders and directors, instead of being creditors, by a company in financial difficulties. It was held that this is not an act of mismanagement or oppression so far as the existing shareholders are concerned but done bonafide in the best interests of the company.

Further, a material change in the management or control, as contemplated in section 398, will be deemed to have occurred,if there is an alteration–

(a) in the Board of Directors; or

(b) in the ownership of the shares of the company; or

(c) in its membership in case company has no share captial; or

(d) in its manager;

It is worth mentioning that in case of oppression, petitioners are required to show facts to justify the making of an order for winding up but no such facts are required to be shown in case of mismanagement. It is enough if the affairs of the company are conducted in a manner prejudicial to the interests of the company or the public interest. Moreover, in case of mismanagement, the relief is granted to prevent the injury being done to the company as a whole. Whereas in case of oppression, the relief is granted to prevent injustice being done to the particular members in their individual capacity.

Few More Acts Held As Mismanagement

he following acts have been held as amounting to mismanagement under section 398—

(1) Where the Board of directors is not legal and illegality is being continued, it will amount to mismanagement prejudicial to public interest.

(2) Where the directors take no serious actions to recover the amounts embezzled, it will amount to mismanagement.

(3) Violation of the conditions of the Company's memorandum by those who are in charge of company's management may amount to mismanagement

(4) Diversion of funds of the company for the benefit of majority group is mismanagement.

(5) Where the shares are being transferred without first being offering them to the existing members; holding meetings without sending notice to members; issue of shares for a consideration other than cash not represented by corresponding assets and burdening the company with additional rental by shifting the company's office have been held to be acts of constituting mismanagement of affairs so as to attract the preventive jurisdiction of Tribunal under Section 242.

Some Acts not held as mismanagement

(1) Termination of the services of a Works Manager who held only 20 shares was not in itself an act of mismanagement.

(2) Bona fide decisions of the directors which are consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong or they cause temporary losses.

(3) Where the directors of a company in financial difficulties arrange with the company's creditors that they may become shareholders and director instead of remaining creditors, was held not be an act of mismanagement rather done bonafide in the best interests of the company.[1]

(4) The mere keeping of the moneys of the company in a Term Deposit is not bad business practice so as constitute mismanagement.

(5) Directors' bonafide decision not to declare dividend and plough back profit *i.e. to create reserves is not mismanagement.*

(6) Section 242 comes into operation only if there is actual mismanagement of the affairs of the company. Slight delay in the payment of full value of shares can in no case be taken to be so prejudicial to the interests of the company as to call for any action u/s 242 of the Act.

Further, there should be present and continuing mismanagement. The charges of mismanagement in the past but not existing at the time of petition cannot be ground of petition under Section 242.

WHO MAY APPLY FOR RELIEF ?

Sections 244 and 241 specify the persons who may apply to the Tribunal for relief in cases of oppression and mismanagement, and they are as follows:

(1) In the case of a company having a share capital.

(a) at least 100 members of the company or 1/10th of the total number of its members whichever is less ; or

(b) any member or members holding at least 1/10th of the issued share capital on which all calls and other sums due have been paid.

The applicant members may be holders of equity shares or preference shares. Where two or more members are entitled to hold one or more shares, they will be treated as one member for the purpose of the application.

(2) In the case of companies without share capital at least 1/5th of the total members of the company.

1. Suresh Chandra Marwaha v. Lauls (p) Ltd., (1978) 48 comp. Cas. 110.

(3) Any lesser number of members, if so authorised by the Central Government. The Central Government will give its consent if in its opinion circumstances exist which make it just and equitable so to do. Such member or members before being so authorised, may however, be required to give such security as the Central Government may deem reasonable for the payment of any cost. Moreover, the power of the Central Government in granting such authorisation is purely administrative and not quasi- judicial and hence no prior notice or hearing need to be given to the company before such authorisation is granted.

(4) The Central Government itself 241(2).

It is not necessary for all the members to apply for relief. Any member or members having obtained the consent in writing of the requisite number of members, he or they may make an application on behalf and for the benefit of all of them. The consent must be given before the petition is made, for the consent given subsequent to the filling of the petition is invalid.

Consent in writing. Obtaining of consent is condition precedent to the making of the application. The expression consent in writing implies that the writing itself should indicate that the persons have given their consent to certain action being taken. In other words, before a member can be said to have consented to a particular action, the said member should have known what was the action to be taken, what was the relief claimed.

Where company is a shareholder, the consent must be given by Board of directors and not by officers of the Company.

Withdrawl of Consent. After the application is made, if such consent is revoked by some of the members, it does not affect maintainability of the application.1 The validity of the petition must be judged on the fact as they are at the time of its presentation. Neither the right of the applicant to proceed with the application, nor the jurisdiction of the Tribunal to dispose of it on its own merits, can be affected by events happening subsequent to the presentation. Hence, a petition does not cease to be maintainable merely because three of the applicants have transferred their shares and ceased to be shareholders of the company. As it is not possible for the parties either to compromise or to withdraw the petition by their own consent, it can be withdrawn only with the sanction of the Tribunal.

NOTICE TO BE GIVEN TO CENTRAL GOVERNMENT OF APPLICANTS UNDER SECTION 241 AND 242

The Tribunal shall give notice of every application made to it under Section 241 or 242 to the Central Government, and shall take into consideration the representations, if any, made to it by Central Government before passing a final orders.

POWERS OF TRIBUNAL

Powers of the Tribunal under Section 242 to prevent oppression and mismanagement are very wide. It has an unfettered discretion to make such order as is necessary to do justice in the facts of the case. In facts, the Tribunal may make any order for the regulation of the conduct of the company's affairs upon such terms and conditions as may, in the opinion of the Tribunal, be just and

1. In re Antigen Laboratories Ltd. (1951) 1 ALL ER 110.

equitable in all the circumstances of the case. Though the powers of the Tribunal are very wide, the application in each case must state in the prayer, the nature of the relief sought. It must contain enough to leave no doubt as to what the applicants want to Tribunal to do.

The order of Tribunal may provide for any one or more of the following measures :

(a) The regulation of the conduct of the Company's affairs in future. Thus, for example, in Life Insurance Corporation of India v. Haridas Mundra1the Court (now Tribunal) deemed it fit to appoint an advisory board to assist the special officer for managing the affairs of the company to the total execlusion of the shareholders.

(b) Purchase of shares of a member. The Tribunal may order for the purchase of the shares or interest of any members of the company by other members or by the company.

An order requiring one party to sell the shares to others should be an appropriate order spelling out the person who should sell and who should purchase and at what price. So where an order referring the disputes between parties to an abbitrator show that the court contemplated passing of final order after receiving the award of the arbitrator such an order cannot be considered as a final order.

(c) Reduction of Share Capital

The Tribunal may order for the reduction of the share capital of the company, provided the company has purchased its own shares under the orders of the Tribunal as aforesaid. And when the Tribunal directs purchase of shares by company the further proceeding under Section 100 to 104 for reduction of share capital is not required to be observed and no notice to the directors will be necessary.

(d) Termination or modification of agreement with MD/Manager/Director.

The Tribunal may order for the termination, setting aside or modification of any agreement howsoever arrived at, between the company on the one hand and any of the following persons, on the other, namely :

(i) the managing director,
(ii) any other director, and
(iii) the manager.

on such terms and conditions as it may think just and equitable.

Under section 243, the following consequencies shall follow :

(i) Vacation of office without following procedure under section 169. In four the Tribunal has unlimited power to remove the existing managerial personnel.
(ii) No compensation for loss of office.
(iii) No similar appointment for 5 year in the company except with the permission of tribunal.

***(e)* Termination or modification of an agreement with third parties**

The Tribunal may order for the termination, setting aside or modification of any agreement between the company or any third party provided the consent of the party has been obtained.

It may be noted that for setting aside or terminating a contract, notice is necessary and not consent. But if the Tribunal wants to modify that can be done only with the consent of the party concerned.

1. Air 1959 Cal. 695.

The third party shall not be eligible to claim any damages for compensation for loss arising because of termination or modification of such agreement.

(f) Fraudulent Preference.

The Tribunal may also set aside any fraudulent preference made within three months before the date of application. It would make such order only if the circumstances are such that the transaction would have been deemed to be a fraudulent preference in an insolvency proceeding against an individual.

The date of the execution of the sale deed must be excluded in the determining the period "within three months". In other words, there should be a net period of three months between the date of transfer and that of application.

Example : A sale deed transferring the assets of a company was executed on May 24, 1974, and the application under section 398 of the act for relief under clause (f) was made on August 24, 1974, it was held that the application was filed within time. The court (now Tribunal) excluded the date of transfer in computing the period of three months. [Roshan Lal Agarwal v. Sheo Ram Butna (1980) 50 Comp. Cas. 243]

(g) Other Relief.

The Tribunal may also make provision for any other matter which appears to the Tribunal to be just and equitable under the circumstances of a particular case, even if it amounts to interference in internal management.

Interim Order by Tribunal. Pending the making by it of a final order 241 or 242, as the case may be, the Tribunal may make on the application of any party to the proceeding, any interim order, which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as may appear to be just and equitable. Interim relief, however, cannot be granted where such relief cannot be given even if the petition succeeds.

Effects of alteration of memorandum or articles of company

Where the order of the Tribunal makes any alteration in the memorandum or articles of the company, the company shall have no power to make any alteration in memorandum or articles inconsistent with the order of the Tribunal.

But such alteration can be made with the leave of the Tribunal. The alterations made by the Tribunal will have the same effect as if they have been made by the company in accordance with the provisions of the Act.

Filing. A certificate copy of every order altering, or giving leave to alter a company's memorandum or articles, shall within 30 days from the making of the order, be filed with the Registrar of Companies. However, the time taken in obtaining the certified copy is to be excluded in counting 30 days.

Penalty. In case of default the company and every other officer of the company who is in default, shall be punishable with fine which may extend to ₹ 50,000.

1. Power of the Central Government to make a reference and appoint directors. Where there is oppression or mismanagement, the Central Government has been empowered to appoint directors on an order passed by the Tribunal to effectively safeguard the interests of the company or its shareholders or the public interest to prevent mismanagement or oppression. The power is in the nature of the preventive action and can be exercised by the Tribunal

(i) either on a reference made by the Central Government or

(ii) an application made by the—

(a) at least 100 members or

(b) *members holding atleast 10% voting powers.*

SHORT ANSWER QUESTIONS

1. What is 'oppression' ?
2. Can there be oppression of majority by the minority ?
3. Give the essentials of section 241 relating to prevention oppression.
4. When will a company be said to be mismanaged ?
5. What relief may a Tribunal grant under section 242 when an application is made to it against mismanagement of a company ?
6. A requisite number of members of a company may apply to the Tribunal for relief under section 241 or 242. What is that requisite number ?
7. Consent letter merely state

   "I hereby record my consent to join the V. Shanker and others in filing company petition under Section 241/242 of the Companies Act against X Co. Ltd." Comment whether it is a valid consent.
8. State whether 'Power of Attorney' holder can give consent.
9. Can the Central Government apply to the Tribunal for relief under section 241 or 242.

TEST QUESTIONS

1. (*a*) Discuss the provisions of the Companies Act, 2013 for the prevention of 'oppression and mis-management.'

   (*b*) Define oppression and mismanagement. State a few instances of oppression along with the relevant case Law.
2. "Majority has its way but minority has its way." Examine the statement.
3. (*a*) Who can apply to the Tribunal for relief in case of oppression and mismanagement be complained of in a company.
4. What remedies are available to the minority shareholders of a company against oppression and mismanagement.
5. Discuss briefly whether it is competent for the majority shareholders to apply to the Tribunal for relief agaist the oppression by the majority shareholders.
6. "The conduct must be burdensome, harsh and wrongful and the mere lack of confidence between the majority shareholders and the minority shareholders would not be enough." Comment and discuss the remedies available to the minority shareholders against oppression and mismanagement.
7. When can the oppression or 'mismanagement' be complained in a company ? What are the powers of the Central Government to prevent oppression or mismanagement of the company ?
8. State the powers of Central Government to prevent oppression or mismanagement in a company ? What are the criteria by which the Central government should be satisfied for exercise for the powers?
9. "Section 241 and 242 are intended to avoid winding up, if possible, and keep the company going, while at the same time receiving the minority shareholders from oppression and mismanagement." Explain.
10. Enumerate the powers of the Tribunal to prevent oppression and mismanagement.
11. Explain the powers of the Central Government to appoint directors on the Board of a company to prevent oppression and mismangement.
12. Law intends relieving minority shareholders from oppression and mismanagement without resorting to winding up of the company. Discuss.
13. To what extent does the Companies Act, 2013, empower the Central Government to remove the managerial personnel in a reference made to the Tribunal ? When can such a reference be made by the Tribunal.

PRACTICAL PROBLEMS

Q. 1. S, a director of X Ltd., filed a petition under section 244 before the Tribunal alleging oppression and mis-management by directors of Y Ltd. The petition was filed on behalf of X Ltd. The directors of Y Ltd contended that the petition is not maintainable as S, even though a director of X Ltd, has no authority to institute the suit. Discuss.

Ans. U/s 244 in the case of a Company having share capital, 100 members of the Company or 1/10th of the total number of its members whichever is less or (ii) any member or members holding atleast 1/10th of the issued share capital on which all calls and other sums due have been paid, have the right to make an application to the Tribunal for the prevention of oppression U/s 241 of the Act. Hence, the petition on behalf of X Ltd is not maintainable unless he is a member and holds not less than 1/10th of the issued capital of the company.

Q. 2. In a case, with the consent of the requisite number, a petition was made by one of the share holders on behalf of all. After the making of the petition, some of the signatories withdrew their consent. Is the petition now invalid ?

Ans. No, the petition remains valid if it was valid at the time of presentation. The utility of petition must be judged on the facts as they are at the time of presentation of petition. [Refer Rajahmundry Electric Supply Corporation Ltd v. A Nageshwar Rao (1956).]

Q. 3. XYZ, directors of a companies were the major shareholders of the company. At a meeting of the Board of directors, it was decided to increase the share capital. Y & Z did not have the money to take up additional shares and feared that X, in consequence, would corner all shares and become predominant in the company. So a general meeting was called and it was resolved that the present members alone should not benefit from the prosperity of the company but others should also share, and a special resolution was passed that the new shares may be offered to about a dozen persons who were not members of the company. X files a petition complaining of oppression saying that Y & Z wanted to throw him out as director and chairman of the Company and they have passed a special resolution to bring about a change in the management.

Ans. In Shanti Prasad Jain Vs Kalinga Tubes Ltd., the court (now Tribunal) held that, the person claiming relief on the ground of oppression has to prove on the part of majority.

(i) Lack of probity

(ii) Unfair Conduct.

(iii) Prejudice to him in the existence of legal and proprietary rights as a shareholder.

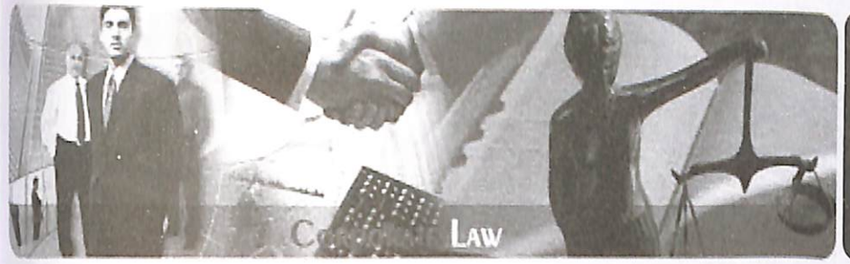
According to the above decision seeking change of management does not, *prima facie*, amount to oppression.

Moreover, in terms of the provisions of Section 62 of the Act, it is permissible for a Company to offer the further issue of shares to any person other than the existing shareholders by passing a special resolution. This requirement having been complied within the present case, there is no illegality in the actions of the company. Accordingly, X will not succeed.

Q. 4. Three shareholders X, Y and Z intend filing a petition before the Tribunal under Sections 241/242 of the Companies Act, 2013. To comply with requirement of one-tenth shareholding, the shareholder X gave consent in writing for and on behalf of his daughter, also a shareholder, who had authorised her father to act on her behalf as her general power of attorney (GPA) holder. Is the consent given by her GPA holder for and on her behalf a valid consent ? Will it affect the petition in any manner if, during the course of proceedings, one of the shareholders withdraws the consent ?

Ans. Consent given by a duly authorised power of attorney for and on behalf of a member, and not personally by such member, has been held to be a valid consent. After the application is made, if such consent is revoked by some of the members, it does not affect maintainability of the application. The validity of the petition must be judged on the facts as they are at the time of its presentation.

□□□



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COMPANY MEETINGS & RESOLUTIONS

(INCLUDING ALL MEETINGS)

COMPARATIVE CHART (Some of the Major Changes)

Points of Comparison	Companies Act, 2013	Companies Act, 1956
(1)	(2)	(3)
	NOTICE FOR MEETING	
Giving *notice for general meetings in electronic mode*	*Section 101 of the 2013* Act permits *giving notice of the general meetings* of the company *through electronic* mode. [Rule 18 of the *Companies* (Management and Administration) Rules, 2014]	No express provision permitting notice to be given in electronic mode.
Consent of members to shorter notice for general meetings	Consent for shorter notice is required from not less than 95% of the members entitled to vote at such meeting (irrespective of whether its is AGM or EGM).	Consent for shorter notice (*i.e. less* than 21 clear days notice) was required to be given by all the members entitled to vote there at (for AGM) and by not less than 95% of the members entitled to vote at such meeting (for meetings other than AGM).
	QUORUM FOR MEETINGS	
Quorum for general meetings for public companies	Section 103 of the 2013 Act fixes quorum for public companies based on the number of members of the company as under :	Quorum requirements for public companies for general meetings are 5 members personally present unless the articles stipulate a large number.
	• 5 members personally present if the number of members as on date of meeting is not more than 1000.	
	• 15 members personally present if the number of members as on date of meeting is more than 1000 but not more than 5000.	

	• 30 members personally present if the number of members as on date of meeting is more than 5000. Thus, quorum requirements for a public company having more than 1000 members stand increased from 5 members personally present to 15/30 members personally present.	
	PROXY	
How many members can a proxy act for ?	A person can act as proxy on behalf of members not exceeding 50 and holding in the aggregate not more than 10% of the total share capital of the company carrying voting rights. A member holding more than 10%, of the total share capital of the company carrying voting rights may appoint a single person as proxy and such person shall not act as proxy for any other person or share-holder. [Section 105 of the 2013 Act, See Rule 19(2) of the Companies (Management and Administration) Rules, 2014]	No such restriction in 1956 Act.
Restrictions on voting rights	Under the 2013 Act, the restriction states under the 1956 Act shall apply to public companies as well as private companies.	The restriction that a company shall not prohibit any member from exercising his voting right on any other ground other than non-payment of calls or lien on shares, applied only to public companies under section 182 of the 1956 Act.
	POSTAL BALLOT	
Postal Ballot	Applicable to all companies except (i) OPC and (ii) company having members up to 200-See Rule 22 of the Companies (Management and Administration) Rules, 2014	Applicable only to listed companies.
	RESOLUTION	
Votes cast electronically, whether to be counted	To be counted for determining whether ordinary or special resolution has been passed.	The 1956 Act did not expressly allow electronic voting.
	MEETING OF BOARD	
First meeting of Board of Directors	First meeting of board of directors-to be held by every company within 30 days of its incorporation.	No such stipulation regarding with it should be held.
Participation of directors in board meetings through video-conferencing	The 2013 Act allows participation of directors in board meetings through video-conferencing or other audio visual means, as may be prescribed.	No enabling provision permitting such participation.

Notice for Board meetings by electronic means	Notice for board meetings may be given by electronic means.	Not permitted.
	AGM	
First AGM	Within 9 months from the end of first financial year.	Within 18 months from date of its incorporation.

INTRODUCTION

A company is a body corporate recognised by law as a person having its entity distinct from its members. It is capable of acting in its own name and can hold property in its own name. Despite all these powers, it is not a physical being. It, therefore, expresses its will or takes its decisions through resolutions passed at regularly convened meetings of the shareholders and their elected representatives, the directors.

Protection of investors is one of the primary themes of the Companies Act. The Companies Act provides the shareholders a forum of protection and then leaves them to a large exent to take care of themselves. The forum is meeting of the shareholders.

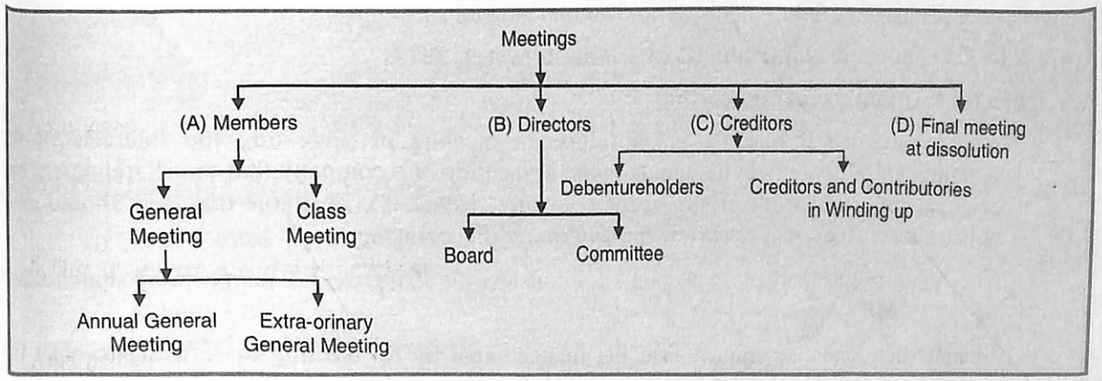
MEANING OF MEETING

In the context of a company, the word 'meeting' implies the coming together of a certain number of members for transacting the business in the agenda, for which a previous notice has been given.

It follows that to constitute a meeting there must be two-or more persons. Generally the purpose of a meeting is to consider issues of common interests to its attendants.

KINDS OF MEETINGS

Company meetings are of different kinds. The following table gives the classification of company meetings.



[NOTE. THE STATUTORY MEETINGS & STATUTORY REPORT U/S 165 OF COMPANIES ACT, 1956 HAVE BEEN OMITTED IN COMPANIES ACT, 2013]

As explained above in the chart, the meetings can be classified into various kinds :

MEETING OF THE MEMBERS

The meetings of members of a company are categorized into two categories :

(1) General Meetings :

The term 'General Meeting' has not been defined anywhere in the Companies Act, 2013, but it signifies any meeting which all those members of a company who have a right to vote are entitled to attend. The resolutions passed in the General meeting are binding on all the members of the company and the company itself, and, unless the memorandum or articles or terms of issue of a class of shares take away or limit the voting rights of a class of members, all members of the company may attend and vote at such meetings.

General Meetings can further be classified as :

(i) Annual General Meeting [U/s 96]
(ii) Extraordinary General Meetings [U/s 100]

(i) Annual General Meeting

Mandatory requirement for holding AGM

Every company (other than a one person company) shall in each year hold in addition to any other meeting a general meeting as its annual general meeting [Section 96].

The term 'year' has not been defined in the Companies Act. It means 'Calender Year' as defined in the General Clauses Act, In other words, 'Calender year' is to be calculated from 1st January to 31st December and not twelve months from the date of incorporation of the company.

The annual general meeting is to be held in addition to any other general meeting that might have been held in a year. It appears that holding of an annual general meeting in every 'calender year' is a statutory necessity.

Which Companies to hold AGM

Every Company except a One Person Company (OPC) whether public or private ; having a share capital or not ; limited or unlimited must hold annual general meeting.

[Note. OPC have been introduced by Companies Act, 2013]

Objects of Annual General Meeting

- An annual general meeting is an important meeting of protecting the interests of the shareholders. It is only at the annual general meeting of a company that the shareholders can exercise control over the affairs of the company. Hence it is desirable that they should meet at least once every year to review the working of the company.
- The Board of directors place accounts for consideration, approval & adoption by shareholders in the AGM.
- Shareholders exercise control over the management by re- electing or refusing to elect the directors.
- The Auditors of the company are also replaced or reappointed by the shareholders in the AGM.

- Dividends proposed by the directors is declared in the AGM.
- The annual general meeting is important because of the nature of business transacted at it. All other matters that require approval of the shareholders are discussed as 'Special Business' in the AGM.

Time period for holding AGM:

	Under the pervious Act 1956	Under company Act 2013
First AGM	First AGM shall be held within 18 months from the date of its incorporation-u/s 166	2013 Act has replaced the deadline of 18 months from the date of incorporation. The first AGM shall be held within 9 months from the end of the first financial year
Subsequent AGM	Under Section 166 and 210 of the Companies Act, 1956 the AGM subsequent to the first AGM was required to be held on the earliest of the three given dates : (i) The meeting must be held in each year (*i.e.*, calendar year) i.e., latest by 31st December each year [Section 166(1) of the 1956 Act] (ii) The meeting must be held within 15 months from the date of the previous annual general meeting. The ROC may extend this by not more than 3 months. [Section 166(1) of the 1956 Act] (iii) The meeting must be held not later than 6 months from the date of the balance sheet. If any extension has been granted under the second proviso to section 166(1) of the 1956 Act, then meeting must be held within 6 months plus period of extension granted. [Section 210(3) of the 1956 Act]	Under the 2013 Act also, the subsequent AGM is required to be held on the earliest of the three dates [Same dates as existed in 1956 Act.] **Only change is that instead of two sections under 1956 Act, now this provision exists under section 96 of Companies Act 2013**
Business Hours	u/s 166(2) of the 1956 Act, every AGM should be called during business hours	u/s 96(2) of 2013 Act, the business hours have been clearly defined *i.e.* between 9 a.m. and 6 p.m.

SUBSEQUENT AGM [U/S 96]

(i) There must be one meeting held in each year, i.e. calendar year. In other words, one separate and distinct meeting every year.

Where a meeting called and held on a day in one year is adjourned to a date in the next year, and held on that date, does not become meeting of that year.

(ii) The gap between two AGM's must not be more than fifteen months.

(iii) AGM must be held not later than 6 months from the close of the financial year (*i.e. from the date of Profit & Loss Account and Balance Sheet).*

Whichever is Earlier

These three requirements are cumulative as well as separate; which means that failure to comply with any of them shall constitute an offence.

1. LEGAL PROVISIONS OF REGARDING AGM

Extension of time. The registrar may, for any special reason extend the time for holding the annual general meeting (except the first annual general meeting) by a period not exceeding three months [Section 96(1)].

2. VALIDITY OF AGM HELD BEYOND STATUTORY TIME

An annual general meeting held beyond the due date is not void & all resolutions passed at such AGM are valid. The only effect is that it involves penalty.

U/s 99 in a nut shell if the ROC does not extend the date of holding the AGM the directors shall be subjected to increasing penalty (i.e. ₹ 1,00,000 and additional fine upto ₹ 5,000 for every day of default) but the meeting shall be a valid meeting. Otherwise, the position of law would become impossible.

3. PROPER AUTHORITY

The Board of Directors is the proper authority to convene AGM and if the managing director, manager, secretary or other officer calls a meeting without such authority, it will not be effectual unless the Board ratifies the act before the meeting is held.

4. NOTICE

A public company must give at least 21 clear days notice for convening annual general meeting. The period of 21 days is calculated from the date of receipt of the notice by the members.

It excludes :

(i) the day of service of the notice;

(ii) the day on which the meeting is to be held.

- Notice is deemed to have been received by the members at the expiration of 48 hours after the letter containing it is posted. In nut shell, a notice must be sent 25 days before the meeting to the effective.
- Annual general meeting may be held with a shorter notice if it is so agreed by not less than 95% of the members entitled to vote in the meeting (Section 101). The consent for a shorter notice may be obtained either before or after the meeting either in writing or through electronic mode.
- The notice shall state the meeting to be an annual general meeting specifically.

NOTICE TO WHOM

After the provisions of Section 77 notice of AGM shall be served on

1. Every member of the company
2. Legal representative of deceased.
3. Receiver or official assignee of an insolvent member.

Pandit Deendayal Upadhyaya Shram Kalyan Mahavidyalaya Guwahati-17 Date Dhaneeram Chariali

4. Auditor or auditors of a company
5. Every director of the company

As per secretarial standard (SS 2) issued by ICSI notice should also be given to :

Practising company secretary who has given the compliance certificate.

Debenture trustee.

In the case of listed company, the stock exchanges on which the shares or debentures of the company are listed.

5. TIME, DATE AND PLACE OF HOLDING THE ANNUAL GENERAL MEETING (SECTION 96(2))

Time. Every annual general meeting shall be called during business hours. Business hours means between 9 am and 6 pm. **(As inserted by 2013 Act).**

It has been clarified by the Department of Company Affairs that the starting point of the meeting should be within the business hours but the duration is left to the meeting itself according to the speed with which it is in a position to go through its agenda. In other words, the meeting may continue beyond business hours. It may be noted that notice which does not mention the time for holding the meeting is invalid.

Day. AGM shall be called on a day which is not a 'public holiday'.

'Public holiday' is defined in section 2(38) of the Act as a public holiday within the meaning of the Negotiable Instruments Act, 1881.

The term 'public holiday' includes Sundays and any other day declared by the Central Government to be a public holiday.

30th June and 31st December are not public holidays under section 96, even if declared as public holidays for the limited purpose of half yearly closing of accounts of banks and treasuries etc.

But, where the Central Government declares a day to be a public holiday after the company has issued notices, it shall not be deemed to be a public holiday in relation to that meeting.

Hence annual general meeting must be held on a day that is not a public holiday. The provisions of section 96 have been held to be mandatory.

6. QUORUM

Quorum of Annual General Meeting is 5 members for a public company and of atleast 2 members for a private company personally present.

Increase in quorum requirements for public companies having more than 1000 members.– **Under the 1956 Act,** the quorum requirement for public companies for general meetings was 5 members personally present unless the articles stipulated a large number. **Section 103 of the 2013 Act** fixes quorum based on the number of members of the company as under–

- 5 members personally present if the number of members as on date of meeting is not more than 1000
- 15 members personally present if the number of members as on date of meeting is more than 1000 but not more than 5000.
- 30 members personally present if the number of members as on date of meeting is more than 5000.

Thus, quorum requirements for a public company having more than 1000 members stand increased by the 2013 Act from 5 members personally present to 15/30 members personally present.

Moreover quorum need to be present only at the commencement of General Meeting.

7. BUSINESS TO BE TRANSACTED (SECTION 102)

The business to be transacted at an AGM may comprise of :

(i) Ordinary business. In the case of annual general meeting, the following business is deemed as ordinary business.

(a) the consideration of the accounts, balance sheet and the report of the board of directors and auditors ;

(b) the declaration of dividend ;

(c) the appointment of directors in the places of those retiring ; and

(d) the appointment of, and the fixing of remuneration of, the auditors.

Ordinary business is transacted by passing ordinary resolution.

(ii) Special Business

All matters other than ordinary business are treated as special business at an annual general meeting.

For transacting special business at a meeting, there shall be annexed to the notice of the meeting an explanatory statement setting out :

(a) all material facts concerning each item of such business, **[Note. Under 2013 Act material facts are those that enable members to understand meaning, scope & implication of items of business to take decisions]** and

(b) in particular, the nature of the concern or interest, if any, of every director or every other key managerial personnel or relatives in each item.

(c) The statement must also state the time and place where the document, if any proposed for approval at the meeting can be inspected by members.

The absence of explanatory statement would make the meeting invalid.

Some of the examples of special business are :

(i) Removal of a director.

(ii) Issue of a bonus shares.

(iii) Issue of a right shares.

(iv) Election of a person as director other than a retiring director.

8. DEFAULT IN HOLDING ANNUAL GENERAL MEETING

The consequences of default in holding annual general meeting may be discussed as follows :

(i) Power of the Tribunal to call annual general meeting [Section 97]

If any company fails to hold an annual general meeting as prescribed u/s 96 of 2013 Act within the prescribed period, the Tribunal on the application of any member, may

(i) either call or

(ii) direct the calling of a general meeting of the company.

(iii) It may give such directions as it thinks fit in regard to the calling, holding, or conducting of such meetings.

(iv) The Tribunal may direct that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(v) A general meeting held at the directions of the Tribunal shall be regarded as an annual general meeting.

It is only a member and not the company that is empowered to invoke the provisions of Section 97. The company cannot seek directions against itself.

It may be noted that only the Tribunal has the power to order the convening of a meeting after the statutory time has elapsed.

(ii) [Section 99] Penalty

If default is made in holding the meeting of the company in accordance with section 96 or in complying with any direction of the Tribunal under section 97, the company and every other officer of the company who is in default, shall be punishable with fine

(i) which may extend to ₹ 1,00,000 and

(ii) in the case of a continuing default with a further fine which may extend to ₹ 5,000 for every day after the first during which the default continues. (Section 99).

EXTRAORDINARY GENERAL MEETING

Regulation 42 of the Table F provides "all general meetings other than annual general meetings shall be called extraordinary general meetings." In other words, a statutory meeting and annual general meeting of a company are called ordinary meetings. All general meetings other than these are called Extraordinary General Meetings.

NEEDS FOR EGM

An extraordinary general meeting may be held for the purpose of dealing with any extra ordinary matter which can't be postponed till the next annual general meetings such as :

- Changes in M.O.A
- Changes in A.O.A
- Reduction or reorganisation of share capital
- Issue of Debentures
- Removal of Director
- Removal of Auditors

For such urgent or special business that may arise between two AGMs, an EGM is convened. Moreover such matters concerning the administration of company's affairs can be transacted only by resolution of the members in general meeting.

BUSINESS TO BE TRANSACTED

All business transacted at such meeting is called special business.

Moreover, in case of special business, every item on the agenda must be accompanied by the 'Explanatory Statement' in terms of Section 102.

WHO CAN CONVENE ?

An extraordinary general meeting may be convened by any one of the following :

A. The Board of directors.

(i) on its own

(ii) on the requisition of shareholders.

B. By Requisitionists themselves.

C. By the National Company Law Tribunal (NCLT).

(A) EXTRAORDINARY MEETING CONVENED BY THE BOARD OF DIRECTORS

(1) On its own—Regulation 43(i) of Table F provides that "Board may, whenever it thinks fit, call an extraordinary general meeting". However, the company secretary has no authority to convene an extraordinary general meeting without such authority, if he calls, it will not be effectual unless the Board of directors ratifies the act before the meeting is held.

Where the directors think fit to convene a meeting, they do so by resolution passed at a duly convened and constituted meeting of the Board.

Notice of EGM. Notice of every EGM together with the explanatory statement must be given to the members at least 21 clear days before the meeting.

A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95 percent or more of the voting right (Section 101).

2. By the Directors on Requisition of Shareholders (Section 100)

The directors are bound to call an extra ordinary general meeting of the company if the following conditions are satisfied :

1. The requisition is signed by the requisite number of members under section 100. **The requisite number of members who shall sign the requisition shall be :**

(i) in the case of a company having a share capital, holders of atleast 10% of the paid up capital of the company and

(ii) in the case of a company not having a share capital, members having at least 10% the total voting powers.

2. The requisition shall state the matters for the consideration of which meeting is to be called (Section 100(3)).

3. The requisition shall be deposited at the registered office of the company (Section 100(3)).

EGM called by Board. *On receipt of a valid requisition*

(i) The Board shall within 21 days from the date of the deposit of a valid requisition proceed to call EGM by giving 21 clear days notice.

(ii) The meeting shall be held within 45 days from the date of the deposit of the requisition.

Time and Venue of Meeting

The provisions of Section 96 regarding time and venue/place of holding AGM has no applicability to the EGM. However, directors are expected to keep in mind, convenience of the members in fixing the time and place of the meeting so that they can exercise their voting rights. A general meeting other than AGM need not be held only at registered office.

(B) EXTRAORDINARY MEETING CONVENED BY THE REQUISITIONISTS (REQUISITIONED MEETING)

If the Board does not, within 21 days from the date of the deposit of a valid requisition, proceed duly to call a meeting on a day not later than 45 days from the date of the deposit of the requisition the meeting may be called : by the requisitionists themselves as follows :

1. Eligible Members. One or more of the requisitionists after the expiration is 3 months from the date of deposity of requisition may proceed to call the meeting provided that :

(i) in the case of a Company having a share capital by such of the requisitionists as represent either,

–the majority in the value of paid up capital or

–at least $\frac{1}{10}$ th of the paid up capital and having the right of voting. **Whichever is less**

(ii) in the case of a company not having a share capital, by the requisitionists having 10% of the total voting power of all the members of the company.

2. Time period for holding EGM.

The extraordinary general meeting requisitioned by the members must be held within three months of the deposit of the requisition.

But a meeting duly commenced before the expiry of the period of three months may be adjourned to some day after the expiry of that period and such a meeting shall be deemed to commence within time. Moreover the meeting shall not be held after the expiration of 3 months from the date of deposit of requrisition.

3. Manner of Calling of EGM. The EGM shall be called in the same manner as nearly as possible as that in which meetings are called by Board of directors. If the registered office is not made available for holding the meeting, it may be held elsewhere.

4. No other business can be transacted except for which it is especially convened. It is important to note that a requisitioned meeting (whether convened by the Board of Directors or by the requisitionists themselves) cannot transact any business other than that for which it has been expressly convened.

5. Expenses to be reimbursed. The company is bound to repay all end reasonable expenses incurred by the requisitionists in calling such a meeting. Any sum so repaid shall be retained by the company out of fees or other remuneration due or likely to become due to directors at fault [Sec. 100(6)].

6. No action against defaulting directors. Since an alternative remedy of calling the meeting lies with the requisitionists no action can be taken against the defaulting directors of the company for not holding the meeting.

(C) POWER OF TRIBUNAL TO CALL EGM

1. Impracticable to Call an EGM. If for any reason it is impracticable to call or hold or conduct

an EGM, the Tribunal may order an EGM to be called, held and conducted in such manner as it thinks fit.

Powers of Tribunal

Tribunal may give directions in respect of place, date and the manner in which the meeting be held and conducted.

Tribunal may also give such ancilliary or consequential directions as it thinks fit (including a direction that one member present in persons or proxy shall be quorum).

WHEN TRIBUNAL TO EXERCISE POWER

Tribunal may exercise such power :

(a) on the application of a member or *(b)* on the application of a director or

(c) suo motu (on its own motion)

Such meeting deemed to be meeting of the company

Any meeting called, held and conducted in accordance with any such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

Note : The Companies Act, 1956 contained provisions relating to statutory meeting and statutory report under Section 165 of that but this section has been omitted in the Companies Act, 2013 and therefore, there is no provision for Statutory Meeting of the Companies under the new Act of 2013.

(2) Class Meetings :

Class Meetings are held to deal with certain matters affecting the interests of the holders of a particular class of shares.

In other words, class meetings are those meetings which are held by shareholders of a particular class of share *e.g.*, preference shares. The class meetings are usually required to be held when it is proposed to alter, vary or affect the rights of a particular class of shares. For effecting such changes, it becomes necessary to call separate class meetings of the holders of those shares and seek their approval. Thus for example, where a company desires to cancel the arrears of dividends on cumulative preference shares, it is necessary to call a meeting of such shareholders and pass a special resolution as required by Section 48 of the Companies Act, 2013.

Class Meetings, are held to pass resolutions which are binding only on the members of the class of shares concerned, and the members of that class alone may attend and vote at that meeting. The purpose for which class meetings are held is to obtain the assent of the concerned class-members to alterations in the rights of the class to which they pertain under the provisions to that effect in the memorandum or articles or to assent to compromises or arrangements which affect the class.

(B) MEETINGS OF THE DIRECTORS

MEETINGS OF THE BOARD

1. Frequency

Note. As per 1956 Act, at least one meeting must be held in every three calender months. But the 2013 Act requires that not more than 120 days shall intervene between 2

executive board meetings. The directors of a company exercise most of their powers in a joint eting called the meetings of the Board.

In the case of every company, a meeting of the Board of directors must be held :

(i) accordingly that not more than 120 days intervene between two board meetings, and

(ii) at least four such meetings shall be held in every year. (Section 173)

In other words no gap between two board meetings should not exceed 120 days and no year hould expire without at least four directors meetings have been held in it. The provisions of Section 73 will be fulfilled if the Board of Director of a Company meet on the first of January or the 30th of pril or any date in between. Similarly board may at least meet on a particular date during May to ugust, Sept. to Dec. and so on. Even, it has been clarified, that Department would have no objection a meeting is held with a gap or 120 days and if at least four such meetings are held in a year.[1]

The object of this section is to ensure that Board meetings are held at reasonably frequent tervals so that the directors may be in touch with the management of the company's affairs.

First Board Meeting. As per 2013 Act, the first meeting of the BOD of every company must be eld within 30 days of its incorporation. **No such provision existed in 1956 Act.**

However, the Central Government is empowered to relax the rule with regard to any class of ompanies. The intention is to save smaller companies having insufficient business to be transacted Board meetings from unnecessary hardships and expenditure involved in holding them.

Though there is no special penalty provided for non-Compliance with the requirements of section 73, the default is punishable under section 450.

NEW PROVISION ADDED IN 2013 ACT : MEETING THROUGH VIDEO CONFERENCING

Under Section 173 of the Companies Act, 2013 :

The 2013 Act allows participation of directors in board meetings through video conferencing or through such other audio visual means, as may be prescribed, which are capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings.

"Video conferencing or other audio visual means" means audio visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides the procedure for convening and conducting the Board meetings through video conferencing or other audio-visual means.

Procedure of Convening Board Meeting (Through video conferencing) (through video conferencing or other audio visual means)

1. Arrangements

Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.

1. Circular (No. 8/16(1)/61-PR Dated 9th May 1961]

The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care —

(a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;

(b) to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;

(c) to record proceedings and prepare the minutes of the meeting ;

(d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year.

(e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and

(f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting.

The persons, who are differently abled, may make request to the Board to allow a person to accompany him.

2. Notice

(a) The notice of the meeting shall be sent to all the directors according to the provisions of section 173 (3)

(b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.

3. Communication of intention by director to participate by video conferencing

(a) A director intending to participate through video conferencing or audio visual means shall communicate his intention to the Chairperson or the company secretary of the company.

(b) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangements in this behalf.

(c) The director, who desire, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year.

(d) In the absence of any intimation under clause (c), it shall be assumed that the director shall attend the meeting in person.

4. Roll call

At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely :

(a) name;

(b) the location from where he is participating;

(c) that he has received the agenda and all the relevant material for the meeting; and

(d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b) ;

• **After the roll call**, the Chairperson or the Company Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairperson and confirm that the required quorum is complete.

A director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the rules.

• **The Chairperson shall ensure** that the required quorum is present throughout the meeting.

• **With respect to every meeting conducted** through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, which shall be in India, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

5. Statutory Registers

The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode, if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

6. Participation of directors and Voting

- Every participant shall identify himself for the record before speaking on any item of business on the agenda.
- If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration by the Director.
- If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

7. Restriction of Access

From the commencement of the meeting and until the conclusion of such meeting, no person other than the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

8. Decision

At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, who dissented from the decision taken by majority.

9. Minutes

- The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.
- The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.
- Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
- After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

PROCEDURE TO HOLD BOARD MEETING FOR OPC/SMALL COMPANY/DORMANT COMPANY (SECTION 173)

1. An OPC (which has more than one director)/ small company/dormant company must hold board meetings as follows :

(a) At least one meeting of Board of Directors to be conducted in each half of a calendar year.

(b) Gap between two meetings should not be less than 90 days.

An OPC which has only one director need not comply with the above provisions.

2. Notice of meeting. As per the 2013 Act, the board meeting shall be called by giving a notice of not less than **seven days (7)** in writing to every director at his address registered with the company. **[Under the 1956 Act, length of the notice period i.e. 7 days was not mentioned].** However for conducting urgent business, a shorter notice may be given. Every officer of the company who is under a duty to give the notice as aforesaid and who fails to do so, shall be punishable with fine which may extend to ₹ 25000. (Section 173). Such notice shall be sent by hand delivery or by post or by electronic means **[Electronic means has been allowed by the 2013 Act).**

The issue of notice to every director is mandatory. Such a notice must be given even to a director who has expressed his inability to attend the meeting. Where a director is improperly included from the Board's meeting, he may sue for the declaration of the entire proceedings as invalid.

3. Place and time of holding Board meeting. The provisions of Section 96 require that AGM of the company must be held at registered office of the company and during working hour only and on a day which is not a public holiday. There is no similar provision in the Act with regard to meetings of the board of directors. Hence, the board meeting may be held anywhere convenient to the directors. Moreover, Section 173 does not prohibits it from holding the Board meeting at a place other than Registered office of the company.

The Department of Company Affairs has clarrified, that it would not raise any objection if the adjourned meeting is held on a public holiday for the convenience of directors, it consider that an original meeting should normally be held on a working day.[1]

1. Letter No. 8/11 (285) 63-PR Dated 2-1-1963]

4. Quorum. It means the minimum number of directors which must be present to make the proceedings of the Board valid.

Section 174 of the Companies Act lays down that the quorum for meting of the Board shall be :

(i) One third of its total strength (any fraction contained in that one-third being rounded off as one), or

(ii) two directors

whichever is higher [Section 174 (1)].

In calculating the total strength any vacancy in the Board is excluded and only the number of directors in office at the moment is taken into account.

Section 174 only indicates the minimum number of directors necessary to constitute a proper quorum. It is open to the company, by its articles, to indicate a higher, but not a lower, number constituting a vaild quorum [*Amrit Kaur v. Kapurthala Flour Oil & General Mills Co. (Pvt.) Ltd. (1984) 56. Comp. Cas. 194]*

Participation of directors in Board Meeting by Video Conferencing or other audio-visual means shall also be counted for the purpose of quorum **under section 174 of 2013 Act. This provision did not exist in 1956 Act.**

A quorum is presumed to be present unless the presumption is questioned at the meeting or the records disclose that a quorum was, in fact, not present.

5. Agenda of Board Meetings

Although it is not obligatory in law, it is customary to send a copy of the agenda, i.e., the business to be transacted at the meeting, along with the notice of every Board meeting. It is usually the duty of the secretary to prepare the agenda of a Board meeting in consulation with the Chairman of the Board of Directors and the Managing Director, if any. Although Board meetings are held frequently and many of the items of business transacted at these meetings are of routine nature, the agenda should be prepared carefully and the relevant reports, statements, accounts, etc., should be kept ready for each item of the agenda.

The agenda should contain short notes on the items to be discussed and should be circulated in advance so that the directors come to the meeting fully prepared to contribute their best to the deliberations on each item of business so that the decisions taken at each board meeting are sound and the best. If, however, any director is interested, he may be furnished with additional information to equip him for effective participation.

6. Chairman at Board Meeting

Every Board meeting must have a chairman to preside over the meeting. The articles of a company usually provide who shall preside over Board meetings. If the articles do not name the chairman, the directors themselves may elect the chairman and fix his term of office at the first Board meeting or in any subsequent meeting as necessary. In case the usual chairman is absent from the meeting till five minutes firm the start of the meeting, the directors present shall nominate one among themselves as the chairman.

7. Resolution by Circulation

The directors exercise their powers by resolution at Board meeting. A resolution may be passed

either at a meeting of the Board or by circulation. A resolution in writing signed by all the members of the Board or Committee thereof, for the time being entitled to receive notice, will be as valid and effectual as if it had been passed at a meeting of the Board or its committee duly convened. For a resolution to be passed by circulation, it must be circulated in draft, together with the necessary papers to all the directors entitled to receive notice of a meeting and must be approved by a majority of them. (Sec. 175).

8.Voting by Directors

The method of voting to be followed at a board meeting is by show of hands. Voting by proxy is not allowed ; so a director cannot send a proxy to a board meeting. A poll can be demanded at a board meeting, though the usual way of voting is by show of hands. Each director has usually, one vote irrespective of his shareholding. But the chairman may, however, be given right to the casting vote.

The Companies Act requires that motions for approval of the prospectus, appointment of a person as manager or managing director in a second company, inter-company investments, etc., must be passed by the Board unanimously.

Every director present at the meeting is entitled to vote except if he is an 'interested director'. A director not entitled to vote, cannot be excluded from the Board meeting.

9. Directors Attendance Book

Before the proceedings of the meetings begin, the secretary passes round to the directors, the directors attendance book, and takes therein the signatures of each of them. It helps in maintaining a complete record of the attendance of the directors. It also helps in fixing responsibility for acts done at a meeting. A specimen of the book is given below.

10. First Board Meeting

Note. Earlier under the Companies Act, 1956. The first Meeting of Directors or the First Board meeting is held just after the incorporation of the company **but now under the 2013 Act, the first meeting of the BOD most be held within 30 days of the date of its incorporation.** This meeting has much importance and needs special attention.

11. Minutes of Board Meetings

According to Section 118 of the Companies Act, every company is required to prepare minutes of the proceeding of every meeting of its Board of directors and meetings of committees of the Board.

The proceedings at Board meeting must be recorded in separate minute book. The director's minute book is kept separate from that of the shareholders, because the members have a statutory right to inspect and demand copies of the latter but not of the former. Minutes should be duly entered in the minute book within 30 days of the conclusion of the meeting. Minutes should be signed and dated by the chairman and confirmed at the subsequent meeting.

(C) MEETINGS OF THE CREDITORS [SECTION 230]

The meetings of the creditors is usually called when the company wants to make any compromise or arrangement with the creditors or any class of them. In fact, these meetings are not

the meetings of the company as they are called by the creditors. Creditor's meeting may be called for any of the following purposes–

(i) to enter into a compromise or arrangement proposed between a company and, its creditors or any class of them; or for a compromise or arrangement between a company and its members or any class of them;

(ii) to seek approval of creditors for amalgamation or reconstruction of a company; or

(iii) to seek consent of the creditors for winding up of a company.

In case of a company which is being wound up, any creditor or class of creditors or liquidator may apply to the Court for ordering a meeting of the creditors or class of creditors. If the majority in number representing 3/4th in value of the creditors be present and voting either in person or by proxy (where allowed under rules made under Section 468) agree to the compromise or arrangement, shall if sanctioned by the Court, be binding on all the creditors, liquidators or contributories, as the case may be.

(i) Meeting for Voluntary Winding up of the Company [u/s 306]

In case of voluntary winding up of the company, the company shall :

- first call a meeting u/s 304 at which the resolution for the voluntary winding up of the company is to be proposed;
- later, the company shall call a meeting of its creditors u/s 306 (either on the same day on which meeting for resolution is called or on its next day).

However, under section 306 the company shall send the notice of both meeting by registered post to the creditors.

(ii) Meeting of the Debenture holders

The company may call the meeting of debenture holders to consider, (i) any variation in the conditions of their security or (ii) any alteration in their rights. The company may also hold debenture holder's meeting for issuing new debentures or effecting a change in the rate of interest on the existing debentures. The rules and procedure of these meetings are usually stated on the reverse of the debenture trust deed.

(D) FINAL MEETING AT DISSOLUTION [SECTION 318]

When the company is fully wound up, the company liquidator shall prepare a report of the winding up. This report shall show that the assets and property of the company has been disposed off and its debts have been fully discharged. Thereafter, the company liquidator shall call a general meeting of the company for laying the final winding up accounts. When the majority of the members of the company are satisfied (after considering the liquidator's report) that the company shall be wound up, then they may pass a resolution for the dissolution of the company.

MEETINGS OF COMMITTEE OF DIRECTORS

It is not always possible for the Board of Directors as such to devote time and energy to carry on investigations on different matters connected with the conduct of the company's affairs. It is the usual practice with the Board to appoint small committees consisting of a few directors with expert

knowledge to investigate and report on various matters and thus facilitate decision-making work of the Board. Directors may delegate their powers to committees, if the articles of association so provide. By so doing, the full Board need not meet more than four or five times in a year. Unless the Articles otherwise provide, a committee of one may also be appointed. These committees have to meet at regular intervals to carry on their work. These are known as *Meetings of Committees of Directors.*

Sec. 179 empowers the Board to delegate the following powers to any committee of directors :

(a) The power to borrow moneys otherwise than on debentures ;

(b) The power to invest the funds of the company ; and

(c) The power to make loans.

The provisions relating to the meeting of a committee of directors are by and large the same as in the case of a meeting of the Board of directors. For example, a chairman presides over the meetings, questions are decided by majority vote, chairman has a casting vote on equality of votes, resolutions can be passed by circulation etc.

The terms of the resolution appointing a committee lay down the manner in which the Board is to be informed and kept in touch with the proceedings of the committee. The chairman of the Board may act as ex-officio chairman of the committee meeting, so that there is cohesion between the Board and its committee.

COMMITTEES UNDER COMPANIES ACT, 2013

(I) AUDIT COMMITTEE

Note. As per section 292(A)(1) of the previous Act of 1956, every public company (whether listed or unlisted) having paid up capital of not less than 5 crores of rupees shall constitute a committee of the Board as 'Audit Committee'. It meant constitution of Audit committee of the Board is *mandatory for a company having a paid up share capital of ₹5 crores or more.*

New Provisions as Per Companies Act, 2013

U/S **177 of Companies Act, 2013 read with Rule 6 of the Companies (Meetings of Board and its Power) Rules, 2014,** the following companies have to compulsorily constitute an Audit committee :

(i) Every listed company;

(ii) All public companies with a paid up capital of ₹ 10 crore or more;

(iii) All public companies having turnover of ₹ 100 crore or more;

(iv) All public companies having in aggregate outstanding loans or borrowings or debentures or deposits exceeding ₹ 50 crores or more.

CONSTITUTION OF AUDIT COMMITTEE

As per previous Act of 1956. Audit Committee shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of

members shall be directors, other than managing or whole-time directors. *[Section 292 A(1)]* The audit committee, thus, shall stand comprised of only non-executive directors. The annual report of the company shall disclose the composition of the Audit Committee. *[Sec. 292 A (4)]*

NEW PROVISION IN 2013 ACT REGARDING CONSTITUTE OF AUDIT COMMITTEE

An Audit Committee shall consist of the following :

- Minimum of three directors;
- Independent directors forming a majority;
- Majority of members including chairperson shall be persons with ability to read and understand the financial statements.

However, there is no prescribed quorum of the Audit committee, the same needs to be laid down by the Board while constituting the committee, if not spelt out, it appears the whole of the committee must meet.

Terms and reference for audit committee

Every Audit Committee constituted shall act in accordance with terms of reference to be specified in writing by the Board. [Section 177]

Chairman of the Audit Committee

The members of the Audit Committee shall elect a chairman from amongst themselves.

The chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.

SCOPE & FUNCTION OF AUDIT COMMITTEE

[Note. The scope & functions have been changed as per now Act of 2013, explained as below].

The audit committee shall act in accordance with the terms of reference to be specified in writing by the Board.

The scope and functions as laid down in Section 177(4) are as below :

- Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall include, among other things :

(i) the recommendation for appointment, remuneration and terms of engagement of auditors of the company,

(ii) review and monitor the auditor's independence and performance, and effectiveness of audit process,

(iii) examination of the financial statements and the auditors' report thereon,

(iv) approval or any subsequent modification of transactions of the company with related parties,

(v) scrutiny of inter-corporate loans and investments,

(vi) valuation of undertakings or assets of the company, wherever it is necessary,

(vii) evaluation of internal financial controls and risk management systems,

(viii) monitoring of end use of funds raised through public offers and related matters.

- The Audit Committee shall have authority to investigate into any matter in relation to the items (i) to (viii) above or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
- The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review financial statements before their submission to the Board and may also discuss any related issues with statutory and Internal auditors and management.

The intention of the legislature appears to be that the audit committee should, however, avoid intruding into the day to day managerial decisions.

RIGHT TO ATTEND MEETING OF AUDIT COMMITTEE :

Under Section 177 of Companies Act, 2013 besides members, the meeting shall be attended by :

- Auditors of a company and the key managerial personnel shall have a right to attend the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.
- **Unlike the 1956 Act, the 2013 Act** does not obligate the auditors of a company to attend Audit Committee Meetings.

As per the previous Act of 1956, the right to attend meetings of Audit Committee besides members lied with :

Auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Recommendations of the Audit Committee

The recommendations of the Audit Committee on any matter relating to financial management including audit report, shall be binding on the Board. [Sec. 292 A (8)]

If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons thereof and communicate such reasons to the shareholders.

Penalty for default [Sec. 177]

If a default is made in complying with the provisions of this section, then the following penalty shall be imposed :

- The company shall be punishable with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 5,00,000 ; and
- Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 1,00,000, or with both.

(II) NOMINATION AND REMUNERATION COMMITTEE

New Provisions as per Companies Act, 2013

U/s 178 of the Companies Act, 2013 read with Rule 6 of the companies (Meetings of Board and its Powers) **Rules, 2014**, the following companies have to compulsorily constitute a Nomination & Rumation Committee :-

(i) Every listed Company ;
(ii) All public companies with a paid up capital of 10 crore or more;
(iii) All public companies having turnover of 100 crores or more;
(iv) All public companies having an aggregate outstanding loans or borrowings or debenture or deposits exceeding 50 crores or more.

Section 178 :-

The Board of Directors shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors:

The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

- The Nomination and Remuneration Committee **shall identify persons who are qualified** to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance.
- The Nomination and Remuneration Committee **shall formulate the criteria for determining qualifications**, positive attributes and independence of a director and recommend to the Board a policy, relating **to the remuneration** for the directors, key managerial personnel and other employees.
- The Nomination and Remuneration Committee shall, while formulating the, policy ensure that –

  (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

  (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

  (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long term performance objectives appropriate to the working of the company and its goals:

Such policy shall be disclosed in the Board's report.

III. STAKEHOLDERS RELATIONSHIP COMMITTEE [SECTION 178 (5)]

The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial years shall constitute a **Stakeholders Relationship Committee** consisting of a **chairperson** who shall be a non-executive director and such other **members** as may be decided by the Board.

- The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.
- The **chairperson** of each of the committees constituted under this section or, in his absence, any other member of the committee authorized by him in this behalf shall **attend general meetings** of the company.

Penalty

- In case of any contravention of the provisions of section 177 and section 178 the company shall be punishable with fine which shall not be less **than one lakh** rupees but which may extend to **five lakh rupees** and every officer of the company who is in default shall be punishable with **imprisonment** for a term which may extend to **one year** or with fine which shall not be less than **twenty-five thousand rupees** but which may extend to **one lakh rupees**, with both:

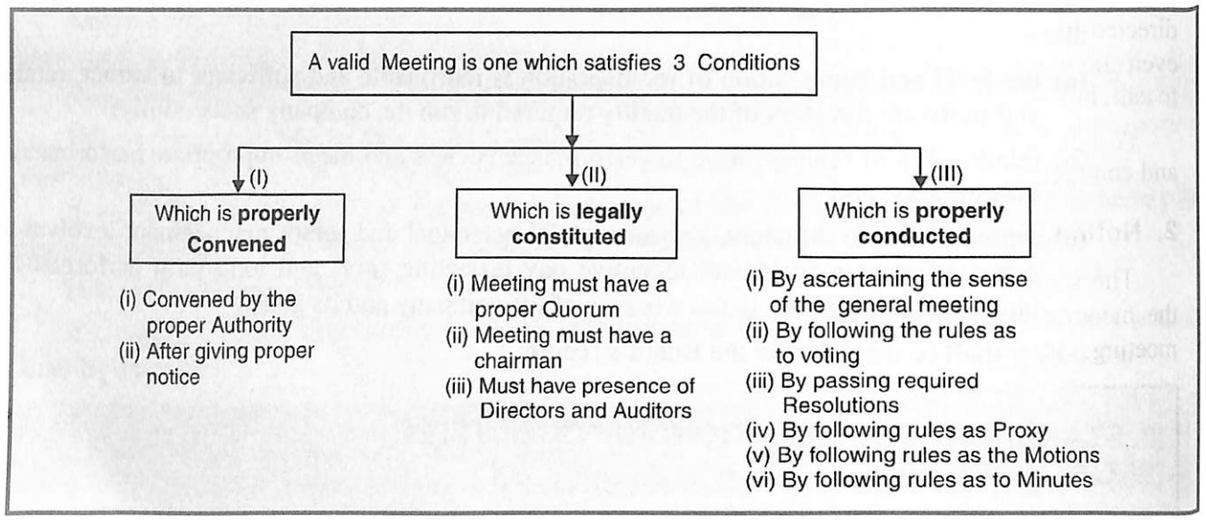
(IV) CSR COMMITTEE

[This committee has been explained in detail in the next chapter – CSR and CSR Committee]

REQUISITES OF A VALID MEETING

A meeting must be called and held in the manner provided in the Act and the articles. Any irregularities in the procedure followed for convening and conducting a meeting will invalidate the proceedings of that meeting. A valid meeting is one, which is duly convened, properly constituted and conducted.

PROPERLY CONVENED



It may be noted that the members or shareholders of the company are bound by the decisions, whether or not they were present provided the meeting was valid. Before a meeting can validly transact any business, the following requirements must be satisfied :

I. MEETING WHICH IS PROPERLY CONVENED

A popery convened meeting is one which is convened by the proper authority and after giving proper and adequate notice to all those who are entitled to attend.

1. Proper Authority

A meeting to be valid must be called by a proper authority. The proper authorities to call the meetings are :

(i) Board of Directors. The Articles of Association of a company normally empower the Board of directors to convene general meeting.

Even Board has power at common law to call a general meeting even if this power is not expressly conferred upon them by Articles.

An individual director has no power to all a general meeting.

Similarly a secretary has no right to convene a general meeting without the authority of the Board of directors. But, such notice may be ratified by the Board before the meeting.

However, where certain directors held a meeting of the Board and prevented certain directors, who were validly in office from attending the meeting, the court held that since the meeting of the Board was unlawful, the notice convening the general meeting of the company also became invalid. But minor irregularity of the Board meeting will not incapacitate the general meeting from acting.

(ii) Members. If the directors do not call the meeting, then requisitionists (members) u/s 100 are eligible to Call EGM.

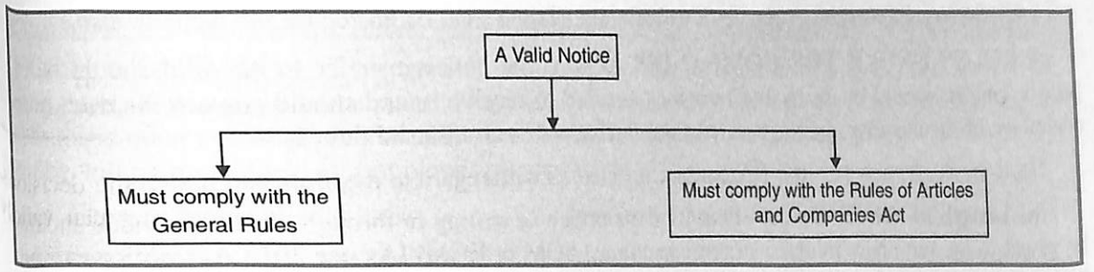
(iii) The Tribunal. An AGM can be called by Tribunal u/s 97.

If for any reason there occurs a default in holding an AGM, then the Tribunal may, on a petition of any member, direct the calling of AGM (Section 97). In case of an extraordinary general meeting (EGM), Tribunal has been conferred with the similar powers. However, an EGM may be called or directed to be called not only on a petition of any member but also on a petition of any director or even *suo motu*. But, power to call an EGM can be exercised only where it has become impracticable to call, hold or conduct such meeting [Section 98].

A meeting so called and conducted shall be deemed to be a meeting of the company duly called and conducted.

2. Notice [Section 101]

The second requirement of a valid meeting is that all those who are concerned with business of the meeting and are entitled to attend it, are communicated of the date, time and business of the meeting. Such a communication is called 'notice of the meeting.'



A **valid notice** of a company meeting is one which **complies** with the **general rules** in relation to notice and which complies with the **rules as** laid down in the **Articles and the Companies** Act.

• General Rules as to a Valid Notice

(a) The notice may take any reasonable form which sufficiently conveys to the person, entitled

to receive it, information enabling the person to attend the meeting and to take part in its deliberations.

(b) The notice must specify the date, time and place of the meeting.

(c) The notice must state the nature of the business to be transacted, that is, a completed agenda of the meeting should be forwarded with or as part of the notice.

(d) The notice must be served in the manner prescribed in the Articles read with the Companies Act.

(e) Notice shall be sent by hand or by ordinary post or by speed post or by registered post or by courier or by facsimile or by e-mail or by any other electronic means

'Electronic means' means any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the Member.

(f) In case the Notice and accompanying documents are given by e-mail, these shall be sent at the Members' e-mail address, registered with the company or provided by the depository, in the manner prescribed under the Act.

In case of the Directors, Auditors, Secretarial Auditors and others, if any, the Notice and accompanying documents shall be sent at the e-mail address provided by them to the company, if being sent by electronic means.

(g) Notice shall be sent to Members by registered post or speed post or courier or e-mail and not by ordinary post in the following cases :

(a) if the company provides the facility of e-voting;

(b) if the item of business is being transacted through postal ballot;

(h) If a Member requests for delivery of Notice through a particular mode, other than one of those listed above, he shall pay such fees as may be determined by the company in its Annual General Meeting and the Notice shall be sent to him in such mode.

(i) In case Meeting is called by the requisitionists themselves where the Board had not proceeded to call the Meeting, the Notice shall be sent to Members by registered post or speed post or email.

(j) In case of companies having a website, the Notice shall be hosted on the website also.

• **RULES UNDER THE COMPANIES ACT :** The notice in order to be valid should be of proper length; should be given to all persons entitled to receive it; and should contain the date, time and place of the meeting and the nature of the business to be transacted thereat.

Sections 20, 96 and 101 and 102 contain provisions with regard to the aforesaid matters.

(a) Length of notice. Not less than 21 days notice in writing or through electronic mode should be given to the members to call a general meeting [AGM or EGM] **[As per 2013 Act notice can be given in the electronic mode u/s 101].**

'Not less than 21 days mean that both the date of the meeting and the date on which it is served are to be excluded. i.e. 21 clear days notice. When a notice is sent by post, it is deemed to be served after 48 hours of posting. This, notice to be valid must be dispatched 25 days before the date of the meeting. The articles may provide for a notice longer but not shorter than 21 days.

When shorter notice will be sufficient. The meeting can however, be called by giving a shorter notice if:

A general meeting may be called after given a shorter notice if consent is given in writing or by electronic mode by not less than ninety-five per cent of the members entitled to vote at such meeting.

(a) In the case of annual general meeting, by the consent of all the members entitled to attend and vote and not merely those present in the meeting.

(b) In the case of any other meeting, by the consent of the members holding not less than 95 per cent *paid up share capital of the company, or holding not less than 95 per cent voting power.*

A person who is present and who votes at the meeting, will not be entitled to challenge the resolution of the ground of an invalidity of the notice.

Notice to whom. (Sec 101) Notice of every meeting must be given to the following persons :

(i) Every member of the company at his registered address in India.

(ii) Legal representative of any deceased member and to an assignee of an insolvent member.

(iii) The auditor or auditors of the company.

(iv) Every director of the company.

If shares are held jointly by more than one person, notice may be served on the joint holder named first in the register in respect of the share [Sec. 21].

The Notice must be given to a Member even if he has waived his right to receive the Notice.

Omission to give notice. Deliberate omission to give notice of the meeting to the members or to a single member will make the meeting invalid.But an accidental omission to give notice to or non-receipt of the notice by any member, shall not invalidate the proceedings at the meeting. The expression 'accidental' implies absence of intention or deliberate design.

Examples : (1) A committee of a club met and passed a resolution expelling Y from the club. X a member of the committee was not summoned to the meeting, as she had previously informed that she would be unable to attend meetings. It was held that the omission to summon X invalidated the proceedings of the committee. [Young v. Ladies Imperial Club Ltd. (1920) 2 K.B. 523 (C.A.)].

(2) Nine members did not receive notice of a meeting because the addressograph plates for them had been separated from the rest because their dividend warrants had been returned through the post undelivered and uncashed. It was held that the ommission was accidental and the meeting was valid.

[Re : West Canadian Collieries Ltd. (1962) All. E.R. 26].

Contents of the notice. Every notice of a company must specify the place, day and hour of the meeting and shall contain a statement of the business to be transacted thereat. If time for holding the meeting and other essential particulars required by the section 101 are not mentioned in the notice, the meeting will be invalid and all resolutions passed thereat will be of no effect.

(a) Place of meeting.

(I) For AGM—

(i) at Registerd office of the Company or

(ii) at some other place within the same city, town or village in which the registered office of the company is situated

(II) for other general meetings : Not subject to aforesaid provision.

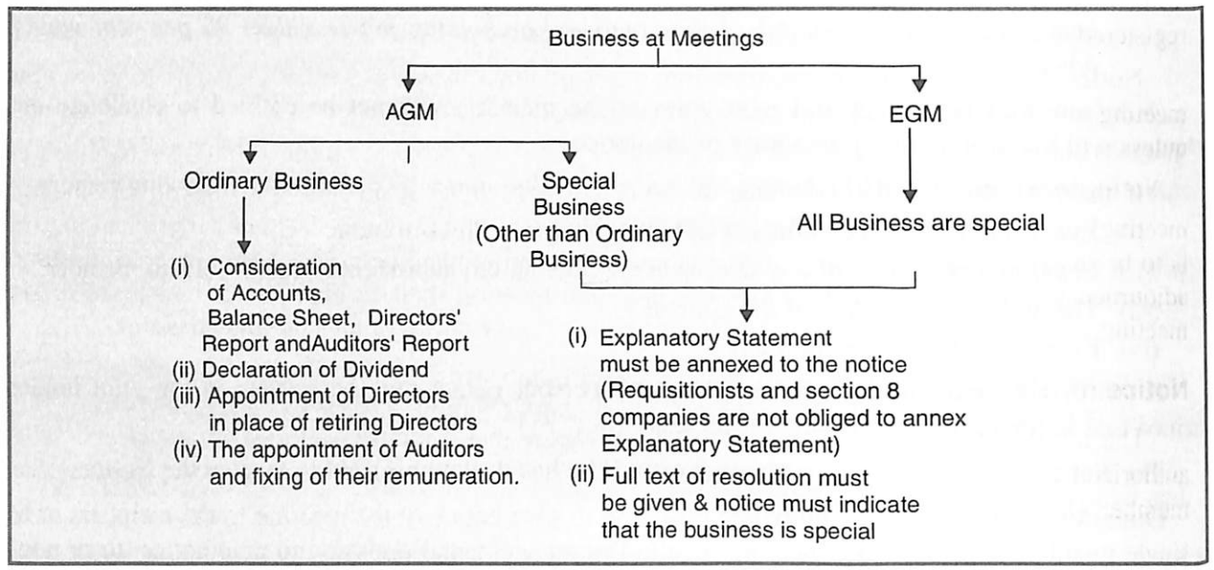
(b) Day of the meeting.

AGM. On any day that is not a public holiday.

For Other General Meetings. No bar to holding of any general meeting on a public holiday.

(c) Time of the meeting. Every AGM must be held during the business hours of the company *i.e.* between 9 am. to 6 pm. But such meeting may continue beyond the usual hours.

Other general meetings can be held at any time.



(d) Agenda. Notice of meeting must contain a statement of nature of the business to be transacted in the meeting which is called as agenda. Section 102 classifies the business into ordinary business and special business.

Ordinary business. The followings business which is transacted at every annual general meeting is considered as ordinary business.

(i) The consideration of financial statements and the report of the Board of directors and auditors.

(ii) The declaration of dividend.

(iii) The appointment of directors in place of those retiring.

(iv) The appointment of and fixing the remuneration of auditors.

Special business. Any business other than ordinary business transacted at an annual general meeting and all business at extraordinary general meeting is deemed as special business.

In case of any items of special business to be transacted in the general meeting, an explanatory statement shall be annexed to the notice of the meeting.

Where any item of special business transacted at meeting affects any other company, the extent of shareholding interest of any directors or manager of the company in that other company, exceeding 20 percent of the paid-up share capital of that other company, must also be mentioned in the explanatory statement.

If the meeting is to accord approval to a document, the explanatory statement must also state the time and place where that document can be inspected.

Mode of Notice (Section 20)

The notice may be sent to a member either personally or by post, or through electronic media to his registered address or the address given by him for sending notices in India.

If the notice is sent by post it is deemed to have been received on the expiry of 48 hours from the date of posting.

A notice by advertisement in a paper circulating in the neighbourhood of the registered office shall be deemed to be duly served, on the date on which it appears, on every member who has no registered address or has not supplied one to the company.

Notice in case of adjourned meeting. An adjourned meeting is a continuation of the original meeting and therefore, a fresh notice of such a meeting is not required to be given to the members unless articles so provide.

If the meeting is adjourned sine die (i.e. without fixing a day for the holding of adjourned meeting) or if fresh business, other than such business as is left uncompleted at the original meeting, is to be discussed, a fresh notice of the adjourned meeting must be given. Also, "when a meeting is adjourned for 30 days or more, notice of adjourned meeting shall be given as in the case of original meeting. Save as aforesaid, it shall not be necessary to give notice of an adjourned meeting."

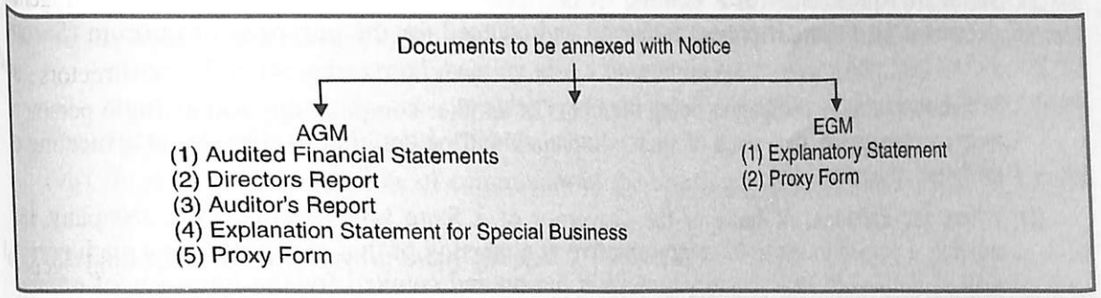
Notice of the Right of a Member to Appoint Proxy

The notice must state with reasonable prominence that a member entitled to attend and vote is authorized to appoint a proxy to attend and vote instead of himself and that a proxy need not be a member. [Section 105]

Documents Accompanying the Notice

SS–2 requires that the Notice of the meeting shall be accompanied, by an attendance slip and a Proxy form with clear instructions for filling, stamping, signing and/or depositing the Proxy form.

The following documents should be annexed to the notice of the meeting.



II. MEETING TO BE LEGALLY CONSTITUTED

Fir a meeting to be legally constituted, there must be proper quorum, a proper person in the chair and proper compliance with the relevant provisions of the Articles of Association of the Act.

(1) PROPER QUORUM [SECTION 103]

'Quorum' means the minimum number of members who must be present in order to constitute a

valid meeting and to validly transact business at the meeting. If the quorum is not present, the meeting shall not be valid and therefore the proceedings of such meeting shall be invalid.

U/s 103 of 2013 Act

Quorum for Public Companies is based on number of members, explained below :

Present No. of Members (on the date of meeting)	Quorum Required
• < 1000 (less than 1000)	5
• > 1000 < 5000 (more than 1000 but less than 5000)	15
• > 5000 (more than 5000)	30

- **Any other Company** —2 members personally present
- Articles may prescribe a larger quorum than provided u/s 103.

Rules Regarding Quorum

As regards quorum at general meetings, the following rules must be followed :

(a) For the purpose of ascertaining quorum, only members present in person, and not by proxies, are to be counted. However, exception to this rule is contained in sections 98 and 100. we shall study about the same a little later.

(b) Preference shareholders present in the meeting and equity shares without voting rights are not to be counted for the purpose of quorum except where the proposed business includes any item directly affecting preference shareholders.

(c) *Joint holders of shares are treated as single member* for purposes of counting quorum.

(d) *A member present in two or more capacities, e.g.,* as an individual member and as a trustee, may be counted as two members personally present for the purpose of quorum.

(e) *If a company is a member* of another company, it may authroise a person by a resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purposes of quorum (Section 113).

Where two or more companies being members of another company appoint a single person as their representative, then each of such companies will be counted in quorum at a meeting of the latter company.

(f) Where the President of India or the Governor of a State holds shares in a company and appoints a person to act as his representative at a meeting of that company, then such person shall be deemed to be a member present in person and counted for the purposes of quorum (Section 112).

(g) Where the total number of members of a company is reduced below the quorum fixed by the Articles, the rule as to quorum will be deemed to be satisfied if all the members of the company attend the meeting in person.

Course of action in case of quorum not being present at general meetings.

If a quorum is not present within half an hour :

(a) If General meeting is called on requisition of members, then such meeting shall stand dissolved.

(b) If general meeting is called otherwise than on requisition of members, the general meeting shall adjourn to :

(i) such day, time and place as the Board may decide.

(ii) If the Board does not so determine the day, time a place, the general meeting shall adjourn to same day, time and place in the next week.

(iii) If at the adjourned meeting also, a quorum is not present within half an hour from the time appointed for holding the meeting, then the members present shall be a quorum.

One man meeting. But, where only one person is present, he cannot form a quorum, as a single member cannot constitute a meeting. The Department of Company Affairs has also clarified that a single member present cannot by himself constitute a quorum. However, the Company Law recognises certain exceptions which are as follows :

In case of class meeting the

(i) one member may constitute a quorum for a meeting where he holds all the shares of a class. Thus, where all the preference shares in a company were held by one shareholder only it was held that a meeting of the preference shareholder attended by him only was valid.

(ii) If there is only one creditor, debentureholders, he shall constitute quorum for the creditors, or debentureholder's, meeting.

(iii) A member present in more than one capacity is counted separately in every capacity. In such a case, one person may form the quorum.

(iv) One member may constitute a quorum for an Annual General Meeting when it is called by the Tribunal under section 97 of the Act.

(v) One member of the company present in proxy or by person, shall be deemed to constitute a meeting where the Tribunal orders a general meeting other than AGM of the company to be held under section 98.

(vi) Where a quorum is not present at a general meeting within half an hour of the meeting, the meeting shall stand adjourned to the same day in the next week at the same time and place. If at the adjourned meeting also a quorum is not present within half an hour of the time of the meeting, the members present are the quorum. In such a case even one member will constitute the quorum.

(vii) In the case of meetings of committees of the board, the committee may constitute a single person.

Should quorum be continuously present ? The Act is silent on the point of time of presence of the quorum at the meeting. However, the Regulation of Table A provides, "No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business."

It had also been held in *Re Hartley Baird Ltd.* that the quorum required is the quorum to be present at the time of beginning to consider the business and it need not be present throughout or at the time of taking the vote on any resolution.

In a nutshell, quorum need to be present only at the commencement of general meeting and does not imply the requirement of a continued presence of quorum throughout the meeting or when the meeting proceeds to vote.

Presumption as to Quorum

Quorum will always be presumed unless it is questioned at the meeting or the records show that a quorum was not, infact present.

(2) CHAIRMAN OF MEETING [SECTION 104]

Appointment of chairman. For the proper conduct of business at meeting a chairman is necessary. His appointment is usually regulated by the articles of association. The articles usually contain provisions on the lines of Table (Schedule I) Regulations 45-47. These Regulations are :

Regulation 45. The chairman, if any, of the Board shall preside at every general meeting of the company.

Regulation 46. If there is no such chairman, or if he is not present within fifteen minutes after the time appointed for holding the meeting or is unwilling to act as chairman of the meeting, the directors present shall elect one of their number to be chairman of the meeting.

Regulation 47. If at any meeting, no director is willing to act as chairman or if no director is present within fifteen minutes after the time appointed for holding the meeting, the members present shall choose one of their number to be the chairman of the meeting.

Election of chairman. If the articles of association of a company do not contain any provision for the appointment of a chairman such appointment shall be made in accordance with the provisions of section 104.

In this regard section 104 lays down.

(i) Members personally present shall elect one of themselves to be the chairman.
(ii) Election of chairman shall be made by voting on a show of hands.
(iii) If a poll is demanded on the election of a chairman, it shall be taken forthwith.
(iv) If some other person is elected chairman as a result of the poll, he shall be chairman for the rest of the meeting.

POWERS OF THE CHAIRMAN

A chairman is necessary for conducting a meeting properly. In order to enable the chairman to fulfil his duties properly, he is given the following powers :

1. To preside over the meeting. The chairman presides over the meetings of the company.

2. Power to decide priority of speakers. The chairman has to decide priority of speakers *i.e. who should speak first and who should follow and in what order.*

3. Power of stop discussion. The chairman of the meeting has the power to stop discussion on a matter after it has been reasonably debated. In fact, the chairman must not misuse this power as to prevent fair discussion. Even the majority present can vote to compel him to stop discussion but he must ensure that the minority is not stifled (suppressed or prevented) or oppressed in any way.

4. Power to put motions to vote. Chairman has the power to put motions and amendments thereto to the vote, by show of hands first and if properly demanded by poll.

Subject to the provisions of the Act, the chairman of the meetings shall have power to regulate the manner in which a poll be taken. [Section 109].

5. Right to use Casting Vote. The chairman, if the articles provide for it in the case of equality of votes may have a casting vote (second vote). If the articles do not make any such provision, the chairman does not have a second or casting vote. But a casting vote has to be given and cannot be assumed. Chairman has discretion to vote or not to use the casting vote and in case he decides to use the casting vote, it can be different from his first vote.

The Regulation 68(11) of Table F provides that in case of an equality of votes the chairman shall be entitled to a second on Casting Vote.

6. Power to expel disorderly persons. The chairman has the power to maintain order and decorum at a meeting *i.e.* to prevent the use of abusive language and disorderly behaviour of members. In fact, he has a power to cause the removal of disorderly persons who are preventing the transactions of the business and who refuse to leave when requested to do so i.e. to expel unruly member.

7. To give ruling on point of order. Whenever members raise point of order *i.e.* questions relating to rules and regulations, governing the meeting, the chairman has the power to give a ruling on the interpretations of the rules and his ruling will be binding on the members.

8. Power to declare results of the voting. The chairman has a power to decide whether a proxy is good or bad.

- The chairman decision disallowing of votes is conclusive.
- The chairman has power to give ruling on matters of disputes.
- The chairman has power to announce the decision of the meeting which shall be considered to be conclusive (Section 107)

9. Power to get Chairman's Speech Published. The chairman has a power to prepare his speech and get it published in the news papers. But, the publication of chairman's speech in the newspapers is not mandatory.

10. To adjourn a meeting. The chairman can adjourn the meeting under the following circumstances.

(i) When the quorum is not present within half an hour from the time fixed for the meeting.
(ii) If in the opinion of the chairman, it is necessary to do so in order to enable any question to be properly considered.
(iii) If the meeting becomes disorderly *i.e.* violent interruption making it unsafe or seriously difficult for the voters to tender their votes. In other words, when it becomes impossible to conduct and complete the business.
(iv) If the members present adopts a motion of adjournment.

It may be noted, that in case of statutory meeting, the chairman does not have the power to adjourn the meeting it should be decided by the majority vote.

Moreover, the chairman cannot arbitrarily adjourn the meeting or dispose it at his own choice without the consent of the shareholders and if he does so, the meeting can appoint another chairman and continue without him and conduct the business unfinished by the former chairman.

DUTIES OF THE CHAIRMAN

The chairman is responsible for conducting the proceedings of the meeting in a regular and proper manner.

His duties are enumerated hereunder :

1. To see that meeting has been duly convened and is properly constituted. He should see that the meeting is properly convened in accordance with the rules and properly constituted—***i.e.***

(i) *that proper notice was given;*

(ii) that there is a quorum of members present; and

(iii) that his own appointment is regular and in order.

2. To see that Items of business are taken as per agenda. Chairman should see that the items of business are taken in the order set out in the agenda, unless that order is altered with the consent of the meeting.

3. Duty to give reasonable opportunities to speak. Chairman should take care that the due and sufficient opportunity is given to those who wish to speak (and particulars the minority) to express their views on the subject under debate or discussion. Where several people are desirous of speaking, the chairman may take down their names in the order in which they call his attention, and then allow them to speak one by one. He should fix time limit for speakers.

4. To maintain decorum at the meeting. It is the duty of the chairman to maintain proper decorum at the meeting *i.e. to prevent abusive language and disorderly behaviour of members. Preservation of order in the meeting is his foremost duty. Order means maintenance of peace and harmony at the meeting, and it requires a plain good behaviour from those present.*

5. Duty to properly ascertain sense of the meeting. It is the duty of the chairman to see that the sense of the meeting is properly ascertained on each and every motion.

It is the duty of the chairman to give ruling over point of order and all other emergent questions.

Chairman should put all motions and amendment to vote in the manner provided in the rules, supervise the counting of votes to ensure correct assessment of the opinion and declare the result of voting.

6. Duty to exercise casting vote. In the case of equality of votes, it is the duty of the chairman to exercise casting vote, if allowed by the articles.

7. Duty to observe strict impartiality. It is the duty of the chairman to observe strict impartiality even though he may be strongly opposed to any matter.

8. Duty regarding minutes. The minutes of the previous meeting should be properly entered, confirmed and duly signed by the chairman. Hence, he will sign them if no objection is raised by the members as to their correctness.

(3) PRESENCE OF DIRECTORS AND AUDITORS

SS-2, In this regard provides as follows :-

Directors

If any Director is unable to attend the Meeting, the Chairman shall explain such absence at the Meeting.

The Chairman of the Audit Committee, Nomination and Remuneration Committee and the Stakeholders Relationship Committee, or any other Member of any such Committee authorised by the Chairman of the Committee to attend on his behalf, shall attend the General Meeting.

Auditors

The Auditors, unless exempted by the company, shall, either by themselves or through their authorised representative, attend the General Meeting of the company and shall have the right to be heard at such Meetings on that part of the business which concerns them as Auditors.

The authorised representative who attends the General Meeting of the company shall also be qualified to be an Auditor.

Secretarial Auditor

The Secretarial Auditor, unless exempted by the company shall, either by himself or through his authorized representative, attend the Annual General Meeting and shall have the right to be heard at such Meeting on that part of the business which concerns him as Secretarial Auditor.

The Chairman may invite the Secretarial Auditor or his authorised representative to attend any other General Meeting, if he considers it necessary.

The authorised representative who attends the General Meeting of the company shall also be qualified to be a Secretarial Auditor.

MEETING TO BE PROPERLY CONDUCTED

Proper conduct of the meeting means that proper rules for ascertaining the sense of the meeting, the rules for discussion and order in debate must be observed. Also, the proceedings should be recorded properly.

(1) ASCERTAINING THE SENSE OF THE GENERAL MEETING

Unanimity on all matters before a meeting is always not obtained. In the absence of unanimity, the chairman may want to know the wishes of the persons present in the meeting. This is known as ascertaining the sense of the house and for this purpose, he has to put the matter before the members. There are various methods which can be adopted by the chairman to put the matter to vote in order to ascertain the wishes of the members.

They are as follows :

(i) By acclamation : When persons present in a meeting indicate their approval or disapproval of the motion by clapping of hands, cheering or applause, it is known as voting by acclamation. This method is adopted where there is an almost unaminous approval or disapproval. For example, the motion of thanks of the chair is generally adopted by this manner. But, this method should not be adopted if there is a sharp difference of opinion among the members on the issue before them.

(ii) By voice vote : In this case, the chairman puts the proposition before the meeting and persons who are in favour of the proposition say 'yes' and those who are against it say 'no'. The chairman hears both the voices of 'yes' and 'no' and gives his decision after ascertaining the numbers of 'yes' and 'no'. At this stage, a member who is dissatisfied with the chairman's decision on the basis of voice vote may demand a vote by show of hands.

(iii) By division : Under this method, the Chairman requests the members present in the meeting to divide themselves into two blocks – one in favour of the proposal and another against it. The chairman, with the help of the secretary, counts the number of persons in favour and against the proposal and gives his verdict based on majority principle.

(iv) By show of hands : Under this method, the chairman asks all those in favour of the resolution to raise their right hand and when that number is noted, asks all those against, to do likewise. The Chaiman then declares the result of the voting indicating whether the proposal has been carried or lost, by accepting the number which is larger.

(v) By ballot : Under this method, every person present records his vote on a ballot paper and deposits it in the ballot box provided for that purpose. The counting of ballots cast for and against the motion reveals the results. This method ensures secrecy in casting votes.

(vi) By poll : In company meeting, voting by poll is according to the number of shares held by a member. The voting by show of hands may not always reflect the opinion of members upon a value basis. Also, there may be a number of proxies who can vote only by poll and not by show of hands.

It is possible that some of the members present may keep quiet in the voting without expressing 'yes' or 'no' or they may not at all take part in the voting. Under that circumstance they will not be counted on either side.

2. RULES AS TO VOTING

(i) Rules of voting for Equity shareholders. Every member of a company limited by shares and holding any equity share capital therein shall have right to vote, in respect of such capital, on every resolution placed before the company. [Sec. 47(1)(a)]. His voting right on a poll shall be in proportion to his paid up equity capital of the company. [Sec. 47(1)(b)].

Right of an equity shareholder to vote cannot be prohibited on the ground that he has not held shares for any specified period before the meeting or any other ground (section 106).

(ii) Rule of voting for Preference shareholders. Preference shareholders can vote only on the resolutions directly affecting them. [Sec. 47(2)]. Any resolution for winding up the company or for the repayment or reduction of its share capital shall be deemed directly to affect the rights attached to preference shares. But the right of preference shareholders are not 'affected' by the issue of additional ordinary shares, though their voting rights are thereby weakened.[1] But where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

Voting rights of a preference shareholder shall, on a poll, shall be in proportion to his share in the paid-up preference share capital of the company.

(iii) Holder of share warrants. The bearer of a share warrant can vote only if the articles of association of the company provides for it.

(iv) Joint holders. In the case of joint shareholders, the vote of the senior joint holder, whether in person or by proxy, shall be accepted to the exclusion of the votes of other joint holders. For this purpose seniority shall be determined by the order in which the name stands in the register of members.

(v) Insolvent. An insolvent shareholder is entitled to exercise the right to vote provided his name appears on the register of members. The right to vote is given to the person whose name appears in the register of members. However, official receiver should have his name first entered in the register of members and, only then he becomes eligible to vote. Same is needed for the executor of a deceased member.

1. White v. Bristol Acroplane Co. Ltd. (1953) 1 All E.R. 40.

(vi) Representation of corporations in meetings. A body corporate can be a member or creditor of another company. It may authorise a person not necessarily an employee to attend and vote at any meeting of the company. The representative thus appointed is a member personally present for the purposes of quorum and voting by the show of hands and is not merely in the position of a party. A representative can appoint a proxy to attend and vote at the meeting instead of himself. [Section 113].

(vii) Representation of the President and Governor. Where the President of India or the Governor of the State is a member of a company, he may appoint such person as he thinks fit to act as the representative to attend and vote at any meeting of the company. Such a representative shall be deemed to be a member of such a company and shall be entitled to exercise the rights and powers (including the right to vote by proxy) as the President or Governor could exercise as a member of the company. [Section 112]

(viii) Proxy. A proxy is entitled to vote only on a poll and not on a vote by show of hands. [Sec. 105]

(ix) Voting in the First Instance to be by Show of Hands [Sec 107]

At a general meeting, a resolution shall be decided on a show of hands, unless a poll is demanded under Section 109.

But where a poll is demanded, it is not necessary that the resolution should be put to vote by show of hands. On a show of hands each member has one vote and a proxy cannot vote unless the articles otherwise provide.

Chairman's declaration of result to be conclusive. The declaration by the chairman that a resolution on a show of hands has or has not been carried and an entry to that effect in the minutes book shall be conclusive evidence of that fact. [Section 107]. It is not necessary for the chairman to record the evidence of votes cast in favour or against the resolution.

(x) Voting by poll. A vote by a show of hands is only a rough and ready method of taking the sense of a meeting. It is not an accurate method of ascertaining the wishes of the members of a company because the votes of those voting by proxy are not counted. Again it does not pay due regard to the wishes of a member holding a large number of shares since he has only one vote on a show of hands. A poll is more proper and effective means of arriving at the wishes of the members.

Demand for poll (Section 109)

(a) Suo motu by chairman. A poll may be ordered by the chairman on his own motion.

(b) Obligatory to order poll

The chairman is bound to order a poll if demand is made by the following persons :

In case of a company having a share capital	In case of any other company
Any member or members present in person or by proxy holding.	Any member or members present in persons or by proxy and having not less than 1/10 of the total voting power in respect of the resolution
(i) 1/10th of the voting power; or	
(ii) Paid up share capital of ₹ 5 lacs or more	

(xi) Time for Demanding the Poll

A poll may be demanded before or on the declaration of the result of the voting on any resolution

on a show of hands. Such a poll cannot be demanded after the declaration of result and after chairman has taken up any other item from the agenda for consideration of the meeting. When a poll is demanded and ordered to be taken the show of hands goes for nothing. It can be validly demanded even without going through the formality on a show of hands.

Withdrawal of Demand for a Poll

The demand for poll may be withdrawn at any time by the person or persons who made the demand. [Section 109(2)]. And such withdrawal must be before the result of the poll is declared.

Time of Taking Poll [Sec. 109(4)]

If a poll is demanded

(i) on Adjourment—The poll shall be taken forthwith

(ii) on Election of chairman—The poll shall be taken forthwith

(iii) Any other questions—The poll shall be taken at such time, not being later than 48 hours from the time when the demand was made. Even though a time limit of 48 hours is provided, a poll can be taken immediately.

Procedure for a Poll

The chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken. [Sec. 109 (5)].

Each resolution on which a poll is demanded should be put to vote separately.

Securitneers at Poll

The chairman of the company shall appoint two scrutineers to scrutinise the votes given on the poll and to report thereon to him. A scrutineer may be removed at any time by the chairman before the result of the poll is declared. The chairman in such case will fill the vacancy in the office of the scrutineer.

He is also empowered to fill the vacancy in the office of scrutineer arising from any other cause.

One of the scrutineers shall always be a member (not being an officer or employee of the company) present at the meeting provided that such a member is available and willing to be appointed.

E-VOTING

[As per Rule 20 of the Companies (Management and Administration) Rule, 2014]

Voting through electronic means;

(1) Every listed company or a company having not less than one thousand shareholders, shall provide to its members facility to exercise their right to vote at general meetings by electronic means.

(2) A member may exercise his right to vote at any general meeting by electronic means and company may pass any resolution by electronic voting system in accordance with the provisions of this rule.

(i) the expression **'voting by electronic means"** or **"electronic voting system"** means a 'secured system' based process of display of electronic ballot, recording of votes of the

members and the number of votes polled in favour or against, such that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralized server with adequate 'cyber security';

(ii) the expression **"secured system"** means computer hardware software, and procedure that –

(a) are reasonably secure from unauthorized access and misuse;

(b) provide a reasonable level of reliability and correct operation;

(c) are reasonably suited to performing the intended functions; and

(d) adhere to generally accepted security procedures.

(iii) the expression **"Cyber security"** means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorized access, use disclosures, disruption, modification or destruction.

PROCEDURE

A company which opts to provide the facility to its members to exercise their votes at any general meeting by electronic voting system shall follow the following procedure, namely :-

(i) **the notices of the meeting** shall be sent to all the members, auditors of the company, or directors either-

(a) by registered post or speed post ; or

(b) through electronic means like registered e-mail id;

(c) through courier service;

(ii) the notice shall also be **placed on the website** of the company, if any, and of the agency forth with after it is sent to the members;

(iii) the notice of the meeting shall clearly mention **that the business may be transacted** through electronic voting system and the company is providing facility for voting by electronic means;

(iv) the **notice shall clearly indicate the process and manner** for voting by electronic means and the time schedule including the time period during which the votes may be cast and shall also provide the login ID and create a facility for generating password and for keeping security and casting of vote in a secure manner;

(v) the company shall cause **an advertisement to be published**, not less than five days before the date of beginning of the voting period, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district.

The following matters shall be specified :-

(a) statement that the business may be transacted by electronic voting:

(b) the date of completion of sending of notices;

(c) the date and time of commencement of voting through electronic means;

(d) the date and time of end of voting through electronic means;

(e) the statement that voting shall not be allowed beyond the said date and time;

(f) website address of the company and agency, if any, where notice of the meeting is displayed; and

(g) contact details of the person responsible to address the grievances connected with the electronic voting;

(vi) the e-voting shall remain open for not less than one day and not more than three days:

Provided that in all such cases, such voting period shall be completed three days prior to the date of the general meeting;

(vii) during the e-voting period shareholders of the company, holding shares either in physical form or in dematerialized form, as on the record date, may cast their vote electronically :

Provided that once the vote on a resolution is cast by the shareholder he shall not be allowed to change it subsequently;

(viii) at the end of the voting period, the portal where votes are cast shall forthwith be blocked;

(ix) the Board of directors shall appoint one scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an advocate, but not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinize the e-voting process in a fair and transparent manners :

(x) the scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority ;

(xi) the scrutinizer shall, within a period of not exceeding three working days from the date of conclusion of e-voting period, unblock the votes in the presence of at least two witnesses not in the employment of the company and make a scrutinizer's report of the votes cast in favour or against, if any, forthwith to the Chairman;

(xii) the scrutinizer shall maintain a register either manually or electronically to record the assent or dissent, received, mentioning the particulars of name, address, folio number or client ID of the shareholders, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights;

(xiii) the register and all other papers relating to electronic voting shall remain in the safe custody of the scrutinizer until the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the register and other related papers to the company;

(xiv) the results declared along with the scrutinizer's report shall be placed on the website of the company and on the website of the agency within two days of passing of the resolution at the relevant general meeting of members;

(xv) subject to receipt of sufficient votes, the resolution shall be deemed to be passed on the date of the relevant general meeting of members.

Resolution Passed at the Adjourned Meeting (Sec. 116)

A resolution passed at adjourned general meeting shall be treated to have been passed on the date on which it was in fact passed and not on an early date (Section 116)

The result of poll shall be deemed to be a decision of the meeting on the resolutions on which the poll was taken. [Section 109].

(xii) Grounds Restricting the Voting Rights [Sec. 106]

In case of Public Company, voting right of a member can be restricted only on the following grounds :

(i) Non payment of calls on shares

(ii) Non payment of other sums due against a member

(iii) Where the company has, and has exercises, any right of lien on shares.

[Note. This restriction was only applicable to public company u/s 182 of 1956 Act, but under 13 Act this restriction shall apply to both public and private companies)

However in case of Private Company, voting rights can be restricted on any grounds contained in e Articles.

On a poll taken at meeting of a company, a member entitled to more than one vote, or his proxy r other person entitled to vote for him, as the case may be, need not use all his votes in the same ay.

(xiii) Effect of pledge or attachment : Voting rights of a member are not affected by the fact hat his shares have been attached or pledged or a receiver has been appointed.

(xiv) *Participation by shareholders in general meeting by electronic mode/video conferencing -* ection 108 provides that the Central Government may prescribe the class or classes of companies nd manner in which a member may exercise his right to vote by the electronic means. Rule 20 of the Companies (Management and Administration) Rules, 2014, as amended by the Companies Management and Administration) Rules, 2015, in this regard, provides as follows :

Companies having its equity shares listed on a recognized stock exchange or a company having ot less than one thousand members, shall provide to its members facility to exercise their right to ote on resolutions proposed to be considered at general meetings by electronic means.

The aforesaid rule shall, however, be not applicable to : (*i*) small and medium enterprises, namely, companies whose post issue face value capital is up to ₹ 25 crores and whose shares are listed on SME Exchange. (*ii*) Companies listed on the Institutional Trading Platform.

(3) RESOLUTIONS

Decisions of the company are made by resolutions of its members, passed at meetings of members. The word 'resolution' has not been defined in the Companies Act. It may be defined as the formal decision of a meeting on any motion before it. A proposal when passed and accepted by the members becomes resolution.

Three kinds of resolutions are recognised by the Companies Act.

1. Ordinary resolutions [Sec. 114(1)].
2. Special resolutions [Sec. 114(2)].
3. Resolutions requiring a special notice. [Sec. 115].
4. Resolution by postal ballot (Section 110 A).

The Companies Act and the articles of association of a company lay down the type of the resolution required of any particular matter. As a rule, all 'ordinary business' as per the Act can be done by an ordinary resolution; all 'special business' can be done by any type of resolution ordinary and special.

NOTE. Under 2013 Act, votes casted electronically shall be counted determining whether ordinary or special resolution has be passed. No such provision existed in 1956 Act.

However, under certain special conditions, as per the Act, special notice of 14 days to the company is essential for matters to be passed either by ordinary or by special resolution.

1. Ordinary resolution. [Sec. 114(1)]. An ordinary resolution is one which is passed at a general meeting by a simple majority of members entitled to vote therein. Simple majority means that the votes cast either by show of hands or electronically or on a poll in favour of a particular proposal including the casting vote of the chairman exceeds the votes cast against it. Thus, voting for and voting against must both be counted and the neutral votes are to be ignored. The votes may be cast by the members either in person or by proxy, if allowed. An ordinary resolution is sufficient to effect any transaction which is within the powers of the company and is not required either by the articles or the Companies Act to be effected in some other manner. All resolutions which are not special or which do not require special notice are ordinary resolutions.

Ordinary resolutions normally do not require filling with the Registrar of companies. The usual notice of 21 days is however, required for passing an ordinary resolution.

The important items of business of a company which can be transacted with ordinary resolutions are :

(1) Approval of stautory report.
(2) Adoption of directors' report, balance sheet, profit and loss account and auditors' report on the accounts.
(3) Election of directors.
(4) Declaration of dividend.
(5) Appointment of auditors and fixing their remuneration.
(6) Appointment of sole selling agents.
(7) Removal of a director before the expiry of his tenure. It also requires special notice of 14 days to the company.
(8) Appointment of another director in place of the one removed.
(9) Alterations of share capital such as increase, sub-division, consolidation, etc.
(10) Issue of shares at a discount.
(11) Sale of the whole or part of the company's undertaking or business.

2. Special resolution. [Sec. 114(2)]. A resolution shall be a special resolution when.

(i) the intention to propose the resolution as a special resolution has been duly specified in the notice;

(ii) the notice required under the Act (21 days) has been duly given ; and

(iii) the votes cast in favour of the resolution by members entitled to vote either in person or by proxy are not less than three times the number of votes if any, cast against the resolution. The votes may be cast either on a show of hands or by poll. There is no question of a casting vote in case of a special resolution.

An explanatory statement setting out all material facts concerning the subject matter of the special resolution including in particular, the nature of the concern or interest, if any, therein of every director and manager, if any, shall be annexed to the notice of the meeting.

A copy of every special resolution together with the copy of the explanatory statement shall, within thirty days of the passing of the resolution be filed with the registrar who shall record the same.

A special resolution is a most useful part of the the mechanism of a company. It is by and through the instrument of a special resolution that the companies carry out important executive or

administrative acts which are, or may be necessary for the company's benefit. The aim of passing a special resolution is to ensure that every important change shall be made only after due deliberation and with the sanction of the greater body of shareholders of the company.

The articles of association may provide that certain types of business shall be approved by a special resolution. The Act also provides that in certain specified cases, a company must pass a special resolution.

A special resolution is required for the following purposes.

(1) To alter the provision of the memorandum for changing the place of registered office from one State to another or objects of the company. [Sec. 13].
(2) To change the name of the company. [Sec. 13].
(3) To alter the articles of the company. [Sec. 14].
(4) To offer further issue of subscribed capital when shares are offered to outsiders. [Sec. 62].
(5) To create reserve capital.
(6) To reduce the share capital of the company. [Sec. 66].
(7) To authorise payment of interest out of capital.
(8) To request the Central Government to appoint inspectors for investigation of the affairs of the company. [Sec. 213].
(9) To authorise payment of remuneration to directors who are not in the whole time employment of the company. [Sec. 197].
(10) To make the liability of directors unlimited.
(11) To have the company wound up by the NCLT or Tribunal [Sec. 271].
(12) To wind up the company voluntarily. [Sec. 304].

A copy of the special resolution must be plan with the regular within 30 days of passing it.

3. Resolutions requiring special notice. [Sec. 115]. In addition to the above two types of resolutions, there is another class of resolution provided under the Companies Act which require a special notice to be given in respect of them.

Special notice is required in the following cases :

(i) For the appointment of an auditor other than the retiring auditor. [Sec. 140].
(ii) For express resolution that the retiring auditor shall not be reappointed. [Sec. 140].
(iii) For removing a director before the expiry of his term. [Sec. 169].
(iv) For appointing another person as director in place of the director removed. [Sec. 169].
(v) Appointment as director of a person other than the retiring directors section 160.

The articles of a company may provide for additional matters in respect of which special notice is required.

Resolutions requiring special notice

where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of **members holding not less than one per cent of total voting power or holding shares on which such aggregate sum not exceeding five lakh rupees, as may be prescribed, has been paid-up.** The company, in turn, shall give its members notice of the resolution in such manner as may be prescribed.

Rule 23 of the Companies (Management and Administration) Rules, 2014, in this regard, provide as follows :

(i) the notice shall be **sent by members** to the company **not earlier than three months but at least fourteen days before the date of the meeting** at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

(ii) **The company shall** immediately after receipt of the notice, give its members **notice of the resolution at least seven days before the meeting,** exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.

(iii) Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company.

(iv) The notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

In the above cases, the notice of intention to move the resolution shall be given to the company not less than 14 days before the meeting. In computing 14 days the day on which the notice is served and the day of the meeting are excluded. The company must, immediately after receiving the notice, give its members notice of the proposed resolution in the same manner as it gives notice of any meeting. If that is not practicable, the company must give notice either by advertisement in a local newspaper or in any other mode allowed by the articles at least 7 days before the meeting.

A resolution requiring special notice is not actually an independent class of resolution. Such a resolution may be an ordinary or special resolution.

4. Passing of Resolution by Postal Ballot. It is generally noticed that members of a listed company are widely dispersed and there is very poor attendance at the general meetings. The meetings are normally attended by the promoters, their friends and associates who collect proxies and by and large resolutions are passed unanimously and without any dissent. Moreover the general meetings are required to be held during working hours and the shareholders find it difficult to attend the meeting. By Postal Ballot shareholder can take part in decision making of the company.

A listed company may if so desire may get any resolution passed by means of a postal ballot. Section 110 also empowers the central government to declare that certain business can only be conducted by postal ballot. In respect of such notified business it is mandatory for the company to pass the resolution only by postal ballot and shall not be placed for transacting before the general meeting of the company.

List of items that must be transacted through postal ballot

The following items of business shall be transacted only by means of voting through a postal :

(a) alternation of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum ;

(b) alteration of articles of association in relation to insertion or removal of provisions which, under section 2 (68) are required to be included in the articles of a company in order to constitute it a private company;

(c) change in place of registered office outside the local limits of any city, town or village as specified under section 12(5);

(d) change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised under section 13(8)

(e) issue of shares with differential rights as to voting or dividend or otherwise under section 43(a)(ii)

(f) variation in the rights attached to a class of shares or debentures or other securities as specified under section 48;

(g) buy-back of shares by a company under section 68(1);

(h) election of a director under section 151;

(i) sale of the whole or substantially the whole of an undertaking of a company as specified under section 180 (1)(a);

(j) giving loans or extending guarantee or providing security in excess of the limit specified under section 186(3).

Procedure to be followed

Where a company decides to pass any resolution by reporting to postal ballot, it shall follow the following procedure :

(1) It shall send a notice all the shareholders, along with a draft resolution explaining the reasons therefore, and requesting them to send their assent or dissent in writing on a postal ballot (postal ballot means voting by post or through electronic means) within a period of thirty days from the date of dispatch of the notice.

(2) The notice shall be sent either (a) by Registered Post or speed post, or (b) through electronic means like registered 'e-mail id', or (c) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.

(3) An advertisement containing the prescribed information shall be published in a leading English newspaper of the district and having wide circulation and in one principal vernacular newspaper circulating in the district and having wide circulation about having dispatched the ballot papers.

(4) The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

(5) The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.

(6) The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.

(7) If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot including voting by electronic means, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

NOTE. Postal Ballot was applicable only to listed companies under 1956 Act, but now as per 2013 Act postal ballot is applicable to all except (i) OPC (ii) Company having member upto 200.

(4) PROXIES [SECTION 105]

The word 'proxy' may mean any of the following two things.

(i) A person appointed to represent another and vote at the meeting on behalf of another, and

(ii) The instrument by which a person is appointed a proxy.

Appointment of Proxy and His Rights

Section 105 authorises every member to appoint another person as a 'proxy' to attend and vote instead of himself.

Unless Articles provide otherwise :

(1) a member of a company having no share capital can't appoint a proxy;

(2) the member of a private company can't appoint more than one proxy to attend on the same occasion.

But a member of a public company may appoint more than one proxy i.e. he may appoint one proxy in respect of certain shares held by him and a different proxy for other shares held by him. A private company can also provide in the articles that a proxy should be a member.

(3) a proxy cannot vote except on a poll.

Note. Under Companies Act, 2013 a person can act as proxy on behalf of members not exceeding 50 and holding in the aggregate not more than 10% of the total share capital. [There was no such restriction in previous companies Act of 1956]

Notice of the Meeting [Sec. 105(2)]

Every notice calling a meeting of the company having a share capital or the articles of which provide for voting by proxy at a meeting, must mention with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy and that a proxy need not be a member. Every officer of the company who is in default in complying with this provision is punishable with fine which may extend upto ₹ 5,000.

Requirements as to instrument of proxy

The instrument appointing a proxy must be in writing in the form prescribed and signed by the appointer or by his attorney duly authorised in writing. If the appointer is a corporate body, it must be under its seal or signed by an officer or attorney duly authorised.

In the case of joint members, all of them should sign, unless the articles otherwise provide.

The name signed in the proxy should not be different from the name appearing in the register of members. If it differs, the proxy may be rejected, unless authority for using such different signatures is produced with the proxy.

A proxy form shall be in the form as prescribed in rules made under section 105 [Regulation 57 Table F]. An instrument appointing a proxy, if in any of the forms set out in schedule, shall not be

questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles. Where it is not in any such forms, it may be questioned if it does not comply with the requirements of the articles of the company.

As per Rule 19 of Companies (Management and Administration) Rules, 2014 :

(1) The appointment of proxy shall be in the Form No. MGT. 11

(2) A person can act as proxy on behalf of members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying voting rights. However, a member holding more than ten percent, of the total share capital of company carrying voting rights may point a single person as proxy and such person shall not act as proxy for any other person or shareholder.

Proxy is liable to stamp duty. Stamp duty is at present 30 paise and an unstamped proxy will be ignored. A proxy cannot be used for more than one meeting.

Proxy must be deposited within 48 hours

The instrument appointing a proxy must be deposited with the company within 48 hours before the meeting. A company cannot legally require proxies to be deposited with it earlier than 48 hours before the time of the meeting. Any provision in the articles which requires the instrument appointing a proxy to be received by the company more than 48 hours before the meeting shall have effect as if a period of 48 hours had been specified in such provision. There is, however, nothing in the Act to prevent the lodging of such instrument less than 48 hours before the meeting *e.g., it may require proxies to be deposited at least 40 hours before the time of holding the meeting. Subject to this the instrument must be deposited within the time specified by the articles.*

Canvassing by directors for proxies prohibited

Where a company issues invitations at its expense to members, giving names of persons to be appointed as proxies for the purpose of any meeting then every officer of the company who knowingly issued the invitation or permitted the same shall be liable to a fine which may extend to ₹ 10,000. [Sec. 105(5)]

An officer shall not be punishable by reason only of the issue of invitation to a member at his request in writing of a form of appointment naming the proxy or of a list of persons willing to act as proxies, if the form or the list is available on request in writing to every member entitled to vote at the meeting by proxy.

RIGHTS OF PROXY

(i) A proxy can demand a poll u/s 109.

(ii) A proxy can vote only on a poll.

(iii) A proxy can use his votes differently

DISABILITIES OF PROXY

(i) The proxy has no right to speak at a meeting. [Sec. 105]. Hence, he cannot take part in any discussion. There is, however, no provision preventing a proxy putting questions in writing and sending the same to the chairman for answer.

(ii) A proxy is not counted for the purpose of quorum.

A motion or proposed resolution put to the meeting is open to discussion and after the discussion is closed, the chairman puts the proposed resolution to vote. After counting the number for and against, he declares the result.

In a nutshell, 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.

But a proxy has no right of inspection either of proxy forms or the minutes of the general meeting.[1]

REVOCATION OF PROXY

The relationship between a shareholder and his proxy is that of principal and agent.

A proxy is always revocable. A proxy can be revoked at any time before the proxy has voted. A latter proxy revokes one of earlier date. If there are two or more proxies given by the same shareholder in respect of the same shares, the proxy bearing the latest date will supersede the earlier one. If the proxies bear no date or bear the same date, both the proxies would be ineffective. Death of a member revokes the proxy but if the company has no notice of such death, then the vote given by the proxy will be valid. Where a shareholder who having given a proxy personally attends and votes at the meeting, the proxy is revoked thereby. "It would be strange if a person in the position of an agent could say to his principal, you have entrusted to me a power which I will not allow to pass back to you although you demand the right to exercise it."[2] The revocation must however, conform to any provisions in the articles. The articles may provide that a vote given by a proxy should be valid notwithstanding the revocation by the appointer unless the notice of revocation was received at the office of company before the meeting. Accordingly, where a revocation was communicated before the poll but not before the meeting, it was held to be ineffective and the proxy's vote stood.[3] Where however, there is no provision in the articles, the power of revocation would be unfettered.

Example : A proxy had exercised his vote in the first poll of a meeting but the proxy was revoked before the final poll was held. In the absence of any provision in the articles, the revocation was held to be effective. **[Narayana Chettiar v. Kaleshwar Mills AIR. 1952 Madras 515].**

Under the Indian Contract Act, 1872, agency coupled with interest cannot be revoked. On the same principle, if a proxy is a candidate for election to the office of a director of the company proxy is coupled with interest and, hence, irrevocable.

Inspection of Proxies

Every member entitled to vote at the meeting is authorised to inspect the proxies during the 24 hours preceding the meeting till the conclusion of the meeting. For such inspection the member must give at least three days notice in writing to the company. Such inspection cannot be taken by a proxy.

A Body Corporate can Appoint a Proxy

A body corporate can be a member or creditor of another company. It may authorise a person,

1. Amoi Cowasji v. Person A. 1926 Sind 295.
2. Cousins v. International Brick Co. Ltd. (1931) 2 Ch. 90.
3. Spiller v. Mayo Development Co. (1926) W.N. 87.

nor necessarily an employee, to attend and vote at any meeting of the company. The representative thus appointed is a member personally present for the purposes of quorum and voting by the show of hands and is not merely in the position of a proxy. A representative can appoint a proxy to attend and vote at the meeting instead of himself. [Sec. 113].

Rule 19 of the Company (Management and Administration) Rules 2014

(1) The appointment of proxy shall be in form No. MGT – 14.

(2) In case of company registered under Section 8, the members of such company shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

(3) Proxy can be appointed as follows : -

(i) On behalf of members not exceeding 50 and holding in aggregate not more than 10% of total share capital of company carrying voting right → One person can act as proxy.

(ii) On behalf of members holding more than 10% of total share capital of company carrying voting right → A single person acts as proxy and such person shall not act as proxy of such other person or shareholder.

(5) Motion

Motion - The term 'motion' indicates a proposal made at a meeting by any member. Such a motion may be passed without any change or modification. But, if some-members feel that the motion in the form proposed needs some change or modification, they may move an amendment. **A motion when passed, with or without amendment, is called a resolution.**

A motion should always be in writing and before it is brought before the meeting, the necessary notice, if any required, must be given. A person proposing a motion is called the mover and the motion should be signed by him.

Amendment - An 'amendment' is a proposed alteration or modification in the terms or wording of the motion which is yet to be considered by the meeting. An amendment to a motion may –

(i) add some new words to the motion, or

(ii) replace some words of the motion by some other words, or

(iii) drop some words from the motion, or

(iv) change the place or position of words or certain phrases in the motion.

Formal motion : A 'formal motion' is a motion relating to the procedure at a meeting and is moved for the purpose of interrupting or delaying or speeding up the discussion on a motion. Formal motions are also known as procedural or 'dilatory' motions. A 'formal motion' takes precedence over all other motions. A 'formal motion' need not be in writing, nor does it require any previous notice. The principal types of formal motions are :

(i) The closure motion - This motion is moved in order to close a prolonged and useless discussion on a motion. Any member may move closure motion by moving that the question be now 'put' (*i.e.*, put to vote). After it is seconded, it is put to vote. If the motion is carried, discussion on the main motion immediately stops. If the closure motion is lost, discussion on the main motion is resumed.

(ii) Previous question - The object of moving this motion is to prevent a vote being taken on the main motion under discussion. Any member who has not already spoken on the main motion may move this motion. This motion can be moved with regard to a main motion only and has to be properly seconded. The formal motion is then put to vote and, if it is carried, discussion on the main

motion automatically ceases and it cannot be taken up against at the same meeting. If the motion is lost, the main motion is immediately put to vote without any further discussion.

The chairman may not permit the moving of such a motion if he thinks that it is being used improperly.

(iii) Next business - This motion is moved in order to shelve discussion on the main motion before the meeting. Any member may move 'that the meeting do proceed to the next business'. After it is seconded, it is put to vote and if it is carried, the main motion under discussion is dropped at once. If it is lost, discussion on the motion is resumed.

(iv) Adjournment - The object of moving this motion is to suspend either entirely or partially the proceedings of the meeting either for a particular period or indefinitely (*i.e., sine die*). This motion may also be used to postpone discussion on a motion. Any member may rise and move that the meeting be now adjourned. After seconding, the motion is put to vote. If the motion is carried, the proceedings of the meeting cease forthwith. The date, time and place at which adjourned meeting will be resumed are generally fixed at the same meeting unless it is adjourned *sine dies*.

Point of order - A point of order deals with the conduct or procedure of the meeting. There are four bases upon which points of order can be called :

(a) Incorrect procedure - It implies that some member is contravening the rules of the meeting, e.g., speaking far longer than the time allowed, proposing an amendment incorrectly, speaking out of turn, and so on.

(b) Irrelevance - When the speaker is speaking outside the scope of the notice then it is known as irrelevancy.

(c) Unparliamentary language - It is bad language, such as personal abuse. Also, it implies something derogatory to the association, place or person.

(d) Transgressing the rules of the organization - The procedure laid down in the standing orders of the organization should be followed. If that is not followed, a point of order can be raised.

As soon as a point of order is raised, debatd on the main motion will stop. The chairman has to give his ruling or decision on a point of order at once. His ruling on any matter of procedure is final. If he rules out the point of order, debate on the motion will be resumed.

(6) MINUTES OF THE MEETING [SECTION 118]

The term 'minutes' mean the official record of the meetings of a company. These are a summary of the business transacted, decisions and the resolutions arrived at the meeting.

Minutes are like a precis, not a narrative : Obligation to maintain minutes.

Every company is required to keep minutes of the proceedings of :

(a) every general meeting;

(b) every meeting of Board of directors; and

(c) every meeting of committee of the Board of directors.

(d) every resolution passed by postal ballot.

For this purpose, every company is required to make entries of the proceedings of its meetings in books kept for that purpose within 30 days of the conclusion thereof. The pages of every minute book must be consecutively numbered.

2. Signing of minutes. Each page of every minutes a proceeding shall be initialled or signed and the last page of the record of proceedings of each meeting in such book shall be dated and signed.

Signing by Whom

(a) In the case of minutes the proceedings of a meeting of the Board or of a Committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting.

(b) In the case of minutes of proceedings of a general meeting, by the chairman of the same meeting or in the event of the death or inability of the chairman by a director duly authorised by the Board for the purpose.

3. Minutes not to be attached by pasting or otherwise. Minutes of the proceedings of a meeting shall not be attached to any such book by pasting or otherwise.

It means that the minutes have to be written by hand

4. Loose leaf minutes. A company may keep its minutes of meetings in loose leaf binders provided the following conditions are satisfied.

(1) The pages containing minutes are duly typed and serially numbered.

(2) Each page is initialled or signed and the last page is dated and signed by the chairman.

(3) The loose leaves are bound at a reasonable interval not exceeding 6 months.

(4) The loose leaves are kept in safe custody under lock and key.

(5) Contents of minutes. The minuts of each meeting shall :

(i) contain a fair and correct summary of the proceedings thereat, and

(ii) include all appointments of officers made thereat.

In addition to it, in case of a meeting of the Board of directors or its committee the minutes shall also contain :

(a) the names of the directors present at the meeting; and

(b) in case of each resolution passed at the meeting, the names of the directors dissenting from, or not concurring in, the resolution, if any. (Sec. 118(2), (3) and (4))

Defamatory and detrimental matters to be excluded at the discretion of chairman. The minutes must not contain any matter which, in the opinion of the chairman of the meeting :

(a) is or could reasonably be regarded as defamatory of any person;

(b) is irrelevant or immaterial to the proceeding; or

(c) is detrimental t the interests of the company.

The discretion in regard to such inclusion or non-inclusion of any matter in the minutes lies with chairman. [Sec. 118(6)]

Penalty. If default is made in complying with the foregoing provisions, the company shall be liable to a penalty of ₹ 25,000 which may extend to ₹ 1,00,000 and every officer in default to a penalty of ₹ 5,000.

Minutes to be evidence. Minutes of the meetings kept in accordance with the provisions of Section 118 shall be evidence of the proceedings, recorded therein. If something is not recorded in the minutes that can be proved by proper evidence.

Presumption to be drawn where minutes duly drawn and signed. Until the contrary is proved, every general meeting of the company or meeting of the directors or a committee of directors in respect of the proceeding whereof, minutes have been so made and signed, shall be

(1) deemed to have been duly called and held

(2) the proceedings at these meetings shall be deemed to have duly taken place, and

(3) all appointments of directors or liquidators made at the meeting shall be deemed to be valid. (Sec 118(8)]

Location and inspection of minutes book. The minutes books of the general meetings of a company must be kept at the registered office of the company and be open during business hours for the inspection of any member without charge for at lesat two hours a day. A member is entitled to be furnished within 7 days, after he has made a request in that behalf to the company, with a copy of any minutes, on payment of such sum as may be prescribed, for every one hundred words, or fractional part thereof, required to be copied. If inspection is refused or if any copy is not furnished within the specified time, the company and every other officer of the company who is in default shall be punishable with fine which may extend to ₹ 5,000 for each offence. Moreover, the Central Government may, by order, compel an immediate inspection of the books or direct that the copy required shall forthwith be sent to the person requiring it.

Publication of reports. No document purporting to be a report of the proceedings of a general meeting of a company, can be circulated or advertised at the expense of the company unless it includes the matters required by section 118, to be contained in the minutes of the proceedings of such meeting. Contravention is punishable with fine which may extend to ₹ 5,000.

SHORT ANSWER QUESTIONS

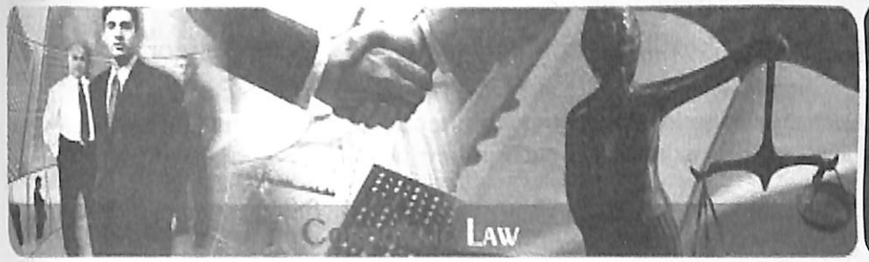
1. What are the requisites of a valid meeting ?
2. Who are the proper authorities to convene different kinds of company meetings?
3. What is a notice ? What are the requisites of a valid notice ?
4. What do you mean by 'clear days' in connection with the issue of a notice ?
5. What should be the length required for calling the general meeting of a company?
6. Who are the persons on whom notice of meeting is served ?
7. What is meant by quorum ?
8. What are the provisions relating to quorum for different kinds of company meetings ?
9. Should a quorum be present throughout the meeting ?
10. What is meant by an 'agenda' ?
11. What is the object of preparing an agenda ?
12. Is it obligatory to send an agenda with the notice of every meeting ?
13. What is loophole agendum ?
14. Who is the chairman of a meeting ?
15. How is the chairman of a meeting appointed ?
16. Why is a chairman necessary for a meeting of a company ?
17. What do ycu understand by proxy ?
18. What is a resolution ?
19. What are the different classes of resolutions which may be passed by a company?
20. What is a special resolution ?
21. What is a resolution requiring special notice ?
22. For what purposes is a special resolution required ?

TEST QUESTIONS

1. What are the various kinds of meetings that can be held by a company, and of the nature of business that can be transacted in each meeting ?
2. What are the requisites of a valid general meeting ?
3. Discuss the provisions of the Companies Act as to the length of the notice required for calling general meeting of the company. Under what circumstances will a general meeting be validly held when notice given is shorter than that normally required by the Act.
4. State the law relating to the contents of the notice and the persons on whom it must be served. What is the position of notice advertised in newspaper in the neighbourhood of the registered office of the company ?
5. What is a 'notice' of meeting ? Mention the requisites of a valid notice. What do you mean by clear days in connection with issue of notices ?
6. What is meant by quorum ? What are the statutory provisions relating to quorum for different kinds of company meetings ? Should a quorum be present throughout the meeting ?
7. What is a quorum and how is it determined at general meeting of a company? Are there any circumstances when one person may constitute meetings ?
8. Define quorum ? What is the quorum for Board and general meetings ? When the total strength of the board of directors fall below the number of directors fixed for quorum, what are the Boards powers in such a situation ? At a general meeting which was adjourned for want of quorum only one member was present, will the business transacted at such a meeting be valid ?
9. Distinguish between ordinary and special business.
10. Who is the chairman of a meeting ? How is the chairman of a general meeting of a company usually appointed ? Explain the powers and duties of the chairman.
11. Define the term 'minutes' and discuss the various provisions regarding the keeping of minutes.
12. Who is entitled to inspect the minutes books of general meetings and the Board meeting respectively ? Does the Act require minutes to be submitted to a meeting for confirmation before they are signed ? State the provisions of the Act as regard signing the minutes of general meetings and the Board meetings. What are the general rules relating to maintenance of minutes in loose leaf form ?
13. What is a poll ? How is it demanded ? Discuss the procedure for conducting poll when it has been granted by the chairman of a meeting ? Can the preference shareholders present at a meeting demand a poll ? Elaborate your answer.
14. The following persons attend the annual general meeting of a public company :
    (i) A member holding 1/10th of the paid-up equity capital of the company;
    (ii) A preference shareholder;
    (iii) A proxy holder;
    (iv) The public trustee;
    (v) Joint shareholders;
    (vi) Representative of company member.
    How are they counted for purposes of quorum and what are their voting rights ?
15. (a) Can a member use his vote differently ?
    (b) How does a company which is a member of another company exercise its vote at a meeting of the latter ?
    (c) What is passing of resolution by postal ballot.
16. Write short notes on :
    (i) Representation of corporations, Presendent of India and Governors of States in meetings of companies of which they are members.
    (ii) Exercise of voting rights in respect of shares held in trust.

17. What do you mean by proxy ? What are the statutory provisions regarding proxies ?
18. What are the different classes of resolutions which may be passed by a company? Give the instances of the business for which each class is required.
19. Distinguish between 'Ordinary Business' and 'Special Business' in a general meeting. What business can be conducted as "Ordinary Business" ? Can ordinary business be conducted in an extraordinary general meeting ? Can special business be conducted at an annual general meeting ? Elaborate your answer.
20. Mention the various resolutions and agreements which are required to be registered with the Registrar of companies.
21. Distinguish between a special resolution and a resolution requiring special notice. For what purposes is a special resolution required ?
22. What are the objects of holding the annual general meeting of a company ? Draft a notice calling such a meeting.
23. Give legal provisions relating to the annual general meeting of a company.
24. Draft a suitable notice and agenda for the annual general meeting of a company.
25. Draft a complete notice of an annual general meeting of a public company, setting out in serial order the ordinary business to be transacted at that meeting.
26. What is a Director's report ? Draft a short directors' report of ABC Co. Ltd. using imaginary figures and other details regarding the company.
27. What do you mean by extraordinary general meeting ? Who may call such a meeting ? Explain secretary's duties in connection with extraordinary general meeting.
28. Discuss the statutory provisions and procedure for holding the extraordinary general meeting
    (a) on requisition by the shareholders and (b) by the requisitionists themselves.
29. Draft a notice calling an extraordinary general meeting of a public company.
30. What is an explanatory statement ? When and why such a statement becomes necessary under the law ?
31. State the object of an extraordinary general meeting ? What are the duties of a company secretary with regard to the extraordinary meeting ?
32. What is meant by an agenda ? Draft a specimen agenda for the first Board meeting of a public company.
33. How is the agenda of a Board meeting prepared ? What are the usual items found in the agenda of a Board meeting ?
34. Describe the role of the company secretary of a public limited company in calling, and conducting a Board meeting.
35. Writes notes on the following :
    (a) Disinterested quorum, (b) Resolution by circulation,
    (c) Meetings of Committee of directors, (d) Director's attendance book
    (e) E-voting
36. Briefly explain the committees formed under the Companies Act, 2013.

□□□



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CSR AND CSR COMMITTEE

COMPARATIVE CHART (Some of the Major Changes)

CORPORATE SOCIAL RESPONSIBILITY	
Companies (Accounts) rules, 2014 (Rules under the 2013 Act)	**Rules under the 1956 Act**
Companies (CSR Policy) Rules, 2014 deals with CSR obligations of companies which are required to comply with section 135.	No corresponding provisions in the rules framed made under the 1956 Act.
Disclosures in Board's Report about CSR Policy. The disclosure of contents of Corporate Social Responsibility Policy in the Board's report and on the company's website, if any, shall be as per annexure attached to the Companies (Corporate Social Responsibility Policy) Rules, 2014. [Rule 9]	No requirements regarding CSR/CSR disclosures in the 1956 Act or the rules made thereunder.

Points of Comparison	Companies Act, 2013	Companies Act, 1956
	CORPORATE SOCIAL RESPONSIBILITY	
Corporate Social Responsibility (CSR)	In every financial year, CSR spends of at least 2% of the average net profits the company made during the 3 immediately preceding financial year is mandatory for every company satisfying any of the following criteria : • Having net worth of ₹ 500 crores or more, or • Having turnover of ₹ 1,000 crores or more, or • Having net profit of ₹ 5 crores or more **[Under Companies Corporate Social Responsibility) Rules, 2014]**	No provisions regarding this in the 1956 Act.

CORPORATE SOCIAL RESPONSIBILITY

(Added as a New Provision under the Companies Act, 2013)

[U/S 135 of 2013 Act read with companies (CSR Policy) Rules, 2014]

MEANING OF CORPORATE SOCIAL RESPONSIBILITY

Rule 2(c) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 defines the term "Corporate Social Responsibility (CSR)" which means and includes but is not limited to :

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

Projects or programs relating to activities undertaken by the board of directors of a Company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

Applicability

Under Section 135 of the Companies Act, 2013 **every company :**

- having **net worth of ₹ 500 crore** or more ; or
- having **turnover of ₹ 1000 crore** or more ; or
- having **net profit of ₹ 5 crore** or more

during any financial year shall constitute a CSR committee of the Board.

Meaning of "Net Profit"

Rule 2(f) of the CSR Rules, 2014 provides meaning of the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :

(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act :

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956 (1 of 1956) shall not be required to re-calculated in accordance with the provision of the Act :

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

CONSTITUTION OF CSR COMMITTEE

Rule 2(d) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 draws reference to the Corporate Social Responsibility Committee referred to in section 135, which **as per rule 5 of the Companies (CSR policy) Rules, 2014 the CSR** Committee shall be constituted in the following manner :

(i) an unlisted public company or a private company covered under section 135(1) which is not required to appoint an independent director pursuant to section 149(4) of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of a least two persons of which one person shall be specified under section 380(1)(d) of the Act and another person shall be nominated by the foreign company.

The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

The constitution of CSR committee shall be disclosed in the Directors' report. [Section 135(2)]

Functions of CSR Committee

Section 135(3) provides that the CSR committee shall :

(a) Formulate and recommend to the Board, a CSR policy, which will indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) Recommend the amount of expenditure to be incurred on the activities referred to in the CSR policy;

(c) Monitor CSR policy from time to time.

MEANING OF CSR POLICY

Rule 2(e) provides that "CSR Policy" relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

CSR Policy Under Rule 6 of the Companies (CSR Policy) Rules, 2014

Rule 6 provides that :

(1) The CSR Policy of the company shall, inter-alia, include the following namely :

(a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs :

Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities included by a company in its Corporate Social Responsibility Policy are related to the activities included in Schedule VII of the Act.

(2) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

CSR ACTIVITIES

Rules 4 of the CSR says that the CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise :

Provided that —

(i) if such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects;

(ii) the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

- A company may also collaborate with the companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committee of respective companies are in a position to report separately on such projects or programs in accordance with these rules.
- U/S 135 (5) the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.
- The CSR projects or programs of activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.
- Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.
- Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

List of CSR Activities

Schedule VII of the Companies Act, 2013 sets out the activities, which may be included by companies in their CSR policies.

These activities relate to :

(i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation and making available safe drinking water ;

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental substitutability, ecological balance, protection of flora and fauna, animal, welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veterans, war windows and their dependents;

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects.

Expenditure on CSR activities

Section 135(5) of the Companies Act, 2013 set forth the mandatory spending by the company in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years. For this purpose, the average net profit will be calculated in accordance with section 198.

The company will give preference to local area and areas around where it operates, for spending the amount earmarked for CSR activities.

If a company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount.

Rule 7 provides that CSR expenditure shall include all expenditure including contribution to corpus for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

CSR REPORTING :

[Under Rule 8 of the companies (CSR Policy) Rules, 2014]

(1) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.

(2) In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR.

Display of CSR Activities on its website (Rule 9)

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company's website, if any, as per the particulars specified in the Annexure.

Role of Board of Directors

Section 135(4) provides that the Board of Directors shall —

(a) after taking into account the recommendations made by the CSR Committee, approve the CSR Policy for the company and disclose contents of such Policy in the Directors' Report and also place it on the company's website, if any in the Form specified under Companies (CSR) Rules, 2014; and

(b) ensure that the activities as are included in CSR Policy of the company are undertaken by the company;

(c) ensure 2% spending on CSR activities;

(d) report CSR activities in Board' report and

(e) disclose non-compliance (if any) with the CSR provisions.

CSR Rules, 2014 provide the format in which all qualifying companies shall report the details of their CSR initiatives in the Director's report and in the company's website.

Responsibility of the Board of Directors

(a) To ensure that atleast 2% of average net profit of last 3 preceding years in spent on CSR activities every year, *'Net Profit'* shall mean, net profit *before tax* per books of accounts and shall not include profits arising from branches outside India.

(b) 2% CSR spending would be computed at 2% of the average net profits made by the company during every block of three years. For the purpose of First CSR reporting the Net Profit shall mean average of the annual net profit of the preceding three financial years ending on or before 31 March 2014.

(c) To approve the CSR Policy after considering recommendations of CSR Committee.

(d) To disclose CSR policy and initiatives in Board's report and Company's website.

(e) To ensure that activities reflected in CSR policy are actually undertaken by company.

(f) If the company does not spend 2% of net profits as required, then Board to report the reasons in the Board's report.

Compliance with regard to CSR

(1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules :

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

(2) Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to —

(a) constitute a CSR Committee; and

(b) comply with the provisions contained in sub-sections (2) to (5) of the said section, till such time it meets the criteria specified in sub-section (1) of section 135.

Consequences of not complying with the CSR provisions :

- As per section 450 the company and every officer of the company who is in default or such other person shall be punishable with maximum fine upto ₹ 10,000 and where the contravention is continuing one, with a further maximum fine upto ₹ 1,000 for every day after the first during which the contravention continues.

- Section 451 provides that if a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

Corporate Social Responsibility Voluntary Guidelines, 2009

The Ministry of Corporate Affairs has issued Corporate Social Responsibility Guidelines, 2009, which aim to enable business to focus as well as contribute towards the interests of the stakeholders and the society. The new CSR guidelines state that the CSR initiatives of Indian companies should become integral part of overall business policy and aligned with business goals. The guidelines set out six core elements for companies to address. **(For guidelines refer Ministry of Corporate Affairs website www.mca.gov.in).**

TEST QUESTIONS

1. Define CSR. Explain the list of CSR activities.
2. Explain in detail the role and responsibility of BOD's in context to CSR.
3. Highlight the importance of CSR from company's point of view.

SHORT ANSWER QUESTIONS

1. Write a short note on CSR.
2. What are CSR activities ?
3. What is CSR reporting ?

□□□

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