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Bachelor of Commerce

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COMPANY LAW

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MEANING, FEATURES AND TYPES OF COMPANIES

STRUCTURE

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1.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Understand the meaning of a company and its features.
- Get the insight of lifting the corporate veil.
- Know how companies are classified on various basis.

1.1 INTRODUCTION

Limitations of traditional forms of business organisations i.e. sole proprietor and partnership, led to the advent of company form of organisation. The traditional forms of organisations failed to meet the increasing requirements of capital and skills needed for large-scale business enterprises. The industrial revolution brought about revolutionary changes in the methods of production. The production was not confined to the local limits of a city, town or village but became international in character. This, in turn, resulted in an ever growing need for capital and managerial skills which was never experienced before. Another key factor which led to the rapid development of the company form of organisation was the reluctance on the part of the sole traders or partners in the partnership firms, to bear the brunt of unlimited liability.

The company form of organisation furnished the organisers with twin advantages of limited liability and huge capital resources, besides, free transferability of shares and a separate legal entity. The last two, combined with other characteristics of the company form of organisation, enabled greater mobilisation of capital resources and a longer life-perpetual existence of the company, irrespective of the life of the members of the company constituting it.

1.2 MEANING OF A COMPANY

According to Section 2 (20) of the Companies Act, 2013 "company" means a company incorporated under this Act or under any previous company law. A company incorporated under any previous company law means an existing company.

The definition given above fails to reveal what a company is or what its salient characteristics are. Chief Justice Marshall of U.S.A. has defined a company in the following words: "A corporation is an artificial being, invisible, intangible and existing only in the contemplation of law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental, to its very existence."

According to Prof. Haney, "A company is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal." This definition given by Prof. Haney very clearly reveals what a company is and what its essential characteristics are.

1.2.1 FEATURES OF A COMPANY

Following are the essential characteristics of a company:

1. Incorporated association. A company is an incorporated or registered association. It is created either by an Act of Legislature or by registration under the Companies Act. An unincorporated association cannot be called a company in the strict legal sense of the word. Only after a company is incorporated or registered, it becomes a separate entity.

2. Artificial legal person. A company is an artificial person as against a natural person. It is created by a process of law. It has no physical existence. It has no body and as such you cannot shake it down in a fit of anger. It has no soul, no conscience and hence, it is called an artificial person. At the same time, it enjoys certain rights and has some obligations like a natural person. It can transfer property, enter into contracts, sue or be sued and fined for violating the provisions of the Companies Act.

3. Separate entity. A company, after it is incorporated, acquires a separate entity or what is called a juristic personality, entirely distinct from the individual members constituting it. It has the right to own and transfer property. It can sue and be sued in its own name by its members as well as outsiders. Even if a shareholder owns virtually the whole of its capital, the company is a separate legal entity in the eyes of law, as distinguished from a shareholder.

This principle was enunciated in the famous case of Salomon v. Salomon & Co. Ltd. (1897) A. C. 22. One Salomon, a leather merchant, sold his business for £ 30,000 to Salomon & Co. Ltd. The Salomon & Co. consisted of Salomon himself, his wife, four sons and one daughter. The purchase consideration was paid by the company to Salomon by allotment of 20,000 fully paid shares of £ 1 each and £ 10,000 worth of debentures carrying a floating charge over all the assets belonging to the company. One share each was allotted to the other six members comprising his wife, four sons and one daughter. Salomon, thus, had an absolute control over the company. After a period of only one year, the company ran into financial difficulties and was ordered to be wound-up. The creditors of the company sought priority over the debenture holders on the ground that the company and Mr. Salomon were one and the same person. They further contended that the company was a mere ‘alias’ or an agent for Salomon. The business was, solely his, conducted solely for him and by him and the company was mere ‘sham’ and ‘fraud’. Hence, Salomon was liable to indemnify the company against its trading debts. The House of Lords, however, held that the existence of a company is quite independent and distinct from its members and that the company’s assets must be applied in payment of the debentures first in priority to unsecured creditors.

The following observations made by Lord Macnaghten in this connection are worth noting: “The company is at law a different person altogether from the subscribers ‘to the Memorandum’ and, though it may be that after incorporation the business is precisely the same as it was before, and ‘the same persons are managers, and the same hands receive the profits, the company ‘is not in law the agent of the subscribers or trustee for them’. Nor are the subscribers, as members, liable in any shape or form, except to the extent and in the manner provided by the Act.”

4. Perpetual existence. A company has a continued existence. As a company has a separate entity, it is comparatively more stable than a sole proprietorship or partnership. The life of the company is not dependent upon the life of the individual members constituting it. The death, insolvency, insanity or retirement of any member or director does not affect the life of the company. Even the death of all the members will not mean the death of the company.

During the war all the members of one private company, while in general meeting, were killed by a bomb. But the company survived, not even a hydrogen bomb could have destroyed it.

5. Common seal. Since a company is an artificial person it cannot act by itself. It has to act through natural persons the directors. The directors, while entering into contracts on behalf of the company are required by law to affix the company’s seal, if there is any, as a token of its signature.

6. Limited liability. Perhaps, the most important advantage for which a company is formed, is the limited liability. The liability of every member of the company is limited to pay the face or nominal value of a share. If he has paid the full amount due on his share, he will not be required to pay anything more to meet company’s liability. For example, if the face value of a share in a company is ₹ 10 and the shareholder has paid ₹ 8, his liability to the company is for the remaining balance of ₹ 2 only and no more. In case of a company limited by guarantee, the liability of the member is limited to the amount he has guaranteed to contribute to the assets of the company, in the event of its being wound-up.

7. Transferability of shares. One of the important characteristics of a company is transferability of its shares. The shares of a public company are freely transferable. The Articles of a public company cannot and of a private company must impose restrictions on the transfer of shares. However, a company cannot impose absolute restrictions on transfer of its shares. Such a restriction would be void. As per the Companies Act, 2013, a public company, whose shares are listed on a recognised stock exchange cannot refuse to register transfer of its shares.

8. Separate property. It is a corollary of the concept of separate entity. A company is regarded as a separate entity distinct from its members. Such a company is capable of owning, enjoying and also of transferring property in its own name. Although, its members or shareholders contribute its capital, yet they are not the joint owners of the property of the company. No member can claim himself to be the owner of the company's property during its existence or on its winding-up. The shareholders do not even have an insurable interest in the property of the company.

9. Capacity to sue. A company is a separate legal entity. As such, it can sue and be sued in its own name.

1.2.2 LIFTING THE CORPORATE VEIL

A company is regarded as a separate entity distinct from its members [Salomon v. Salomon Co. Ltd. (1897) A.C. 22]. As such, the members cannot be held liable for the acts of the company. Thus, there is a veil (curtain or cloak) between the company and its members. Ordinarily, the Court or Tribunal will not look behind the corporate entity i.e., the Court or Tribunal will not see who are the real persons controlling the company.

However, this concept of separate entity cannot be misused by the members of the company to evade taxes or play fraud on people. In such cases, the Court or Tribunal cannot be a silent spectator. As such, the Court or Tribunal can and ought to lift or pierce the corporate veil to look or find out the real persons doing the mischief under the garb of corporate personality. This is known as "lifting or piercing the corporate veil".

The circumstances under which the Court or Tribunal can lift the corporate veil may be broadly divided into two categories:

(A) Cases falling under judicial decisions.

(B) Cases falling under express statutory provisions.

(A) Under Judicial Decisions

L Protection of revenue. The Courts have lifted the corporate veil where it was used to evade taxes or circumvent tax obligations.

Santanu Roy v. Union of India (1988) 38 E.L.T. (Del.). In this case show cause notices were issued to individual directors of M/s Duncan Agro Industries Ltd. by the Central Excise authorities for alleged evasion of excise duty by reason of fraud. This was challenged by the directors on the ground of the liability being that of the company. The High Court lifted the corporate veil to determine the liability of the directors. The Court observed that any director, who is a party to the fraud or commissioning of any tort, is personally liable.

2. Prevention of fraud or improper conduct. If the separate entity of the company is misused for defrauding people or avoiding legal obligations, the Court or Tribunal can lift the corporate veil.

Gilford Motor Co. v. Horne (1913) 1 Ch. 935, Horne was appointed as a managing director of Gilford Motor Co. The service agreement imposed a condition that Horne shall not solicit the customers of the company. Horne formed a company which solicited the plaintiff s customers. Held, the company was a mere cloak or sham for the purpose of enabling Horne to commit breach of his service agreement to solicit customers. The Court restrained Horne, as well as the defendant company, from soliciting customers.

3. Determination of enemy character of a company. When the management of a company is in the hands of persons residing in an enemy country, the Court or Tribunal may lift the corporate veil as the company acquires an enemy character. In such cases to allow alien enemies to trade under the garb of corporate entity, will be against public policy.

4. Avoidance of welfare legislation. The Court or Tribunal can lift the corporate veil if it finds that the company is misusing its corporate entity to avoid welfare legislation.

5. To determine contempt of Court. Where corporate veil is used to avoid contempt of Court or Tribunal, the Court or Tribunal can pierce the corporate veil and punish the guilty persons for contempt of Court.

6. Determination of technical competence of the company. Just as to determine enemy character of a company corporate veil can be pierced, similarly, to determine technical competence of the company, its corporate veil can be pierced.

(B) Under Express Statutory Provisions

The Companies Act, has also made certain express provisions under which the corporate veil can be lifted. Some of the important cases are as follows:

1. Reduction of members below the statutory minimum. If at any time the number of members of a public company falls below 7 (below 2 in case of a private company) and the business of the company is carried on for more than 6 months, while the number is so reduced, every member who is aware of the fact shall be severally liable for all debts of the company contracted after the said period of 6 months However, the members who left the company during the said 6 months period will not be liable. It should be noted that members who continue after 6 months period shall be liable only when they are aware that the number of members has fallen below the statutory minimum. Thus, it would be seen that the Company Law lifts the corporate veil in such cases and makes the members personally liable despite the fact that company is a separate entity and the liability of the members is limited.

2. Misrepresentation in prospectus [Sec. 35 (I) and 447]. If misrepresentation is made in a prospectus, every person, who authorised the issue of the prospectus, shall be personally liable to those who subscribed on the faith of untrue statements made in the prospectus.

Criminal liability for misstatements in prospectus (Sec.34). 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 authorises the issue of such prospectus shall be liable under section 447:

Civil liability for misstatement in a prospectus. (Sec. 35) (1). Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who:

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

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

(c) is a promoter of the company;

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

(e) is an expert referred to in sub-section (5) of Section 26, shall, without prejudice to any punishment to which any person may be liable under Section 36, be liable to pay compensation to every person who has sustained such loss or damage.

(2) No person shall be liable under sub-section (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.

(c) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

3. Fraudulently inducing persons to invest money (Sec. 36). Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into:

(a) any agreement for, or with a view to acquiring, disposing of, subscribing for, or underwriting securities; or

(b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution shall be liable for action under section 447.

4. Failure to return application money [Sees. 39 (3)]. If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

In case of any default to return application, 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. [Sec. 39(4)].

5. Improper use of "Limited" or "Private Limited" words after the name of a company (Sec. 453). If any person or persons trade or carry on business under any name or title, of which the word "Limited" or the words "Private Limited" or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated with limited liability, or unless duly incorporated as a private company with limited liability, as the case may be, punishable with fine which shall not be less than five hundred rupees but may extend to two thousand rupees for every day for which that name or title has been used.

6. Holding and subsidiary companies [Sec. 2(46)]. A "holding company" is one which controls the management of the other company while the other company is called its subsidiary. In the eyes of law, holding and subsidiary companies are separate entities. It has been held that even a 100% subsidiary is a separate entity and its holding company will not be liable for its acts.

However, the Court or Tribunal may lift the corporate veil in order to establish the relationship of holding and subsidiary company to find out the real persons who control the affairs of the company. As such, in some cases the law may not treat a subsidiary company as an independent company. For example, every holding company shall attach to its Balance Sheet, copies of the Balance Sheet, Profit and Loss Account, Directors Report and Auditor's Report in respect of each of its subsidiary company. Again, when a private company becomes a subsidiary of a public company, virtually it is treated as a public company.

7. For investigation of affairs of a company (Sections 90 and 216). In case, an inspector is appointed to investigate the affairs of a company he is empowered to investigate the affairs of anybody corporate under the same management or group. For the purpose of fixing responsibility for mismanagement, fraud etc. the corporate veil or personality can be disregarded, i.e., the persons behind the legal facade can be identified and punished.

8. For investigation of ownership of a company (Sections 90 and 216). The Central Government may appoint one or more inspectors to investigate and report on the membership of any company for the purpose of determining the true persons (a) who are, or have been, financially interested in the company; and (b) who are, or have been, able to control or materially influence the policies of the company. For this purpose, the corporate veil can be lifted so as to identify the real persons controlling the company.

9. To check fraudulent trading (Sec. 447). If during the winding-up of a company, it appears that the business of the company has been carried on with intent to defraud the creditors of the company or any other person, or for fraudulent purposes, the Court or Tribunal can lift the corporate veil to find out the real persons responsible for it. The Court or Tribunal may hold those persons personally liable for all or any debts of the company without any limitation of liability.

1.3 TYPES OF COMPANIES

These are various kinds of companies and these can be classified on a number of basis. The important basis on which these companies can be classified is as follows:

1.3.1 On the Basis of Creation

There are three principal modes in which a company may be created. These are:

(i) Chartered companies. In olden times, kings by virtue of the powers vested in them, used to create companies by granting Royal Charter. Such companies were known as 'Chartered Companies', and were governed by their Charters. Example of such companies are The Bank of England, The East India Company, etc. The Companies Act did not apply to them. Such companies are not created now-a-days.

(ii) Statutory companies. Such a company is created by statutes or special Acts of Parliament or State Legislatures. Such companies are incorporated to carry on business of national importance. For example, The Reserve. Bank of India, The Life Insurance Corporation of India, The Food Corporation of India, etc. These companies are conferred special powers and are governed by the provisions of the Acts by which such companies are created. However, provisions of the Companies Act may also apply to these companies in so far as they are not inconsistent with the provisions of the Special Acts under which these companies are created. Such companies need not use the word 'Limited' at the end of their names.

(iii) Incorporated or registered companies. A company registered under the Companies Act is known as a registered or incorporated company. By far the largest number of companies is created in this manner. Such companies may be public or private; with limited or unlimited liability; having share capital or no capital.

1.3.2 On the basis of Liability

On the basis of liability, companies are classified under the following three heads: (i) Limited by shares, (ii) Limited by guarantee and (iii) Unlimited company.

(i) Limited by Shares Sec. 2 (22). ‘Company limited by shares’ means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.” The shareholders are liable to pay unpaid amount, if any, due on the shares held by them. There is no danger of private property of the members being used for the payment of creditors of the company. The unpaid amount on the shares may be called up by the company at any time. By far, the largest number of companies is of this type.

(ii) Limited by Guarantee Sec. 2(21). “Company limited by guarantee’ means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.” Companies formed for non-trading purposes, e.g., for the promotion of art, science, culture, sports, etc. are limited by guarantee. The liability of its members is limited, by its Memorandum, to such an amount as the members have respectively undertaken 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 or of such debts and liabilities as may have been contracted before he ceases to be a member as the case may be. The amount guaranteed by each member cannot be demanded until the company is wound up. Such members are liable in case the present members are unable to contribute the guaranteed amount. Such companies may be granted exemption by the Government from using the word ‘Limited’ or ‘Private Limited’ as part of their name.

(iii) Unlimited Company. Just as the liability of sole traders or partners is unlimited, the liability of the members of an unlimited company may be unlimited. A member can be called upon to pay an unlimited amount to pay off the creditors in proportion to his interest in the company. However, there is an important difference in the nature of liability of the members of an unlimited company. Creditors of an unlimited company cannot file suit against the individual members directly. In case of a partnership firm, creditors can directly sue the partners. A company limited or unlimited is regarded as a separate entity from its members. Such companies are rarely found these days.

1.3.3 On the Basis of Number of Members

On the basis of number of members, companies are classified under the following heads:

(i) Private Company Sec. 2(68). A ‘Private company’ is defined by Sec. 2(68) (iii) as .a company which by its articles

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, and Producer Company, limits, the number of members to 200, and

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.

Provided further that:

(A) persons who are in the employment of the company; and

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

(iii) prohibits any invitation to the public to subscribe for securities of the company

Ownership and control of a private limited company is confined to a close friends and relatives. Thus, a private company is an organisation which enables a family or association of close friends to get the benefits of limited liability vis-a-vis all the advantages of a partnership organisation i.e. close control and secrecy of business, etc. The name of a private company must end with the words ‘Private Limited’ or its abbreviation “(P) Ltd.”. A private company does not employ public funds and is usually run as a family concern. Therefore, in comparison to a public company, a private company enjoys certain privileges.

(ii) One person Company Sec. 2(62). ‘One person company’ means a company which has only one person as a member. It shall be a private company.

The Companies Act, 2013 vide Sec. 3(1) has introduced the new concept of One Person Company. Provided that the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber’s death or his in capacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company alongwith its memorandum and articles:

Provided further that such other person may withdraw his consent in such manner as may be prescribed.

Provided also that the member of One Person Company may at any time manage the name of such other person by giving notice in such manner as may prescribed.

Provided also that it shall be the duty of the member of One Person Company to intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed, and the company shall intimate the Registrar any such change within such time and in such manner may be prescribed:

Provided also that any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

Such a company i.e. One Person Company may be either:

(a) a company limited by shares; or

(b) a company limited by guarantee; or

(c) an unlimited company.

(iii) Public Company Sec. 2(71). 'Public company' means a company: which is not a private company. Provided that a company which is a subsidiary of a company not being a private company shall be deemed to be public company for the purposes of this Act even where such subsidiary companies continues to be a private company in its articles. In simple words, a private company which is a subsidiary of a public company will become a public company.

Thus, the restrictions which apply to a private company are not applicable to a public company. There is no restriction on transfer of shares—its shares are freely transferable. There is no restriction on the maximum number of members and it can offer its shares and debentures to the public for subscription through a prospectus. Thus the ownership and control of a public company is in the hands of public at large.

PRIVILEGES OF A PRIVATE COMPANY

One of the important objects of company law is to protect the interests of the public. As such, to safeguard the interest of the shareholders of a public company which raises its capital from the public, a large number of provisions have been made. However, in case of private companies, no such public interest is involved as these companies do not raise their capital from the public. Hence, private companies have been granted a number of privileges and exemptions. The exemptions available to private companies are as follows:

(1) It can be started only with two members as against seven required for a public company.

(2) It can work with only two directors in place of three as are required in case of a public company.

(3) It is not required to file a prospectus.

(4) It can allot shares without waiting for the minimum subscription.

(5) It need not issue right shares to the existing members.

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

(7) Only two persons personally present will form the quorum unless the Articles provide for a larger number.

(8) Poll can be demanded by one member if not more than 7 members are present, and by 2 members if more than seven members are present.

(9) Unless the Articles of the company provide otherwise, a member of a private company cannot appoint more than one proxy to attend the meeting on the same occasion.

(10) Directors need not file their consent to act as director or to take up qualification shares and pay for them.

(11) Directors of a private company holding office for life before 1st April, 1952 cannot be removed.

(12) A private company can give financial assistance directly or indirectly for purchase or subscription of its own shares.

(13) No restrictions on loans to directors apply to private companies.

(14) No restrictions on the appointment, payment of remuneration to Directors or Managing Directors.

(15) No restrictions on the number of companies to be managed by a director. In case of a public company one person cannot become director in more than 20 companies and managing director in more than 2 companies.

(16) All the Directors can be permanent and need not retire by rotation.

(17) Provisions regarding general meetings, voting, etc. need not be followed by a private company.

(18) No restrictions on loans to other companies under the same management

(19) No right of appeal to the Company Law Tribunal in case a private company does not register a transfer or transmissed of shares.

(20) Restriction regarding inter-company investment of funds in the same group do not apply to private companies.

(21) Company Law Tribunal cannot prevent change in the Board of Directors of an independent private company if in its opinion such change is prejudicial to the interest of the company.

(22) Only members of a private company can inspect and copy its Profit and Loss Account filed with the Registrar of Companies.

(23) A private company may provide for additional grounds for disqualifications of directors.

(24) A private company may provide for additional grounds for vacation of office by a director.

(25) No restrictions on interested director to participate or vote in Board's proceedings.

Conversion of Companies

(A) Conversion of a Private Company into a Public Company

A private company may become a public company either by defaulter or choice.

1. Conversion by default. If a private company makes a default in complying with the conditions of Sec. 2 (68) (e.g. exceeding the limit of 200 members or inviting public to purchase its shares or debentures), it ceases to be a private company and shall be treated as a public company. It shall not be entitled to the privileges and exemptions conferred on private companies under the Act.

However, if the Company Law Tribunal is satisfied that the non-compliance was accidental or due to inadvertence or other sufficient cause, it may grant relief from such consequences. It may also grant relief on just and equitable grounds. While granting relief, it may impose such terms and conditions as seem to it just and equitable.

2. Conversion by choice or volition. When it is desired to convert a private company into a public company, it can be done by altering the articles to this effect so as to remove the restrictions imposed upon a private company.

It will be necessary for the company to increase its paid-up share capital by passing an ordinary resolution. Again, necessary changes in the Articles to suit the needs of a public company e.g. provisions regarding general meetings, election of directors, annual accounts and audit etc. are made. It is usual to prepare new Articles or to adopt Table A in such cases.

The company is required to file with the Registrar of Companies, within 15 days of alteration of Articles, the following documents:

1. a copy of the special resolution;

2. a printed copy of the altered or new Articles, as the case may be;

3. a copy of the prospectus;

4. a copy of the ordinary resolution to increase the share capital, if increased.

After conversion, the company shall cease to be a private company and will lose all of its privileges and exemptions.

(B) Conversion of Public Company into a Private Company

Likewise a public company can be converted into a private company. A special resolution is to be passed to alter the Articles so as to:

(1) restrict the right to transfer shares of the company;

(2) limit the number of members to two hundred excluding:

(a) present employees who are member.

(b) ex-employees who are still members of the company.

(3) prohibit invitation to public to subscribe for any shares in or debentures of the company or to make deposit.

After obtaining the approval of the Tribunal, the following documents with necessary fees should be filed with the Registrar of Companies within 15 days of the order granting permission:

(1) a copy of Special Resolution;

(2) a printed copy of altered Articles;

(3) a copy of Tribunal's order granting approval to convert the company into a private company.

1.3.4 On the Basis of Ownership

On the basis of ownership, companies may be classified into (i) Government company and (ii) Non-Government company.

(i) Government Company [Sec. 2(45)]. Government company means any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State

Government or Governments or partly by the Central Government or partly by any State Government or Government and includes a company which is a subsidiary company of such a Government Company. The Companies Act is applicable to such companies subject to the modification as approved by both Houses of Parliament.

(ii) Non-Government Company. Companies which are not Government companies i.e. which are not owned and controlled by the Central or any State Government(s) are called Non- Government companies. A public limited company is usually a non-Government company.

1.3.5 On the Basis of Control of a Unit

On the basis of control of a unit, companies can be classified into (i) Holding company and (ii) Subsidiary company.

(i) Holding company [Sec. 2(46)]. A holding company in relation to one or more other companies means a company of which such companies are subsidiary companies.

(ii) Subsidiary company [Sec. 2(87)]. "Subsidiary company" or "subsidiary" in relation to any other company (that is to say a holding company), means a company in which the holding company:

A company is a subsidiary of another if-

(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.

Provided such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such number 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-clause (i) or (ii) is of another subsidiary of the holding company;

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

The Act defines a holding company and a subsidiary company by explaining the circumstances in which a company shall be deemed to be subsidiary of another.

1.3.6 On the Basis of National Interest

On the basis of national interest companies can be classified as (i) Indian Company, (ii) Foreign Company.

(i) Indian Company. A company incorporated in India and having a place of business in India is an Indian company. However, all other companies, unless those are foreign companies, are Indian companies.

(ii) Foreign Company [Sec. 2(42)]. Foreign company means any company or body corporate incorporated outside India which:

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

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

However, a foreign company in which fifty percent or more of the paid-up share capital (equity or preference or both) is held by Indian citizens and/or companies incorporated in India, shall comply with such other provisions as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India. (Sec. 379)

1.3.7 Companies not for Profit

Sec. 4 requires a company formed for profit to use the word 'Limited' or 'Ltd.' at the end of its name if it is a public company and 'Private Limited' or 'Pvt. Ltd.' if it is a private company. However, a company formed for promoting commerce, art, science, religion, charity or any other useful object, not for profit, with limited liability, can be exempted (under a license under Sec. 8 from the Central Government) from using the word limited or private limited at the end of its name. Such companies are popularly called 'Licensed Companies'. Such a company has to apply its profits, if any, or other income in promoting its objects. It cannot pay any dividend to its members [Akil Deshastha, etc. Mandal v. Joint Charity Commr., (1973) 43 Comp. Cas. 361]. The Central Government can grant a license on such terms and conditions as it thinks fit. The Central Government may also direct that these conditions shall be inserted (given) in the Memorandum or in the Articles of Association of the company or, partly in one and partly in the other. The company is under an obligation to abide by these conditions and regulations.

Such a company cannot alter the object clause of its Memorandum without the previous approval of the Central Government. If the company contravenes this provision, its license can be revoked.

1.3.8 Illegal Association

A body of persons for the achievement of some common object is called an “association”. Broadly, such an association may be (i) for profit, or (ii) not for profit, i.e., for the promotion of art, culture, religion, etc. To protect the public from the mischief of large trading associations, whose membership may be constantly changing, the Companies Act, 2013 provides for their compulsory registration.

According to Sec. 464 every association of persons consisting of more than prescribed number of persons for the purpose of carrying on any business for gain, must be registered under the Companies Act, 2013 or be formed under some other Indian Law (e.g. an association may be registered under the Co-operative Societies Act, 1912). In case such an association is not registered, it will be called an illegal association and it has no legal existence. However, a Hindu Undivided Family carrying on any business with more than the prescribed number of persons will not be an illegal association even if it is not registered under the Companies Act, 2013 or any other law. But in case two or more joint Hindu families form a partnership, then a joint family shall not count as one person but all the adult members of both the joint families shall be counted. The number of minors in both the joint families will be ignored. It is because a partnership firm has no separate legal entity, its partners will be counted as separate members of the company. However, the number of person that may be prescribed under this section shall not exceed 100.

1.4 Check Your Progress

Fill in the blanks

1. The name of company can be changed by…………. .
2. The Reserve Bank of India is an example of a ……….. .
3. The company is an ………… legal person.
4. A company registered under the Companies Act is known as……….. .
5. On a share of Rs.100 of a company, a shareholder has already paid Rs.30. His liability is now limited to ………… .

1.5 SUMMARY

A company is a voluntary association of persons formed for the purpose of doing business having a distinct name and limited liability. The life of a company does not depend on the death, insolvency or retirement of any or all shareholders or directors. Lifting the corporate veil means disregarding the corporate personality and looking behind the real person who control the companies affairs. It is the duty of the Court to lift the veil to protect public policy and prevent transactions contrary to public policy. Companies Act recognises different types of companies that can be registered under the Act. There are various factors on the basis of which companies can be classified.

1.6 KEYWORDS

Company: It is a voluntary association of persons formed for the purpose of doing business having a distinct name and limited liability.

One Person Company: It is a one shareholder corporate identity, where legal and financial liability is limited to the company only.

Company limited by Guarantee: These are such companies where shareholders promise to pay a fixed amount to meet the liabilities of a company in the case of liquidation.

Statutory Companies: These are the companies incorporated by a special Act of Parliament and activities of these companies are governed by respective Act.

Public Company: It means a company which is not a private company.

1.7 SELF ASSESSMENT TEST

1. Define a company. Explain its characteristics.
2. "A company is an artificial person created by law with a perpetual succession and a common seal." Comment on the above statement and clearly explain the characteristics of a company.
3. "A company is a separate entity." Do you agree? Under what circumstances corporate veil can be pierced?
4. Define a private company. What privileges and exemptions are granted to a private company?
5. What is a private company? How can a private company be converted into a public company and vice-versa?
6. Distinguish between:

   (a) A company limited by shares, and A company limited by guarantee.

How the above two differ from an unlimited company?

7. Write short notes on:

(a) Chartered company, (b) Illegal association,

(c) Holding company (d) Subsidiary company,

(e) Government company, (f) Foreign company.

1.8 Answers to Check Your Progress

1. A special resolution
2. Statutory company
3. Artificial
4. Registered or Incorporated Company
5. Rs. 70

1.9 REFERENCES/SUGGESTED READINGS

- A.K. Mujumdar and G.K. Kapoor, Company law and Practice, Taxmann Publishing House, New Delhi.
- M.C. Kuchhal, Modern Indian Company Law, Delhi.
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- D.K. Jain, Company Law, Ready Reckoner, Bharat Law House Pvt. Ltd., Delhi.

Subject: Company Law	
Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 02	
INCORPORATION OF A COMPANY	

STRUCTURE

2.0 Learning Objectives

2.1 Introduction

2.2 Promotion of a Company

2.3 Incorporation of Company and Commencement of Business

2.4 Check Your Progress

2.5 Summary

2.6 Keywords

2.7 Self-Assessment Test

2.8 Answers to Check Your Progress

2.9 References/Suggested Readings

2.0 LEARNING OBJECTIVES

Upon competing this lesson, you should be able to:

- Get insights of the legal position of promoters, their status, duties and liabilities.
- Understand the procedure of incorporation of a company.
- Explain the effect of getting the Certificate of Incorporation.

2.1 INTRODUCTION

A company is an artificial person but does not take birth like natural people. A company is a creature of law. The formation of a company is a legal process, which involves a series of steps and legal formalities. These steps are to be taken by a person or a group of persons interested in the formation of a company. There are three stages in the formation of a company namely promotion, incorporation and commencement of business. The present lesson discusses in detail the process of incorporation of a company in India.

2.2 PROMOTION OF A COMPANY

Promotion is the very first stage in the formation of a company. Promotion begins when someone discovers an idea or when the idea comes to the mind of someone regarding some business. Promotion includes the analysis and feasibility of converting the idea into reality. Any person who assumes the responsibility of promotion is called ‘Promoter’.

Promotion has been defined as:

(1) According to Prof. E.S. Mead, “Promotion includes four elements - discovery, investigation, assembling and financing”.

(2) According to C.W. Gerstenberg, “Promotion may be defined as the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.”

Stages in Promotion

There are four stages involved in promotion:

(1) Discovery of an Idea: An individual or a group of persons may discover an idea of starting a new business or expanding an existing business. For example, one may discover an idea to start a Cinema Hall in a particular area. There may not be a Cinema Hall in that area or the idea may be to break the monopoly of an existing Cinema Hall in that area.

(2) Investigation: Discovered business opportunities have to be investigated thoroughly before any money can be invested to exploit them. The person discovering the idea may be very optimistic. His optimism may be because of his over enthusiasm or for other reasons. Continuing our previous illustration of a Cinema Hall, investigation will be done to ascertain:

(i) Whether necessary size of plot of land for the Cinema is available or not.

(ii) Whether necessary permission to run the Cinema Hall will be available from the local authorities, i.e., Delhi Development Authority, Delhi Municipal Corporation etc. if the hail is to be constructed in Delhi.

(iii) How much capital would be required?

(iv) How much income would be generated?

(v) Whether the capital invested would give a reasonable rate of return and so on.

(3) Assembly: Having discovered and investigated the profitability of a business proposition, steps will be taken to put the idea into practice. This will involve acquisition of land and buildings, plant and machinery, patent rights etc. At this stage promoters associate other persons who also act as first directors of the proposed company. Later on, the promoters enter into pre-incorporation contracts for the assembly of the necessary assets and properties to run the company.

(4) Registration or Incorporation of a Company: For the purpose of registration of the company, the promoters have to take the following steps:

(i) To prepare the Memorandum of Association and Articles of Association.

(ii) To get certificate of incorporation.

(iii) To get certificate of commencement of business.

Promoter

The promoter is a person who does the necessary preliminary work incidental to the formation of a company. It is compendious term used for a person who undertakes, does and goes through all the necessary and incidental preliminaries, keeping in the view the object to bring into existence an incorporated company.

Chronologically, the first persons who controls a company's affairs are its promoters. It is they who conceive the idea of forming the company with reference to a given object and then to set it going and it is they who take necessary steps to incorporate it.

In Whaley Bridge Calico Printing Co. Vs. Green Smith (1880) 5 QBD, 109, Lord Bowen stated that the term 'promoter' is a term not of law, but of business operations familiar to the commercial world, by which a company is generally brought into existence.

According to Lord Lindley, "With respect to the word, we are of opinion that it has no very definite meaning. As used in connection with companies the term 'promoter' involves the idea of exertion for the purpose of setting up and starting a company."

Who are Promoters

A registered company may act as a promoter whether a person is or is not a promoter of a company is a question of fact depending upon the role performed by him in the formation of the company. A person who does not play a prominent role may also be a promoter if he has so acted. But if a person is employed merely in a professional or technical capacity such as solicitor, accountant, valuer or business consultant, he will not be a promoter. It also excludes such persons who act in a professional capacity or persons engaged in procuring the formation of a company. But if any such person acts beyond the scope of professional duty and helps in any way in the formation of a company or in preparations for the management of its affairs, he will become a promoter.

Types of Promoters

The promoters may be of the following types:

(1) Accidental Promoters: Some persons are not the professional promoters. Sometimes some idea strikes to their mind accidentally and they try to convert it into reality. They are known as accidental promoters.

(2) Professional Promoters: These promoters take the promotion as their profession. They usually perform the work of promotion for various business undertakings. Professional promoters may be an individual, partnership firm, an association of persons and even a company.

(3) Financial Promoters: Some are the promoters who undertake the promotion of a company, complete the professional activities and then purchase the entire share capital of the company promoted. They provide financial certainty and assurance to the company. Later on, they may sell the shares at some profit.

Functions of a Promoter

Promoters are the persons who give birth to a company. They are the founders of a business enterprise. They have many functions to perform, which are as follows:

(1) To get the idea of the formation of a company.

(2) To analyse the idea.

(3) To consult the experts of the field regarding the feasibility of idea.

(4) To search out the persons who may agree to be the first directors of the company and to sign the Memorandum of Association.

(5) To decide the name, the place of registered office, the places of the offices, the object of the company, the amount of capital and its composition.

(6) To prepare and enter into contracts with underwriters.

(7) To select and decide the bankers, auditors, brokers and legal experts.

(8) To prepare the Memorandum of Association, Articles of Association and Prospectus.

(9) To file the necessary documents with the Registrar of Companies.

(10) To get the certificate of incorporation

(11) To get the permission and to arrange for the use of capital.

(12) If the company has to purchase a going concern business, to finalise the purchase contract of such business.

(13) To enter into contracts with the vendors, underwriters, brokers and managing agents.

(14) To collect the amount on the issue of share capital.

(15) To get the certificate of commencement of business.

(16) To pay the preliminary expenses.

(17) To appoint the required number of personnel for the whole process.

To sum up, it can be concluded that a promoter performs all activities right from conceiving the idea in his mind to the commencement of business by the company. Thus, the promoter after establishment of company, comes out of the picture and lets the company go on with its business.

Rights of Promoters

Promoters have the following rights in the company:

(1) Right to Receive the Preliminary Expenses: Promoters are empowered to receive the preliminary expenses that they have incurred in the process of formation of company. It should be remembered that the promotes cannot file a suit to recover the preliminary expenses from the company. They can recover it only if there is a contract between them and the company and such a contract can take place after the company comes into existence i.e. certificate of incorporation and after certificate of commencement of business have been obtained and the contract is adopted (not ratified) by the company. Therefore, the promoters must have a valid contract entered into by the company after incorporation with them. Only in that case they can recover their preliminary expenses.

(2) Right to Receive Proportional Amounts from Fellow Promoters: Sometimes, the company is promoted by more than one promoter. In such a case, the company, if under contract, can make the full payment of their remuneration to any of the promoters. In that case, other promoters are empowered to collect their proportionate remuneration from their co-promoters.

(3) Right to Receive Remuneration: Promoters have to take a lot of pains for the promotion of a company. For this, they are entitled to get some remuneration from the company, they promote. The remuneration may be in cash, in the form of shares or debentures in the form of commission etc. Whatever mode of payment has been decided, they must get their remuneration according to that after disclosing it to an independent board of direction.

Liabilities of Promoters

The promoters have the following liabilities:

1. Promoters are the Founders of a Company: Therefore, they are under certain obligations which are as under:

(a) To Disclose and Repay the Secret Profits: If the promoter has made any profit out of a transaction, a promoter is bound to disclose it.

(b) Profit: As a corollary of the duty of full disclosure of material facts, a promoter is duty bound not to make any secret profit directly or indirectly. In case, he makes any secret profit he is liable to return the same to the company.

In Gluckstein Vs. Barnes (1900) A.C. 240, a syndicate purchased the Olympia Company for £ 1,40,000 with a view to forming a company and reselling it to the new company. The syndicate promoted a new company and sold the Olympia to it for £ 1,80,000 making a profit of £ 40,000. Before the syndicate purchased the Olympia, it had purchased its debenture at a discount knowing that the debentures would be paid in full if the sale to the new company materialised. The new company paid the debentures in full with the result the syndicate made a profit of £ 40,000 and not the profit of £ 20,000 made on account of debentures. The House of Lords held that the promoters must pay £20,000 to the company as they have not made full disclosure.

2. Liability of Full Disclosure Material Facts: If the promoter fails to make a full disclosure of all relevant facts including any profit and his personal interest in a transaction with company, the company may sue him for damages for breach of his fiduciary duty and recover from him any secret profit mode directly or indirectly.

It should be noted that the disclosure to be made effective must be real and express, constructive disclosure is not enough. In case the promoters fail to do so, the company may rescind the contract and sue the promoters to return the money paid. Erlanger Vs. New Sambrero Phosphate Co. (1878) 3 A.C. 1218 well illustrates the point.

A syndicate, of which E was the head, purchased an island containing phosphate mines. E promoted a company and named fictitious persons as its directors. E sold the property to the new company by a contract between a nominee of the syndicate and the company at double the price originally paid by him (E). The purchase agreement was approved at the shareholders meeting. However, no material facts were disclosed at the meeting. The company went into liquidation and the liquidator sued E to recover the profit made. E argued that the directors had full knowledge of the transaction. The Court rejected his plea on the ground that the disclosure was not made to an independent Broad of Directors.

3. Liability for Preliminary Contracts: A promoter remains personally liable for preliminary contracts made by him because such contracts are not legally binding on the company even after incorporation. Since the company was not in existence when such contracts were made, the company cannot ratify them. The promoters may not be liable if such contracts are either adopted by the company or specifically enforced by the Court under the Specific Relief Act, 1963.

4. Liability for Misstatement in Prospectus: A promoter will be liable for any omission of any material facts or misstatement made in the prospectus if he was a party to the issue of the prospectus. In case, the promoter is guilty of omission or misstatement of facts in the prospectus, he will be liable to pay compensation to every person who suffered any loss or damage because of such a prospectus. The promoter may also become liable to criminal proceedings.

5. Liability in Course of Winding-up: If during the winding-up proceedings an application is made by the official liquidator, the Tribunal may make a promoter liable for misfeasance or breach of trust committed by him in the promotion or formation of the company [Sec. 300].

If the official liquidator has made a report to the Tribunal alleging fraud, the Tribunal may order public examination of the promoter. The Court or Tribunal having jurisdiction to wind up a company is empowered to suspend him for a period extending upto 5 years from becoming a director or taking part in the promotion, formation or management of a company, if he is found guilty of fraudulent conduct in the course of winding-up of the company.

Remuneration of the Promoter

A promoter has no right to get compensation from the company for his services in promoting the company, unless there is a contract to that effect. In practice, a promoter takes remuneration for his services in one of the following ways:

(1) Cash Payment: The very first and the traditional method of making the payment for the services of promoters is to pay in cash.

(2) Shares and Debentures: The second method for making the payment to promoter is to allot them the shares and debentures of the company promoted by them.

(3) Commission: Promoters may also be paid for their services by way of commission in the net profits of the company for a certain period.

(4) Promoter may sell his own property at a profit to the company for cash or fully paid shares provided he makes disclosure to this effect.

Any remuneration paid to the promoters must be disclosed in the prospectus.

Pre-incorporation or Preliminary Contracts: The promoters of a company usually enter into contracts to acquire some property or right in the company which is yet to be incorporated, such contracts are called pre-incorporation or preliminary contract. The promoters generally enter into such contracts as agents for the company about to be formed. The legal position is that “Two consenting parties are necessary to a contract whereas the company, before incorporation, is not an entity.”

According to law of agency, a person cannot act as an agent for another who is not in existence. Thus, a company is not bound by a pre-incorporation contract.

A solicitor was engaged to prepare the necessary documents and to obtain the registration certificate of a company. He paid the registration fee and incurred the necessary expense. After registration the company refused to pay for the services and expenses. The Court held that, “the company could not be sued in law for those expenses, in as much as it was not in existence at the time when the expenses were incurred.” [English and Colonial Produce Co. (1906)2 Ch. 435].

Position of Promoters as Regards Pre-incorporation Contracts

Following is the position of a promoters regarding pre-incorporation contracts:

(1) Company not Bound by Pre-Incorporation Contracts: A company when it comes into existence is not bound by a pre-incorporation contracts even where it takes the benefit of the contract entered into on its behalf.

(2) Company cannot Enforce Pre-incorporation Contracts: A company cannot after incorporation enforce the contract made before its incorporation.

The leading case on the point is in Natal Land and Colonization Co. Ltd. Vs. Pauline Colliery Syndicate Ltd. (1904) A.C. 120. N. Co. entered into a contract with A, who was acting as the nominee of the syndicate (which was not yet incorporated) to grant a lease of coal mining rights. After the syndicate was registered, it sued N. Co. for specific performance of the agreement. It was held that the syndicate was not entitled to the lease as the company was not in existence when the contract was signed.

(3) Promoter Personally Liable: The promoters remain personally liable on a contract made on behalf of a company not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in company's name.

(4) Ratification of a Pre-incorporation Contract: A company cannot ratify a contract entered into by promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it comes into existence. The adoption of the pre-incorporation contracts by the company will not create a legal contract between the company and the other parties even though the adoption of the contract is made as one of the objects of the company in its Memorandum and Articles. In such a case, it is safer for the promoters acting on the behalf of the company about to be formed to provide in the contract that:

(i) If the company makes a fresh contract in terms of the pre-corporation, the liability of the promoters shall come to an end; and

(ii) If the company does not make a fresh contract within a limited period, either of the parties may rescind the contract.

However, Specific Relief Act, 1963 provides some relief in this direction. Sec. 15(h) and 19(c) of the Specific Relief Act provide that when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, such contract may be specifically enforced by or against the company. The important condition in this connection is that these contracts should be for the purposes of the company. Thus, in Imperial Ice Manufacturing Co. Vs. Manchershaw 13 Mum, L.R. 165 it was observed that such contracts should be for the working purposes of the company such as a contract for the supply of machinery for making ice, etc.

2.3 INCORPORATION OF COMPANY AND COMMENCEMENT OF BUSINESS

INCORPORATION OF COMPANY

Incorporation or registration of the company is the second stage in the formation of a company. Any seven or more persons (two or more in case of a private company) can form the company. Even one person can also form a company. Association for any lawful purpose may form an incorporated company with or without limited liability. Companies limited by shares are the most popular form of companies.

Lawful Purpose: The purpose for which a company is proposed to be established must be lawful. It must not be in contravention of the general law of the country.

Documents to be Filed with Registrar: Before a company is registered, it is desirable to ascertain from the Registrar of the companies if the proposed name of the company is approved. Then, the following documents duly stamped together with the necessary fees are to be filed with the Registrar of the Companies of the State in which the registered office of the company is to be situated:

(1) Filing Documents with the Registrar [Sec. 71]: These shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the following documents and information for registration, namely:

(a) Memorandum and Article: The Memorandum and Articles of the company duly signed by all the subscribers to the Memorandum in such manner as may be prescribed.

(b) Declaration in Prescribed Form: 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.

(c) Affidavit from the Subscriber: 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.

(d) Address for Correspondence: The address for correspondence till its registered office is established.

(e) Detail Particulars: The particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the Memorandum alongwith proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.

(f) Particulars of First Director: 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; and

(g) Particulars of the Interests of the First Directors: The particulars of the interest of the persons mentioned in the Articles as the first directors of the company in other firms or bodies corporate alongwith their consent to act as directors of the company in such form and manner as may be prescribed.

(2) Registrar to Issue Certificate of Incorporation: The Registrar on the basis of documents and information filed under sub-section (1) shall register all ie documents and information referred to in that sub-section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

(3) Allotment of Corporate Identity Number: On and from the date mentioned in the certificate of incorporation issued under sub-section (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.

(4) Preservation of Documents: The company shall maintain and preserve at its registered office copies of all documents and information as originally filed with Registrar till its dissolution under this Act.

(5) Action against False Particulars: If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under Section 447.

(6) Liable for Action under Section 447: Without prejudice to the provisions of sub-section (5) where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under clause (b) of sub-section (1) shall each be liable for action under Section 447.

(7) Power of Tribunal: Without prejudice to the provisions of sub-section (6), where a 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 Tribunal may, on an application made to it, on being satisfied that the situation so warrants:

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

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

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

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

(e) pass such other orders as it may deem fit:

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

(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.

Effect of Registration [Section 9]

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the Memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the Memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

COMMENCEMENT OF BUSINESS

A company both public as well as private after its incorporation, cannot start its business immediately. These have to obtain one more certificate known as certificate to commence business.

Certificate to commence business is issued by the Registrar of Companies after the following conditions are complied with (Sec. 11):

(1) A company having a share capital shall not commence any business or exercise any borrowing powers unless:

(a) Filing of declaration: A declaration is filed by a director in such form and verified in such manner as may be prescribed, with the Registrar that every subscriber to the Memorandum has paid the value of the shares agreed to be taken by him on the date of making of this declaration; and

(b) Filing of verification its Registered office: The company has filed with the Registrar a verification of its registered office as provided in sub-section (2) of section 12.

(2) Penalty: If any default is made in complying with the requirements of this section, the company shall be liable to a penalty which may extend to five thousand rupees and every officer who is in default shall be punishable with fine which may extend to one thousand rupees for every day during which the default continues.

(3) Action for removal of Name: Where no declaration has been filed with the Registrar under clause (a) of sub-section (1) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations he may, without prejudice to the provisions of sub-section (2), initiate action for the removal of the name of the company from the register of companies under Chapter XVIII.

2.4 CHECK YOUR PROGRESS

Fill in the blanks

1. Private company can start its business immediately after the issue of ……
2. Public company should start business only getting the certificate of ……..
3. …… members should sign the MOA in case of public company.
4. ……… stands in the fiduciary position of the company.
5. Pre- incorporation contract is also known as ………. .

2.5 SUMMARY

Formation of a company is a lengthy process broadly divided into promotion, incorporation and commencement of business. The persons who bring the company into existence are known as promoters. A promoter is not entitled to any remuneration unless the company agrees to make such payment after incorporation. Incorporation or registration is the second stage in the formation of a company. It involves preparation of Memorandum and Articles of Association, making of statutory declaration and filing of these documents and consent of directors alongwith the necessary registration and stamp fees. When the Registrar of Companies is satisfied that all the requirements of the Act have been complied with, he will register the company and issue a certificate of incorporation. Thereupon, the company comes into existence. The certificate of incorporation is a conclusive evidence that the company has been duly registered. A company can commence business only after it has obtained certificate to commence business.

2.6 KEYWORDS

Promoter: He is a person who bring the company into existence.

Preliminary Contracts: Contracts which are entered into, by agents on behalf of a prospective company before it has come into existence.

Incorporation of a Company: It means the fulfilment of those legal requirements which bring a company into existence.

2.7 SELF ASSESSMENT TEST

1. Explain the procedure for the incorporation of a company and state the name of documents that are to be filed with the Registrar of the company.
2. Discuss the legal formalities that are to be complied with under Indian Companies Act regarding the formation of the company.
3. Set out the different steps in the formation of a limited liability company from promotion to the commencement of business.
4. What is meant by incorporation of a company? Describe the process of incorporation of a company.
5. Who is a company promoter? Discuss the work of a company promoter and his relationship with the company promoted by him.
6. What do you mean by Promoters? Explain the functions, rights and liabilities of company promoters.

2.8 ANSWERS TO CHECK YOUR PROGRESS

1. Certificate of incorporation
2. Commencement of business
3. 7
4. Promoters
5. Preliminary

2.9 REFERENCES/SUGGESTED READINGS

- Avtar Singh, Company Law, Eastern Book Company, Lucknow.
- A.K. Mujumdar and G.K. Kapoor, Company law and Practice, Taxmann Publishing House, New Delhi.
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Lesson No.: 03	
MEMORANDUM OF ASSOCIATION	

STRUCTURE

3.0 Learning Objectives

3.1 Introduction

3.2 Meaning of Memorandum of Association

3.2.1 Purpose of Memorandum of Association

3.2.2 Contents of Memorandum of Association

3.2.3 Alteration in Memorandum of Association

3.3 Doctrine of Ultra vires

3.4 Check Your Progress

3.5 Summary

3.6 Keywords

3.7 Self-Assessment Test

3.8 Answers to Check Your Progress

3.9 References/Suggested Readings

3.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the meaning and purpose of Memorandum of Association;
- Understand the provisions of Companies Act as to clauses of the memorandum;
- Describe the procedure of alteration of the clauses of the memorandum; and
- Discuss the doctrine of ultra vires and effects of ultra vires acts.

3.1 INTRODUCTION

The memorandum of association is one of the basic documents required to be originally framed by every company and filed with the Registrar for its registration. It sets out the constitution of the company and provides the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world. Memorandum of association decides the type of activities a company can do and also its relationship with the outside world.

3.2 MEANING OF MEMORANDUM OF ASSOCIATION

The first step in the formation of a company is to prepare Memorandum of Association. According to Sec. 2(56) of Indian Company Act, 2013, "Memorandum means the Memorandum of Association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act".

It is the most important document of a company. It is called 'Charter of the Company' because it contains the object of the company and limits the powers of the company. It is compulsory to file this document at the time of registration of the company.

A Fundamental Document: The Memorandum of Association is a document of great importance in relation to the company. It contains the fundamental conditions on which alone the company is allowed to be incorporated. It lays down the area of operation of the company. It also regulates the external affairs of the company in relation to the outsiders. The purpose is to enable shareholders and those who deal with the company to know the permitted range of the enterprise. It not only shows the object of the formation of a company but also the utmost possible scope of it.

3.2.1 PURPOSE OF MEMORANDUM OF ASSOCIATION

The purpose of the Memorandum is two fold:

(1) The prospective shareholders shall know the field to or the purpose for which their money is going to be used by the company and what risk they are undertaking in making investment.

(2) The outsiders dealing with the company shall know with certainty as to what the objects of the company are and as to whether the contractual relations into which they contemplate to enter with the company is within the objects of the company.

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

Each subscriber shall sign and add his address, description and occupation, if any, in the presence of at least one witness.

3.2.2 CONTENTS OF MEMORANDUM OF ASSOCIATION

The Memorandum of any company shall contain the following clauses:

(I) Name clause (II) Situation clause (III) Object clause

(IV) Liability clause (V) Capital clause (VI) Subscription clause

I. Name Clause

The first clause of the Memorandum shall state the name of the proposed company. The name of a company establishes its identity and the symbol of its existence.

Rules regarding Name: A company may, subject to the following rules, select any suitable name:

(1) Undesirable Name to be Avoided: A company cannot be registered by a name which, in the opinion of the Central Government, is undesirable. Broadly speaking, a name is undesirable and therefore rejected, if it is either:

(a) Too similar to the name of another company, or

(b) Misleading, i.e., suggesting that the company is connected with a particular business or that it is an association of a particular type when this is not the case.

(2) Injunction if Identical Name Adopted: If a company gets registered with a name which resembles the name of an existing company, the other company with whom the name resembles can apply to the Court for an injunction to restrain the new company from adopting the identical name [Ewing Butter Cup Margarine Co. Ltd. (1917) 2 Ch. 1]. This is of because of the reputation and company gains a monopoly of the use of that name and no other company can be registered under a name identical with it or so nearly resembling it as is calculated to deceive.

An injunction will not be granted to prevent the use of a purely descriptive word with a definite meaning and in common use. However, the Court or Tribunal will not grant an injunction to prevent the use of a purely descriptive word with a definite meaning and in common use.

In the case of Aerators Ltd. Vs. Tollitt (1902) 2 Ch. 3191, a company registered as Aerators Limited sought to restrain the registration of another company under the name of ‘Automatic Aerators Patents Limited’. The main object of both the companies was the manufacture of apparatus for the instantaneous automatic aeration of liquids although the patents and apparatus of the two companies were distinct. The Court refused to grant injunction.

(3) Limited or ‘Private Limited’ as the Last Word or the Words of the Name: The Memorandum shall state the name of the company with ‘Limited’ as the last word in case of a public limited company and with the ‘Private Limited’ as the last word of the name in case of a private limited company.

The omission to use word ‘Limited’ as part of the name of a company shall make the name incorrect. If a company makes the contract without the use of the word ‘Limited’, the officers of the company who make the contract would be deemed to be personally liable. The omission to use the word ‘Limited’ as part of the name of a company must have been deliberate and not merely accidental. Note the following case:

In the case of Dermatine Co. Ltd. Vs. Ashworth (1905) T.L.R 510, a bill of exchange drawn upon a limited company in its proper name was duly accepted by two directors of the company. The rubber stamp by which the words of acceptance were impressed on the bill was longer than the paper of the bill and hence the word ‘Limited’ was missed. Held the company was liable to pay and directors were not personally liable. “It was an error of the most trifling kind and mischief aimed at by the Act did not exist.”

(4) Prohibition of Use of Certain Names: The Emblems and Names (Prevention of Improper Use) Act, 1950 prohibits the use of or registration of a company with any name or emblem specified in the Schedule to that Act. The Schedule specifies the following items, i.e., the name emblem or official seal of the UNO, World Health Organisation, the United Nations Educational, Scientific and Cultural Organisation, the World Meteorological Organisation and the International Civil Aviation Organisation, the Indian National Flag, the name, emblem or official seal of the Central Government and State Government. The name emblem or official seal of the President of India or Governor of any State or connection with any local authority or any corporation or body constituted by the Government under any law for the time being in force.

Once a company is registered with a certain name, it must appear in a conspicuous manner on the outside of every office or place of work and on letters, notices and cheques etc. of the company. In case of one-person company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Penalty. If default is made in complying with this provision, the company and every officer in default shall be liable to fine, which may extend to ₹ 1,000 per day till the default continues.

II. Situation Clause

The second clause of the Memorandum must mention the name of the State in which the registered office of the company is to be situated. This fixes the domicile of the company. It is sufficient to mention the name of the State in which the registered office of the company is to be situated. Actual address is not mentioned in the Memorandum. However, notice of its registered office and every change therein has to be given to the Registrar within 15 days of incorporation or change, as the case may be. It is usual to file the notice of registered office of the company along with the Memorandum at the time of registration. For default, the above penalty shall also apply in this case.

According to Sec. 12(3), every company shall:

(a) paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed therefore are not those of the language or of one of the languages in general use in that locality, also in the characters of that language or of one of those languages;

(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 alongwith telephone number, fax number, if any, e-mail and website addresses, if any, printed on all its business letters, billheads, letter papers and in all its notices and other official publications; and

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

Provided that where a company has changed its name or names during the last two years, it shall paint or affix or print, as the case may be, alongwith its name, the former name or names so changed during the last two years as required under clauses (a) and (c):

Provided further that the words ‘One Person Company’ shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

III. The Object Clause

The objects of a company shall be clearly set forth in the Memorandum, for a company can do what is within or incidental to, the objects stated in the Memorandum. The object clause both defines and confines scope of the company's power and once registered, it can only be altered as provided by the Act.

Purpose of the Object Clause: The purpose of object clause in the Memorandum is two-fold:

Firstly, it protects the investors who learn from it the purpose to which their money can be applied. It ensures that their money will not be risked in any business which is not authorised by the Memorandum. Secondly, it protects tile creditors and other persons who deal with the company as they can infer (know) from it the extent of the company's powers.

Any act done beyond the powers conferred by the Memorandum will be ultra vires. A Company is free to choose its objects but the objects should not be illegal, unlawful, against public policy or against the Companies Act, e.g. to trade with enemy etc.

The object for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

In Evans Vs. Brunner Mond & Co. (1921)1 Ch. 359, a company engaged in manufacture of chemicals, proposed to devote a substantial sum of money to the encouragement of scientific education. It was proved that this Act would ultimately benefit the company, but a shareholder objected on the ground that it was beyond the powers of the company. Held, the proposal was fairly incidental to the company's object.

IV. Liability Clause

The liability of members of the company whether limited or unlimited is stated in liability clause, and also state:

(i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

(ii) in the case of a company limited by guarantee, the amount upto which each member undertakes to contribute:

(A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

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

V. Capital Clause

The Memorandum of a company, having a share capital, shall state the amount of the share capital with which the company is to be registered and the division thereof into shares of a fixed amount.

Sec. 4(i)(e) states that the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the Memorandum agree to subscribe which shall not be less than one share; and

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

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

VI. Subscription Clause

Though this clause is not numbered in the Act, is generally given at the and of the Memorandum. This clause reads like this “we the several persons, whose names, addresses and occupations are subscribed, are desirious of being formed into a company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.”

In case of ‘One Person Company’, subscription clause reads like this “I, whose name and address is given below, am desirous of forming a company in pursuance of this Memorandum of Association and agree to take all the shares in the capital of the company.”

This clause states that the persons subscribing their signatures to the Memorandum are willing to form themselves into an association. One subscriber cannot attest the signature of the other. A subscriber is also required to take at least one share. He should mention against his name the number of shares taken by him. In case of a public company, the Memorandum shall be signed by at least seven persons (two in case of a private company).

3.2.3 ALTERATION IN MEMORANDUM OF ASSOCIATION

Memorandum of Association is the fundamental document of a company. It cannot be and should not be freely altered. Sec. 13 of this Act states the manner in which Memorandum of Association can be altered.

I. Alteration in Name Clause

Sec. 13, (1) save as provided in Section 61, a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum,

(2) Any change in the name of a company shall be subject to the provisions of sub-section (2) and (3) of Section 4 and shall not have effect except with the approval of the Central Government in writing:

Provided that no such approval shall be necessary where the only change in the name of the company is the deletion therefrom, or addition thereto, of the word 'Private', consequent on the conversion of any one class of companies to another class in accordance with the provisions of this Act.

(3) When any change in the name of a company is made under sub-section (2), the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

II. Alteration in Situation Clause

A company can change its registered office from one place to another according to the provisions of this Act under section 13.

(1) The alteration of the Memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government on an application in such form and manner as may be prescribed [Sec. 13(4)].

(2) The Central Government shall dispose of the application under sub-section (4) within a period of sixty days and before passing its order may satisfy itself that the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company or that the sufficient provisions has been made by the company either for the due discharge of all its debts and obligations or that adequate security has been provided for such discharge [Sec. 13(5).

(3) Save as provided in Section 64, a company shall, in relation to any alteration of its Memorandum, file with the Registrar:

(a) the special resolution passed by the company under sub-section (1);

(b) the approval of the Central Government under sub-section (2), if the alteration involves any change in the name of the company [Sec. 13(6)].

(4) Where an alteration of the Memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration [Sec. 13(7)].

III. Alteration in Object Clause

Sec. 13 of the Companies Act, 2013 states a company can change its objects in furtherance of the objectives stated in the Memorandum.

An alteration should be made in accordance with the provisions and the manner prescribed. For changing the object clause, the company has to pass a special resolution and obtain the approval of the Central Government. Every change shall be noted in every copy of the Memorandum. A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and:

(i) the details, as may be prescribed, in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;

(ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board of India.

The Registrar shall register any alteration of the Memorandum with respect to the objects of the company and certify the registration within a period of 30 days from the date of filing of the special resolution in accordance with clause (a) of sub-section (6) of this section.

No alteration made under this section shall have any effect until it has been registered in accordance with the provisions of this section.

Any alteration of the Memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

Penalty: In case of default the company and every officer who is in default shall be liable to a penalty of ` 1,000 for every copy of the Memorandum or Article issued without such alteration [Sec. 15(2)].

IV. Change in Liability Clause

The liability of the members cannot be made unlimited without their consent in writing. By changing Memorandum or Articles, a member cannot be compelled to buy additional shares of the company. However an association, by altering its Memorandum or Articles can raise the periodical subscription without the consent of its members in writing. Further, liability of the directors, managing directors or manager can be made unlimited with their consent provided the Article so provide.

Further unlimited liability of the shareholders can be made limited by passing a special resolution and obtaining the approval by the Company Law Tribunal. In the alternative an, unlimited company may register itself as a limited company. However, it will not affect any debt, liabilities, obligations already incurred or contracts made before such registration.

V. Alteration in Capital Clause

Power of Limited Company to Alter its Share Capital [Sec. 61]

(1) A limited company having a share capital may, if so authorised by its Articles, alter its Memorandum in its general meeting to:

(a) increase its authorised share capital by such amount as it thinks expedient;

(b) consolidate and divide all or any of its share capital into share of a larger amount than its existing shares:

Provided that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

(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, or any of them, into shares of smaller amount than is fixed by the Memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

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

Notice to be given to Registrar for Alteration of Share Capital [Sec. 64]

(1) Where:

(a) a company alters its share capital in any manner specified in sub-section (1) of Section 61;

b) an order made by the Government under sub-section (4) read with sub-section (6) of section 62 has the effect of increasing authorised capital of a company; and or

(c) a company redeems any redeemable preference shares.

The company shall file a notice in the prescribed form with the Registrar within a period of 30 days of such alteration or increase or redemption, as the case may be, along with an altered Memorandum.

(2) If a company and any officer of the company who is in default contravenes the provisions of sub-section (1), it or he shall be punishable with fine which may extend to one thousand rupees for each day during which such default continues, or five lakh rupees, whichever is less.

3.3 DOCTRINE OF ULTRA VIRES

A company has the power to do all such thing as are:

(1) Authorised to be done by the Companies Act, 2013;

(2) Essential to the attainment of its object specified in the Memorandum; and

(3) Reasonable and fairly incidental to its objects.

Everything else is ultra vires the company. Ultra means ‘beyond’ and ‘vires’ means ‘powers’. The term ‘ultra vires’ a company means that the doing of the act is beyond the legal power and authority of the company. All ultra vires acts of a company shall be fully null and void and can never be ratified and become valid even though, all the shareholders of the company agree to ratify such transactions. It is not necessary that an act to be considered ultra vires must be illegal; it may be and may not be. It cannot become ultra vires by reasons of estoppel, lapse of time, ratification, acquiescence or delay. The rule is meant to protect future shareholders and the public at large who deal with the company. The leading case on the point is Ashbury Rly. Carriage & Iron Company Ltd. Vs. Riche (1975) L.R. 7 H.L. 653, A company was incorporated with the objects:

(a) Make, sell or lend on hire, railway carriages and wagons;

(b) To carry on the business of mechanical engineers and general contractors;

(c) To purchase lease, work and sell mines, minerals, land and buildings.

The company entered into a contract with Riche for the financing of the construction of a railway line in Belgium. The question raised was whether that contract was valid. The House of Lords held that the contract was ultra vires the company and void so that not even the subsequent assent of the whole body of shareholders could ratify it.

The doctrine of ultra vires as laid down in the Ashbury's case was affirmed by the House of Lords in Attorney General Vs. Great Eastern Railway Co. (1880) 5 Ap. Cas 473. It was stated that the doctrine of ultra vires "ought to be reasonably and not unreasonably, understood and applied, and whatever may fairly be regarded as incidental to or consequential upon those things which the legislature has authorised ought not be held by Judicial construction to be ultra vires." Note the following case:

Deuchar Vs. Gas Light & Coke Co. (1925) A. (69)], a gas company was empowered to make and supply gas, manufacture and sell residuals and to provide such apparatus and materials as it deemed requisite for those purposes. After purchasing Caustic Soda for a number of years it decided to manufacture its own Caustic Soda. Held, it was not ultra vires the company.

The main feature of doctrine of ultra vires is that a company being a corporate person should not be punished for its own acts or acts of its agents, if they are beyond its powers and privileges. A contract of a company which is ultra vires is wholly void and of no legal effect. But there is nothing to prevent a company from protecting its property. The leading case on this point is:

National Telephone Co. Vs. St. Peter Port Constables (1900) A.C. 317. A telephone company put up telephone wires in a certain area. The company had no power in the Memorandum to put up wires there. The defendants cut them down. Held, the company could sue for damage to the wires.

Ultra-vires acts may be classified into the following parts:

(1) When an act is performed or a transaction is carried out which, though legal in itself, is not authorised by the object clause in the Memorandum or by statute. It is said to be ultra vires the company.

(2) If an act is ultra vires the company, it cannot be ratified even by the whole body of shareholders.

(3) If an act is ultra vires the directors i.e., beyond the scope and powers of the directors but intra vires that company, it can be ratified by the shareholders by a special resolution in a general meeting.

(4) If an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolution in a general meeting.

Effects of Ultra Vires Transactions

Ultra vires transactions are the acts for which a company or its directors are not authorised to do such acts have the following effects:

(1) Company is not Bound by Ultra Vires Acts: A company is not bound by the ultra vires acts and a company can never ratify these acts even though all the shareholders of the company agree to ratify their acts.

(2) Personal Liability of Directors: Any member of a company can maintain an action against the directors of the company to compel them to restore to the company the funds of the company that have been employed by them in ultra vires transactions. If any funds of the company are misapplied, the directors are personally liable to the company for breach of trust even when the misapplication by the directors is done is good faith or when it is not fraudulent.

In Sharpe Re (1892) 1 Ch. 154, case the directors of a company paid dividends on shares out of capital which is an ultra vires act. The company was afterwards wound-up. Held, the directors were liable to refund the money to the company.

(3) Injunction Order: If any member of the company feels that the company is going to do anything ultra vires, he may go to the Court and obtain an injunction order to get the work stayed.

(4) Ultra Vires Contracts are Void and Illegal: If company has entered into any contract which is ultra vires its Memorandum, all such contracts are completely void and hence can never be ratified.

(5) Liability of the Directors for Breach of Warranty of Authority: Directors are known as the agents of the company. They must work within the limits and powers of the company. If it is proved that they have induced any one to enter into any contract ultra vires the Memorandum of company, they will be held personally liable for such contracts and liable for breach of their duties. They will have to compensate all the losses of that person.

In the case of Weeks Vs. Propert (1873) LR & C.P 427, the directors of a railway company which had fully exhausted its borrowing powers advertised for money to be lent on debentures, 'W' lent £500 upon the footing of advertisement and received a debenture. Held, the debenture was void but 'W' could sue the directors for breach of warranty of authority.

(6) No Suit can be Filed: A company can not sue any person for its ultra vires act and similarly, it can not be sued by others.

(7) Ultra Vires Acquired Property: If a company has acquired some property under an ultra vires transaction, it has the right to hold that property and protect it against damages by other persons.

(8) Ultra Vires Torts: A company is not liable for torts (civil wrongs) committed by its agents or servants during the course of ultra vires transactions.

Exceptions to the Doctrine of Ultra Vires

Following are the exceptions to the doctrine of ultra vires:

1. If an act is ultra vires the directors of a company but is intra vires the company, the company may ratify it.
2. If an act is ultra vires the Articles of Association of a company, the Articles may be altered to include the act within the powers of the company.
3. It an act is intra vires but is irregularly done, the shareholders may ratify it.
4. If a person borrows money from a company under a contract which is ultra vires the company, the company can sue him for the recovery of the money.
5. If an act is ultra vires the company, the right arising independently thereon are not affected.
6. If a company takes an ultra vires loan and uses it to pay off intra vires debts, the lender who has lent money is substituted in place of creditors and as such he can recover the money.

7. If a company has taken an ultra vires loan through some misinterpretation of fact by the directors, the lender has the right to make directors personally liable on the ground of breach of implied warranty of authority.
8. If a director of a company makes payment ultra vires the company, the company can compel him to refund the amount.

3.4 CHECK YOUR PROGRESS

Fill in the blanks

1. A company can change its name at its own discretion by passing ……..
2. Any change in the address of the registered office must be communicated to the registrar with in ……….
3. Companies are now allotted a ……… in addition to their name.
4. MOA should be in form …….. in case of a unlimited liability.
5. Ultra vires means ………..

3.5 SUMMARY

Memorandum of Association of a company is the most important document of a company. It is the charter of a company. It defines and confines the powers of a company. Any act which is beyond the powers conferred by the Memorandum is called ultra vires. It contains name clause, situation clause, object clause, liability clause, capital clause and subscription clause. The name of the company can be altered by a special resolution and with the approval of Central Government in writing. By change of name, the constitution of the company is not changed, only the name changes. A company can change its registered office from one place to another within the local limits of the city, town or village, where it is situated, by merely passing a Board resolution. A company can change its objects clause by passing a special resolution. Companies Act permits a company, by a special resolution and after compiling with the procedure specified, alter the provisions of its memorandum.

3.6 KEYWORDS

Memorandum of Association: It is a charter of a company and defines the limitations of the powers of a company.

Doctrine of Ultra Vires: A doctrine declaring that any act contrary or in excess of the scope of the activity of the company will be null and void and not binding on the company.

3.7 SELF ASSESSMENT TEST

1. What is a Memorandum of Association? What are its contents?
2. "The Memorandum of Association is the fundamental law or a charter of the company defining the object and limiting the powers of a company." Explain.
3. What are the compulsory clauses in the Memorandum of Association? In what cases, in what mode and to what extent can a company alter these clauses?
4. Set out the restrictions imposed on the choice of a name for a company. How can a company change its name?
5. Explain the necessity of setting out clearly the objects in the Memorandum of Association as per the Companies Act, 2014.
6. Why is it necessary for a company to have a registered office? Can the registered office of a company be changed?
7. Discuss the doctrine of ultra vires vis-a-vis a company, the directors and the Articles. What is the legal effect of ultra vires acts?
8. "Memorandum of Association is the most important charter of a company." Discuss. How can it be altered?

3.8 ANSWERS TO CHECK YOUR PROGRESS

1. Special Resolution
2. 1 Month
3. CIN
4. Table E
5. Beyond the Power

3.9 REFERENCES/SUGGESTED READINGS

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STRUCTURE

4.0 Learning Objectives

4.1 Introduction

4.2 Meaning of Articles of Association

4.2.1 Contents of Articles of Association

4.2.2 Models of Articles of Association

4.2.3 Alternation of Articles of Association

4.3 Article and Memorandum of Association

4.3.1 Articles and Memorandum: Their Relation

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4.3.3 Legal effect of Memorandum and Articles of Association

4.3.4 Constructive Notice of Memorandum and Articles

4.3.5 Doctrine of Indoor Management

4.4 Check Your Progress

4.5 Summary

4.6 Keywords

4.7 Self-Assessment Test

4.8 Answers to Check Your Progress

4.9 References/Suggested Readings

4.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the meaning and contents of articles of association of a company.
- Describe the provisions and procedure of alteration of articles.
- Explain the relationship and difference between memorandum and articles of association.
- Discuss the legal effect of memorandum and articles of association.
- Throw light on the doctrine of constructive notice and indoor management.

4.1 INTRODUCTION

A company is an incorporated body so there have to be some rules and regulations for the management of its internal affairs and conduct of its business. It is equally important for a company to have some guidelines for managing its relationship with its members and also between the members. Moreover, the rights and duties of its members and the company are also to be recorded. A document which serve all these mentioned purpose is called the articles of association. Articles of association of a company are the internal rule book that every incorporated organisation must have and work by. It forms a part of the constitution of the organisation which establishes a contract between the members and organization and also among the members themselves. Articles also set out the rights and duties of directors and stockholders individually and in meetings.

4.2 MEANING OF ARTICLES OF ASSOCIATION

The Articles of Association are the rules, regulations and bye-laws for the internal management of the affairs of the company. They are framed with the object of carrying out the aims and objects as set out in the Memorandum of Association.

The Articles of Association have been defined by Sec. 2(5) of Indian Companies Act, 2013 as "Article means the Articles of Association of company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act."

The Article shall also contain such matters, as may be prescribed. Provided that nothing prescribed in this sub-section shall be deemed to prevent a company from including such additional matters in its Articles as may be considered necessary for its management.

The Article may contain provisions for entrenchment to the effect that specified provisions of the Articles may be altered only if conditions or procedures as that are more restrictive than those applicable in case of special resolution, are met or complied with.

The Article of a company shall be in respective forms specified in Table F, G, H, I and J in Schedule I as may be applicable to such company.

The Articles are next in importance to the Memorandum which contains the fundamental conditions upon which alone a company is allowed to be incorporated. They are as such subordinate to and controlled by the Memorandum. In Ashbury Railway Carriage & Iron Company Ltd. Vs. Riche (1875) L. R.7 H.L. 653, it was observed that the 'Articles' play a part subsidiary to the Memorandum of Association. They accept the Memorandum of Association as charter of the company and so accepting it. The Articles proceed to define the duties, the rights and the powers of the governing body as between themselves and the company at large, mode and term in which changes in internal regulation of the company may from time to time be made.

In framing the Articles of a company care must be taken that regulations framed do not go beyond the power of company itself as contemplated by the Memorandum of Association. They should also not violate any of the provision of the Companies Act. In Peveril Gold Mines Ltd. Re (1898) Ch 122 case, it was stated that the contents of the Articles should not violate the provisions of the Companies Act.

4.2.1 Contents of Articles of Association

Articles usually contain provisions relating to the following matters:

(1) The amount of share capital and its division.

(2) Amount of minimum subscription.

(3) Call money and procedure to call.

(4) Procedure for the allotment of shares.

(5) Procedure for the forfeiture and re-issue of shares.

(6) Provision for the reorganisation of shares capital.

(7) Procedure for the reduction of share capital.

(8) Procedure to confirm preliminary contracts.

(9) Right to borrow and the procedure of arranging loans.

(10) Commission payable on underwriting and brokerage.

(11) Types of meetings and the time to call them.

(12) Share certificates.

(13) Lien on shares and transfer of shares.

(14) Conversion of shares into stock.

(15) Voting rights of members, voting and poll procedures.

(16) Directors, their appointment, remuneration, qualifications, power and proceeding of Board of Directors.

(17) Rules regarding auditor, manager, secretary and treasurer.

(18) Rules regarding use of common seal.

(19) Rules regarding the keeping of books of accounts

(20) Rules regarding the capitalisation of profits.

(21) Rules regarding the creation of reserve funds

(22) Rules regarding the winding-up to company.

(23) Rules regarding the commission on shares and debentures.

(24) Rules regarding the issue of preference shares.

(25) Right to pay interest out of capital.

(26) Right to issue the share warrants.

(27) Right to appoint internal auditor.

(28) Right to declare interim dividend.

(29) Right to limit the rights of directors.

(30) Right to distribute the profits of the company.

In addition to the above matters, an un-limited company must disclose in Articles of Association the number of share with which the company is to be registered and the amount of share capital, if any, with which the company is to be registered. In case of a company limited by guarantee, Articles of Association must disclose the number of members with which the company is to be registered. It must also disclose the amount of guarantee that they have agreed to contribute in case of winding-up of company.

4.2.2 MODELS OF ARTICLES OF ASSOCIATION

Schedule I of the Companies Act gives various model forms of Articles of Association of various types of companies which are as follows:

Table F: Articles of Association of a company limited by shares.

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: Article of Association of an unlimited company and having share capital.

Table J: Article of Association of an unlimited company and not having share capital.

Companies which must have their own Articles

The following companies shall have their own Articles:

(a) Unlimited companies.

(b) Companies limited by guarantee.

(c) Private companies limited by shares.

The Articles must be signed by the subscribers of Memorandum and registered along with the Memorandum.

4.2.3 ALTERATION OF ARTICLES FO ASSOCIATION

For the alteration of Articles, Sec. 14 of Indian Companies Act, 2013 states that:

(1) Subject to the provisions of this Act and the conditions contained in its Memorandum, if any, a company may, by a special resolution, alter its Articles including alterations having the effect of conversion of:

(a) a private company into a public company; or

(b) a public company into a private company:

Provided that where a company being a private company alters its Articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the Articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company:

Provided further that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.

(2) Every alteration of the Articles under this section and a copy of the order of the Tribunal approving the alteration as per sub-section (1) shall be filed with the Registrar, together with a printed copy of the altered Articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

(3) Any alteration of the Articles registered under sub-section (2) shall, subject to the provisions of this Act, be valid as if it were originally in the Articles. As per Sec. 15 of this Act, alteration of Memorandum or Articles to be noted in every copy:

(1) Every alteration made in the Memorandum or Articles of a company shall be noted in every copy of the Memorandum or Articles, as the case may be.

(2) If a company makes any default in complying with the provisions of sub-section (1), the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the Memorandum or Articles issued without such alteration.

Limitations of the Alteration

Following are the limitations of the alteration of Articles:

(1) Must not be in Consistent with the Act: The alteration of the Articles must not be inconsistent with or go beyond the provisions of the Companies Act.

(2) Must not Conflict with Memorandum: The alteration of the Articles must not exceed the power given by the Memorandum or conflict with the provisions of the Memorandum. If it does, it will be ultra vires and wholly void or inoperative.

(3) Must not Sanction Anything Illegal: The alteration must not purport to sanction anything which is illegal. But if it is illegal and it is not clearly prohibited by the Memorandum it may be held to be valid even where it alters the whole structure of the company.

(4) Must be for the Benefit of the Company: The alteration must be bonafide for the benefit of the company as a whole. In Allen Vs. Gold Reefs of West Africa Ltd. (1900) Ch. 656, it was observed that the power of alteration must be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities.

(5) Must not Increase Liability of Members: The alteration must not in any way increase the liability of existing members, but where the company is a club or association, the Articles may be altered to provide for subscription or charge at higher rate.

(6) Alteration by Special Resolution: The alteration can be made only by a special resolution as defined in the Act. Even a clerical error in the Articles should be set right by a special resolution.

(7) Approval of Central Government: When a public company is converted into a private company. The alteration in the Articles which has the effect of converting a public company into a private company can be made only if it is approved by the Central Government.

(8) Breach of Contract: A company is not prevented from altering its Articles even if such an alteration would result in breach of a contract, however, the affected party may file a suit for damages for the breach of contract.

(9) Must not Result in Expulsion of a Member: An assumption by the directors of a company of any power to expel a member by altering its Articles is illegal and void.

(10) No Power of the Court to Amend Articles: The Court has no power to amend or rectify the Articles even where there is a mistake or drafting error which the Court would rectify in case of any other contract. The Court can only declare some clause to be ultra vires.

4.3 ARTICLE AND MEMORANDUM OF ASSOCIATION

4.3.1 ARTICLES AND MEMORANDUM: THEIR RELATION

The Articles are subordinate to Memorandum. The Articles cannot give powers to a company which are not conferred by the Memorandum. This is so because the object of the Memorandum is to state the purpose for which the company has been formed while the Articles provide the manner in which the internal management of the company is to be carried. The Articles may explain or supplement the Memorandum, but cannot extend or enlarge its scope.

The terms of the Memorandum cannot be modified or controlled by the Articles, so far as the fundamental conditions in the Memorandum are concerned, they cannot be explained with aid of the Articles. In this regard Brown L. observed, “The Memorandum contains the fundamental conditions upon which alone company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors and the outside public as well as shareholders. The Articles are the internal regulations of the company”.

4.3.2 DIFFERENCE BETWEEN MEMORANDUM AND ARTICLES OF ASSOCIATION

Following are the differences between memorandum and articles of association:

	Memorandum of Association	**Articles of Association**
(1)	It is the charter of the company. It also defines the company's relationship with outsiders.	They are the regulations for the internal management of the company and are subsidiary to Memorandum.
(2)	It defines the scope of the activities of the company or beyond which the actions of the companies cannot go.	They are the rules for carrying out the objects of the company as set out in the Memorandum.
(3)	It is the main document of the company.	They are subordinate to the Memorandum. If there is a conflict between the Articles and Memorandum, the Memorandum prevails.
(4)	Alteration in Memorandum of Association is very difficult and is not a common feature.	Articles of Association may be altered by passing a special resolution at the meeting.
(5)	Acts done by a company ultra vires the Memorandum are void and cannot be ratified by the shareholders.	Acts done by a company ultra vires the Articles but intra vires the Memorandum can be ratified by a company by passing a special resolution.
(6)	Outsiders are expected to be acquainted with the Memorandum of Association and if the company enters into any contract ultra vires the Memorandum, outsiders have no remedy against the company.	Outsiders are not expected to be acquainted with the Articles of a company and then can enforce the contract against the company if it is ultra vires the Articles of Association.

4.3.3 LEGAL EFFECTS OF MEMORANDUM AND ARTICLES OF ASSOCIATION

Sec. 10 of Indian Companies Act, 2013 states:

(1) Subject to the provisions of this 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 covenants on its and his part to observe all the provisions of the Memorandum and of the Articles.

(2) All monies payable by any member to the company under the Memorandum or Articles shall be a debt due from him to the company.

The above provisions of the Companies Act clearly defines that the Memorandum of Association and the Articles of Association, after the registration bind the company and its members with their provisions. The effect of these provisions is to constitute a contract between each member and the company. The legal implication of these documents may be discussed as to how far documents bind:

(1) Members to the company, (2) Company to the members,

(3) Member Inter Se, (4) Company to the outsiders.

(1) Members to the Company: As between the members and the company, the Memorandum and the Articles constitute a binding contract. The effect of this is that each member is bound to the company to conform to the Memorandum and the Articles as if each member has actually signed the same. Boreland's Trustee Vs. Steel Bros & Co. Ltd. (1901) 1 Ch 279, the Articles of a company as altered provided that the shares of any member who becomes bankrupt should be sold to certain persons at a fair price. B, a shareholder became bankrupt and his trustee in bankruptcy claimed that he was not bound by the altered Articles. Held, the Articles were a personal contract between B and the rest of the members and his trustee were bound by the contract.

(2) Company to the Members: A company is bound to the members in the same manner as the members are bound to the company. The company can exercise its rights as against any member, only in pursuance of, and in accordance with, the Memorandum and the Articles. A member can obtain an injunction restraining the company from doing an ultra vires act. In Wood Vs. Odessa Water Works' Co. (1889)42, Ch, D 636 case, the Articles of W. Company provided that the directors may with the sanction of the company at general meeting declare a dividend to be paid to the members. A resolution was passed to give the shareholders debenture bonds instead of paying dividend in cash. A member filed the suit to restrain the directors from acting on resolution as it was not in accordance with the Articles of the company. Held, the word 'to be paid' meant paid in cash and a shareholder could restrain the company from acting on resolution on the ground that it had contravened the Articles.

(3) Member Inter Se: Members are bound to each other but these documents do not create an express agreement between the members of the company. A member cannot bring a suit in his own name against another member to enforce the Articles. Otherwise, there may be a large number of cases against one defaulter, which will be absurd. However, where the member at fault holds the majority of shares he will not, therefore, be allowed to take an action in the name of the company. In such a case, an action may be brought against him by another shareholder in his own name.

This was established by Lord Herschell in Wettron Vs. Saffery (1897) A. C. 299. “It is quite true that the Articles constitute a contract between each member and the company, but the Articles do not regulate their rights inter se. Such rights can only be conferred by or against a member through the company or through the liquidator.”

In some cases, where the Articles seek to regulate the rights of shareholders in their capacity as members, they constitute a contract between two members and in which case contract can be directly enforced by a member against another without joining the company as a party.

(4) Company to the Outsiders: Neither the company nor its members are bound to the outsiders. This is so even if the names of the outsiders are mentioned in these documents. Again, Articles do not confer any right even upon a member in a capacity other than that of a member. There must be an independent contract entered into between the company and the outsiders.

Eley Vs. Positive Govt. Security Life Ass. Co. (1876) EXD 88, the Articles of the company provided that E should be the solicitor of the company for life and could be removed from office only for misconduct. E took office and became a shareholder. After sometime, the company dismissed him without alleging misconduct. E sued the company for damages for breach of regulations in the Articles. Held, the Articles did not constitute any contract between the company and outsiders as such no action could be taken.

4.3.4 CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

Every outsider dealing with a company is deemed to have notice of the contents of Memorandum and Articles. These documents, on registration with the Registrar, assume the character of public documents, this is known as Constructive Notice of Memorandum and Articles.

The Memorandum and Articles are open and accessible to all. It is the duty of every person dealing with a company to inspect these documents and see that it is within the power of the company to enter into the proposed contract. The legal effect of these constructive notices is that if a person deals with a company in a manner which is not inconsistence with the provisions of the Memorandum or Articles of the company, he must be deemed to have dealt with the company at his own risk and cost if he suffers any loss and because of such a deal, he will have to bear the loss himself.

Kolta Venkataswamy Vs. Ram Murthi (1934) 4 Comp. Case 289, the Articles of Association of a company contained a clause that all deeds and documents of the company shall be signed by the managing director, the secretary and a working director on behalf of the company. A deed of mortgage was signed by the secretary and a working director only. Held, the mortgage could not be enforced as the illegality appeared on the face of deed, and therefore, the deed was invalid notwithstanding that plaintiff acted in good faith and money was applied for the purpose of the company.

The doctrine of constructive notice of the Memorandum and Articles, however, is not a positive doctrine but a negative one. It is like the doctrine of estopple. It does not operate against the company. It operates only against an outsider dealing with the company. It prevents him from alleging that he did not know that the Memorandum and Articles rendered a particular act ultra vires the company.

4.3.5 DOCTRINE OF INDOOR MANAGEMENT

Though the doctrine of constructive notice assumes that the persons dealing with the company has gone through its Memorandum and Articles of Association, however, there is one exception to the above doctrine. The exception is that the persons dealing with the company are not bound to enquire into the regularity of the internal proceedings of the company. They are entitled to assume that the provisions of the Articles of Association of a company have been fully observed by its officers and outsiders cannot be expected to see that the company follows its internal regulations. Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

The Articles empowered the directors to borrow on bond such sums of money, as they were authorised by a proper resolution of the company. They issued a bond to Turquard without the authority of such a resolution. It was held that the company was bound by the loan. The plaintiff was entitled to assume that the necessary resolution had been duly passed. The reason for the rule is that the outsiders cannot know as to what has happened within the doors of the company that were closed to them. Memorandum and Articles are public documents but the minutes book of the director’s meeting or shareholder's meeting. (from where a person could ascertain the internal irregularity). Thus, details of internal proceedings are not open to the public.

The gist of the rule is that persons dealing with limited liability companies are not bound to inquire into the regularity of the internal proceedings and will not be affected by irregularities of which they had no notice.

In Laxmi Ratan Cotton Mills Ltd. Vs. J. K. Jute Mills Co. Ltd (1957) 27 Comp. Case 660 (All) where the plaintiff sued the defendant company for a loan of 1,50,000 it was held that where the act done by a person, acting on behalf of the company is within the scope of his apparent authority. It binds company no matter whether the plaintiff has read the documents or not. In this case, the defendant company raised the place that the transaction was not bindings as no resolution sanctioning the loan was passed by the Board of Directors. The Court held, "A transaction entered into by the borrowing company cannot be defeated merely on the ground that no such resolution was in fact passed. The passing of such a resolution is a mere matter of indoor management and it cannot be used to defeat the just claim of a bonafide creditor".

Exceptions to The Doctrine Indoor Management

The doctrine of indoor management is subject to the following exceptions:

(1) Knowledge of Irregularity: Where a person dealing with the company has actual or constructive notice of the irregularity as regard internal management, he cannot claim the benefit under the rule of indoor management. The rule is based on common sense and any other rule would "encourage ignorance and condone dereliction of duty". In the case of Devi Dutta Mal Vs. Standard Bank of India, A.I.R. (1927) Lah, 797, a transfer of shares in a company was approved by two directors. One of these directors was not validity appointed. The other was disqualified by reason of transferor himself. These facts were known to the transferor. Held, the transfer was ineffective.

In another case of Maward Vs. Patent Ivory Co. (1888) 38 Ch. D. 156, the directors of a company could borrow any amount upto $ 1,000 without the approval of the shareholders in general meeting. But for any amount beyond $ 1,000 they had to obtain the consent of the shareholders in general meeting. The directors themselves lent to the company an amount in excess of borrowing powers of the company without the consent of the shareholders in general meeting. Held, the directors had the notice of the internal irregularity and hence the company was liable to pay only for $ 1,000.

(2) Negligence: Where a person dealing with a company could discover the irregularity if he had made proper inquiries. He cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry.

In the case of Anand Bihari Lal Vs. Dinshaw & Co. A.I.R. (1942) Oudh 417, the plaintiff, in this case, accepted a transfer of company's property from its accountant. Held, the transfer was void as such a transaction was apparently beyond the scope of the accountant's authority.

(3) Forgery: Where the acts done in the name of company on the ground of forgery are void ab initio, the doctrine of indoor management does not apply. A company can never be held bound for forgeries committed by its officers. The leading case on the point is Ruben Vs. Great Fingall Consolidated Co. (1906) A.C. 439. The secretary of a company issued a share certificate under the company's seal with his own signature and the signature of a director forged by him. Held, the share certificate was no binding on the company. The person who advanced money on the strength of the certificate was not entitled to be registered as holder of the share.

(4) No Knowledge of Articles: A person should have knowledge of the Articles if he wants protection under the rule of 'indoor management'. The rule is based on the principle of estoppel and a person can be protected if he has relied on the Articles. As such if a person while entering into contract with a company has no knowledge of the company's Articles of Association, he cannot rely on those Articles as conferring ostensible or apparent authority on the agent of the company with whom he dealt. [Rama Corporation Vs. Proven Tin and General Investment Co. (1952) 2 Q.B. 1471].

4.4 CHECK YOUR PROGRESS

Fill in the blanks

1. The doctrine of indoor management is an ……. to the doctrine of constructive notice.
2. The doctrine of …….. does not apply to acts void ab initio.
3. Signature of memorandum and articles should be done by ……. number of person in public company.
4. Alteration of article must be done only by passing ………..
5. Signature of memorandum and articles should be done by …….. number of person in private company.

4.5 SUMMARY

Articles of association regulates the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contact between the company and the members and between the members inter se. The articles of a company are subordinate to and subject to the memorandum of association. Therefore, any clause in the articles going beyond the memorandum will be ultra vires. The articles are only internal regulations, over which the members of the company have full control and may alter then according to what they think fit. Although a company has a statutory right to alter into articles of association yet the power to alter in subject to the provisions of Companies Act and to the conditions contained in Memorandum. The doctrine of constructive notice provides protection to the company against the outsiders. The principle of indoor management, on the other hand, operates to protect the outsiders against the company.

4.6 KEYWORDS

Articles of Association: A document containing rules and regulations and bye-laws for governing the internal affairs of a company.

Doctrine of Constructive Notice: A doctrine declaring that both Memorandum and Articles are public documents after being registered with the Registrar of Companies and everyone dealing with the company is deemed to have constructive notice of them.

Doctrine of Indoor Management: A doctrine declaring that the outsiders dealing with the company are entitled to presume that the internal formalities as required by the company’s articles must have been observed by the management of the company.

4.7 SELF ASSESSMENT TEST

1. What are Articles of Association? How can they be altered?
2. What is the legal effect of the Articles of Association between:

   (a) Members and the company, (b) Members inter se (c) Company and outsiders.
3. What are the main point of distinction between the Memorandum of Association and Articles of Association?
4. “The power of altering Articles is wide yet it is subject to a large number of limitations.” Explain.

5. Discuss the scope of the 'doctrine of indoor management'. To what extent has the doctrine been incorporated in the Companies Act, 2013?
6. "The doctrine of indoor management is silver lining to strangers dealing with a company." Comment.
7. "The doctrine of constructive notice relating to Memorandum and Articles of Association is not a positive doctrine but a negative one". Discuss.

4.8 ANSWERS TO CHECK YOUR PROGRESS

1. Extension
2. Indoor management
3. 7
4. Special Resolution
5. 2

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Subject: Company Law	
Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 05	

PROSPECTUS AND COMMENCEMENT OF BUSINESS

STRUCTURE

5.0 Learning Objectives

5.1 Introduction

5.2 Meaning of Prospectus

5.2.1 Prospectus

5.2.2 Public Offer

5.2.3 Contents of Prospectus

5.2.4 Registration of Prospectus

5.2.5 Issue of Prospectus

5.2.6 Variations in terms of Contract or Objects

5.3 Types of Prospectus

5.3.1 Abridged Prospectus

5.3.2 Deemed Prospectus

5.3.3 Shelf Prospectus

5.3.4 Red Hearing Prospectus

5.4 Misstatement or Untrue Statement in Prospectus

5.5 Check Your Progress

5.6 Summary

5.7 Keywords

5.8 Self-Assessment Test

5.9 Answers to Check Your Progress

5.10 References/Suggested Readings

5.0 LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- Define public offer, prospectus, abridged prospectus.
- Explain the contents of prospectus.
- Highlight the provisions of registration and issue of prospectus.
- Outline the provisions of shelf prospectus and red hearing prospectus.
- Outline the effects of misstatement in prospectus.

5.1 INTRODUCTION

Every company requires capital for its business activities. Therefore, every company issues its securities. But the public and private companies cannot use almost the same ways or methods for issuing their securities. The ways/modes of issuing securities by both the classes of companies are briefly described in the ensuing paragraphs.

A public company may issue securities in any one or more of the following ways:

1. To public through prospectus, i.e., ‘public offer.’

2. Through private placement.

3. Through a rights issue.

4. Through bonus issue, that is, issue of bonus securities.

It should be clearly noted that a listed company or a company that intends to get its securities listed on any recognized stock exchange can make an offer of its securities to the public. While making such an offer, the company shall comply with the provisions of the Securities and Exchange Board of India Act (SEBI Act), 1992 and the Rules and Regulations made thereunder for issue of securities [Sec. 23(1)].

A private company may issue securities by any one of or all the following ways:

1. Through private placement.

2. Through a rights issue.

3. Through a bonus issue, i.e., issue of bonus securities [Sec. 23(2)].

It is clear from the above description that there is only one difference in the ways of issuing securities by the two classes of companies. All the public companies can issue securities through a prospectus but no private company can do so. But all public companies as well as private companies can adopt any of the remaining methods for issue of their securities.

It also becomes clear that a private company is not entitled to issue its securities through prospectus or to the public. Hence, the provisions of the SEBI Act and the Rules and Regulations made thereunder do not apply to private companies.

5.2 MEANING OF PROSPECTUS

5.2.1 PROSPECTUS

Prospectus means any document described or issued as a prospectus and includes a red herring prospectus (referred to in Section 32) or shelf prospectus (referred to in Section 31) or any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate [Sec. 2(70)].

In simple words, a prospectus is any document that is described or issued as a prospectus by a body corporate for inviting offers from public for subscription or purchase of its securities. It may be noted that the term prospectus include a red herring prospectus, shelf-prospectus, and any notice, circular, advertisement, or other document if it is described or issued as a prospectus. It is issued by a body corporate for inviting offers from public for the subscription or purchase of its securities.

Characteristics/Features

The main characteristics or features of a prospectus are as follows:

1. A prospectus is a document which is described or issued as prospectus by a company.
2. A prospectus. includes any red herring prospectus, shelf prospectus, notice, circular, advertisement, or any other document that is issued as prospectus.
3. It may be issued only by public companies. Private companies cannot issue prospectus.
4. It is issued as an invitation to the public by a public company for inviting offers from the public for the subscription or purchase of its securities.

5. A prospectus is a document in writing. It cannot be oral. An oral invitation to the public is not deemed to be a prospectus. Television and film advertisements cannot be treated as prospectus.
6. The date indicated in the prospectus shall be the deemed date of its publication.
7. Every prospectus issued must contain the matters and set out all the reports specified by the provisions of the Companies Act [Sec. 26].
8. A prospectus is signed by the directors or proposed directors and other persons of the company who authorize it to be issued [Sec. 26].
9. A prospectus can be issued to the public only after its registration with the Registrar.
10. The provisions relating to prospectus by a listed company and public company, which intends to get its shares listed on any stock exchange, are administered by SEBI [Sec. 24(1)].

Who can issue prospectus?

Prospectus may be issued by any of the following:

1. By a public company.
2. By any person on behalf of the public company.
3. By any person who is or who has been engaged or interested in the formation of a company.
4. By any person on behalf of a person who is or who has been engaged or interested in the formation of a public company [Sec. 26(1)].
5. A deemed prospectus may be issued by the person or the company to whom a company allots or agrees to allot securities with a view to the same securities being offered for sale to the public [Sec. 25].

When issue of prospectus not needed?

Issue of prospectus or abridged prospectus is not necessary in the following cases:

1. Where the securities of a public company are not offered to the public [Sec. 23]. This will be the case when the public company issues its securities through private placement offer letter [Sec. 42].
2. Where the securities are offered to the existing members of the company with or without the right of renunciation in favour of any other person.

3. Where the securities offered are uniform in all respects with securities previously issued and dealt in or quoted on a recognized stock exchange [Sec. 26(2)].
4. Where a bona fide invitation is made to a person to enter into an underwriting agreement with respect to the securities [Sec. 33].

   It should be noted that a private company cannot issue a prospectus.

5.2.2 PUBLIC OFFER

Public offer of securities means an offer of securities made to the public through a prospectus. The expression 'public offer' is quite comprehensive and it includes the following kinds of offers:

1. Initial public offer (IPO).
2. Further or follow up public offer (FPO). Both these public offers are made through the prospectus.
3. Offer for sale of securities to the public by an existing shareholder. Such offer is also made through issue of a prospectus. It may be both the initial public offer (IPO) and further or follow up public offer or FPO.

1. **Initial Public Offer (IPO):** When an unlisted company makes either a fresh issue of shares or company's promoters offer their holding of shares for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the company's securities in the stock exchanges. Thus, IPO means any of the following:
   (a) Issue of shares for the first time to the public by an unlisted company.
   (b) Offer of sale of shares for the first time by the promoters of a company out of their holding of shares.
2. **Further or Follow on Public Offer (FPO):** When an already listed company makes either a fresh issue of shares to the public or when promoters of a listed company make an offer for sale of their shareholding to the public, after an IPO, it is called a FPO. Thus, further public offer means any of the following:
   (a) Fresh issue of securities by a listed company at any time after an IPO to the public.
   (b) Offer of sale of securities by the promoters of a listed company out of their holding at any time after an IPO.

In case of any public issue of shares, an offer document is issued to the public, which is known as the prospectus. It is the document containing all the relevant information about the company, promoters, projects, financial details, objects of raising the money, terms of the issue, etc. It is used for inviting public for subscription for securities of a company being offered by the issuer.

Whenever a promoter or a member makes an offer for sale of his holding of securities, he is also required to issue a document for inviting public for subscription of securities of the company. Such a document is called the 'offer for sale,' which is 'deemed to be a prospectus' in legal terms. Legal experts sometimes call it a 'prospectus by implication'.

5.2.3 CONTENTS OF PROSPECTUS

The Companies Act, 2013 does not contain any model prospectus. It only prescribes the contents of a prospectus. It also states that a prospectus shall also contain the matters as may be prescribed. According to the provisions of Companies Act and the Rules made thereunder, a prospectus to be issued shall contain the particulars with respect to the following matters:

I. Date: Every prospectus shall be dated. The date indicated in the prospectus shall be deemed to be the date of its publication.

2. Signature: Every prospectus shall be signed by all persons named therein as directors or proposed directors of the company or by his duly authorized agent.

3. Information: Every prospectus issued by a company or on behalf of a company shall contain the following information:

(a) Names and addresses of the registered office of the company, company secretary, chief financial officer, auditors, legal advisors, bankers, trustees, if any, underwriters and such other persons as may be prescribed.

(b) Dates of opening and closing of the issue.

(c) Declaration about the issue of allotment letters and refunds within the prescribed time. The Rules notified by Ministry of Corporate Affairs (MCA) prescribe that the declaration shall be made by the Board or the Committee authorized by the Board in the prospectus that the allotment letters shall be issued or application money shall be refunded within 15 days from the closure of the issue or such lesser time as may be specified by SEBI. In case of failure to do so, the application money shall be refunded to the applicants forthwith. If the money still remains unpaid, the company shall be liable to pay interest to the applicants at the rate of 15 per cent per annum for the delayed period.

(d) A statement by the Board of directors about the separate bank account with a scheduled bank. This statement shall include that all monies received out of the issue are to be transferred to this account. Moreover, disclosure of details of all monies including utilized and unutilized monies out of the previous issue shall be made in the prescribed manner.

(e) Details about underwriting of the issue. The Rules notified by MCA prescribe that the names, addresses, telephone numbers, fax numbers, and e-mail addresses of the underwriters and the amount underwritten by them shall be stated in the prospectus.

(f) Consent of the directors, auditors, bankers to the issue, expert’s opinion, if any and of such other persons, as may be prescribed. The Rules notified by MCA also prescribe that the prospectus shall contain the consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders, and experts.

(g) The authority for the issue and the details of the resolution passed therefore.

(h) Procedure and time schedule for allotment and issue of securities.

(i) Capital structure of the company in the prescribed manner.

(j) Main objects of public offer, terms of the present issue and such other particulars as may be prescribed [Sec. 26(1) (a)].

(k) Main objects and present business of the company and its location, schedule of implementation of the project [Sec. 26(1) (a)].

(1) Minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash [Sec. 26(1) (a)].

(m) Details of directors including their appointments and remuneration, and such particulars as to the nature and extent of their interests in the company as may be prescribed [Sec. 26(1) (a) and Rule PAS-3 (5)].

(n) Disclosures in such manner as may be prescribed about sources of promoter’s contribution [Sec. 26(1) (a) and Rule PAS-3 (6)].

4. **Particulars of Project:** The prospectus shall also contain the following particulars relating to the project:

   (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.

5. **Particulars of Litigation:** The prospectus shall also contain the particulars relating to any litigation or legal action [Sec. 26(1) (a) and Rule PAS-3(4)].

6. **Reports:** Every prospectus shall also set out the following reports for the purposes of the financial information:

(a) 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.

(b) Reports relating to profits and losses for each of the five financial years (or each of the years of actual existence of the company, whichever is less) immediately preceding the financial year of the issue of prospectus. Such reports shall also include such reports of its subsidiaries. The reports shall be in such a manner as may be prescribed.

(c) Reports made in the prescribed manner by the auditors (i) upon the profits and losses of the business of the company for each of the five financial years (or each of the years of actual existence of the company, whichever is less) immediately preceding the issue and (ii) assets and liabilities of its business on the last date to which the accounts of the business not exceeding 180 days before the issue of the prospectus.

(iv) Reports about the business or transaction to which the proceeds of the securities are to be applied directly or indirectly [Sec. 26(1)(b)].

7. **Declaration:** Prospectus shall also include a declaration made about the compliance of the provisions of this Act. This apart, a statement shall also be included in it to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, and the SEBI Act and the rules and regulations made thereunder [Sec. 26(1) (c)].

8. **Any Other Matters:** A prospectus shall also state such other matters and set out such other reports, as may be prescribed [Sec. 26(1) (d)].

Other Contents

Certain other matters including the following shall also be included in the prospectus:

1. **Additional Matters to be Stated in the Document Issued by Issue House:** The offer for sale by an issue house shall state the following additional particulars:

   (i) The net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates.

   (ii) The time and place at which the contract under which the said securities have been or are to be allotted may be inspected [Sec. 25(3)].

2. **Matters to be Stated on the Face of the Prospectus:** Every prospectus issued shall contain on its face the following matters:

   (a) That a copy has been delivered for registration to the Registrar.

   (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 [Sec. 26(6)].

3. **Reproduction of Provisions Relating to Personation for Acquisition of Securities:** The provisions relating to personation for acquisition etc. of securities shall be prominently reproduced in every prospectus issued by company and in every form of application for securities [Sec. 38].

Conditions for Inclusion of Expert's Certificate

A prospectus issued shall include a statement purporting to be made by an expert subject to the following conditions:

(i) The expert shall not be the person who is and has been engaged, or interested in the formation or promotion or management of the company.

(ii) He has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration.

(iii) A statement of the above fact (consent) has been included in the prospectus [Sec. 26(5)].

Punishment for Non-Inclusion of Contents in Prospectus

If a prospectus is issued in contravention of the provisions relating to contents of prospectus [Section 26], the following shall be punished:

(i) The Company: The company shall be punishable with fine which shall not be less than ` 50,000 but which may extend to ` 3 lakh.

(ii) Every Person who is Party to the Issue: 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 3 years or with fine which shall not be less than ` 50,000 but which may extend to ` 3 lakh, or with both [Sec. 26(9)].

Advertisement of Prospectus

Sometimes, an advertisement of any prospectus of a company is published in any manner. But it shall be necessary to specify therein the contents of its memorandum as regards to the following:

(i) The objects.

(ii) The liability of members.

(iii) The amount of share capital of the company.

(iv) The names of the signatories to the memorandum.

(v) The number of shares subscribed by signatories.

(vi) The capital structure of the company [Sec. 30].

Application of Provisions to Every Prospectus and Application Form

The above stated provisions as to contents of prospectus shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently [Sec. 26(3)].

Exceptions/Exemptions

None of the above provisions as to content of a prospectus shall apply in the following cases:

(a) To issue to existing members or debenture-holders of a company. It shall be immaterial whether an applicant has a right to renounce the shares or not in favour of any other person.

(b) To issue a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognized stock exchange [Sec. 26(2)].

5.2.4 REGISTRATION OF PROSPECTUS

A prospectus can be issued only after its registration. The main provisions with respect to registration of prospectus are as follows:

1. **Preparing Prospectus:** A prospectus needs to be prepared for its registration. It should contain all the matters specified by Section 26 and the Rules made thereunder. In addition, it should set out the following documents, reports, and declaration:

   (i) Consent of directors, auditors, and bankers to the issue and other specified persons.

   (ii) Reports by the auditors of the company with respect to its profits and losses and assets and liabilities and such other prescribed matters.

   (iii) Reports relating to profits and losses for each of the five financial years (or each of the years of actual existence of the company, whichever is less) immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries.

   (iv) Reports by the auditors upon the profits and losses of the business of the company for each of the five financial years (or each of the years of actual existence of the company, whichever is less) immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up.

   (v) A declaration to the effect that the provisions of this Act have been complied with.

   (vi) A statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, and the SEBI Act and the rules and regulations made thereunder.

2. **Dating of Prospectus:** A prospectus should be dated. The date indicated in the prospectus shall be taken as the date of publication of prospectus.

3. **Signing of Prospectus:** The copy of the prospectus which is to be delivered for registration must be signed by every person who is named therein as a director or proposed director of the company. Alternatively, it may be signed by his duly authorized agent in writing [Sec.26].

4. **Approval by Various Agencies:** As per the rules and regulations of SEBI, the draft prospectus has to be approved by the following agencies/authorities:
   (i) The lead manager to the issue.
   (ii) Each of the stock exchanges where the securities of the company are listed or proposed to be listed.
   (iii) The lead financial institution underwriting the issue.
5. **Vetting by SEBI:** A prospectus is vetted by SEBI to ensure adequacy of disclosures. As per the directions of the MCA, the Registrar shall not register a prospectus before it is vetted by SEBI. After vetting, if SEBI is satisfied, it shall certify that the contents of the prospectus are not in contravention of any law or rules and regulations. However, SEBI does not take any responsibility to the correctness of statements made or opinions expressed in the prospectus.
6. **Delivery to the Registrar:** The next step is the delivery of the prospectus along with all documents, approvals, and vetting certificate to the Registrar for its registration. It should be delivered to the Registrar on or before the date of its publication [Sec. 26].
7. **Registration of Prospectus:** The Registrar shall register the prospectus if all the formalities required for registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus. The registration shall be done on or before the date of its publication [Sec. 26].

5.2.5 ISSUES OF PROSPECTUS

The main provisions with respect to the issue of prospectus to public are as follows:

1. **Issue Only after Registration:** No prospectus shall be issued to the public unless it is duly registered by the Registrar. Therefore, only duly registered prospectus must be issued [Sec. 26(4)].
2. **Matters to be Stated on the Face of Prospectus:** Every prospectus issued shall contain on its face the following matters:
   (a) That a copy of it has been delivered for registration to the Registrar.
   (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 [Sec. 26(6)].

3. **Issue of Prospectus within 90 Days:** The prospectus must be issued within 90 days of the date on which a copy thereof is delivered to the Registrar. If a prospectus is issued after 90 days of the date of registration, it shall not be a valid prospectus [Sec. 26(8)].

4. **Penalty for Issue of Prospectus in Contravention of These Provisions:** If a prospectus is issued in contravention of the above provisions, the company shall be punishable with fine which shall not be less than ` 50,000 but which may extend to ` 3 lakh. Moreover, every person who is knowingly a party to the issue of such prospectus shl1 be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ` 50,000 but which may extend to ` 3 lakh or with both [Sec. 26(9)].

5. **Furnishing a Copy of the Prospectus on Request:** Where a request for a copy of the prospectus is made by any person, it shall be furnished to him before the closing of the subscription list and offer. If a company makes any default in complying with this provision, it shall be liable to a penalty of ` 50,000 for each default [Sec. 33].

5.2.6 VARIATION IN TERMS OF CONTRACT OR OBJECTS

Sometimes, a company, which has raised money from public through prospectus, still has any unutilized amount out of the money so raised. If such a company intends to alter or vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued, it can do so if it satisfies the following conditions:

1. Special Resolution: The company shall pass a special resolution through postal ballot for effecting such variation change. The notice of the proposed special resolution through postal ballot shall contain the following particulars:

(a) The original purpose or object of the issue.

(b) The total money raised.

(c) The money utilized for the objects of the company stated in the prospectus.

(d) The extent of achievement of proposed objects (that is 50 per cent, 60 per cent, etc).

(e) The unutilized amount out of the money so raised through the prospectus.

(f) The particulars of the proposed variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued.

(g) The reason and justification for seeking variation.

(h) The proposed time limit within which the proposed varied objects would be achieved.

(i) The clause-wise details as were required with respect to the originally proposed objects of the issue.

(j) The risk factors pertaining to the new objects.

(k) The other relevant information which is necessary for the members to take an informed decision on the proposed resolution.

2. Publication of Notice of Resolution: The company shall publish an advertisement of the notice in respect of such resolution to shareholders. It shall also be published in Form No. PAS- 1 in the newspapers (one in English and one in vernacular language) circulating in the city where the registered office of the company is situated. It shall be indicating clearly the justification for such variation. Such advertisement shall be published simultaneously with dispatch of postal ballot notices to shareholders [Sec. 27 and Rule PAS-7(2)].

The notice shall also be placed on the website of the company, if any.

3. Opportunity to Exit to the Dissenting Shareholders: The promoters and shareholders having control on the company shall give an opportunity to the dissenting shareholders to the resolution to exit from the securities in which they have invested their money. The exit offer shall be given at such price, and in such manner and conditions as may be specified by the SEBI [Sec. 27].

5.3 TYPES OF PROSPECTUS

5.3.1 ABRIDGED PROSPECTUS

An abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf [Sec. 2(1)].

Application Form to be Accompanied by Abridged Prospectus: No form of application for the purchase of any of securities of a company shall be issued unless such form is accompanied by an abridged prospectus [Sec. 33(1)].

Exceptions: But no one shall be required to issue a copy of the abridged prospectus with the form of application in the following cases:

(i) Where the form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities.

(ii) Where it is issued in relation to securities which were not offered to the public [Sec. 33].

Copy of Prospectus on Request: A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him [Sec. 33(2)]

Penalty: If a company makes any default in complying with this provision it shall be liable to a penalty of ` 50000 for each default [Sec. 33].

The SEBI Regulations make it clear that the Lead Merchant Banker is responsible for compliance with the provisions in respect of the abridged prospectus.

5.3.2 DEEMED PROSPECTUS

Now-a-days, it is a common practice that the securities of a company are allotted or agreed to be allotted to some intermediary known as the 'issuing house.' The issuing house, in turn, is required to offer all or any of these securities to the public by means of some document. Such a document issued by an issuing house is known as offer for sale of securities. For all purposes it shall be and deemed to be a prospectus issued by the company. The provisions relating to offer for sale of securities by an issuing house are summarized here.

1. Deemed Prospectus: Sometimes, a company allots or agrees to allot any securities of the company to another company or firm with a view to all or any of those securities being offered for sale to the public. In such a case, any document by which such offer for sale is made by that another company or firm shall be and deemed to be a prospectus issued by the company.

Since, the offer document issued by another company or firm is a deemed prospectus, it shall have the following consequences:

(i) All the provisions with respect to contents of the prospectus shall apply to the document.

(ii) The provisions as to registration and issue of prospectus shall also apply to this document.

(iii) Any misstatement in the document or omission of any material fact from the document shall have the same effect as in case of a prospectus.

(iv) The liability of the persons authorizing the issue of a false or misleading document to the subscribers of securities shall be the same as that of the persons authorizing the issue of such prospectus [Sec. 25(1)].

2. Presumption of Intention to Offer Securities to the Public: Generally, the agreement with the issuing house contains the clauses that securities shall be offered to the public. But in the absence of any express provision in the agreement, the intention to offer securities to the public shall be presumed in the following cases unless the contrary is proved:

(i) If the offer of the securities or any of them for sale to the public (by issuing house) is made within six months of allotment or agreement to allot (to the issuing house) the securities.

(ii) If at the date of offer (by issuing house) to the public, the whole consideration to be received by the company in respect of the securities has not been received by it [Sec. 25(2)].

3. Additional Matters to be Stated: The offer for sale must state all the matters and set out all the reports as specified by Section 26. Besides these, the following additional particulars should be stated in the offer for sale:

(i) The net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates.

(ii) The time and place at which the contract under which the said securities have been or are to be allotted may be inspected [Sec. 25(3)).

4. Persons Offering to be Named in the Prospectus as Directors: The persons making the offer shall be named in the prospectus as directors of the company [Sec. 25(3)].

5. Signing of Offer for Sale: Where a person making an offer (i.e., issuing house) is a company, it shall be sufficient if the offer document is signed on behalf of the company by two directors of the company or if it is a firm, it is signed on behalf of the firm by not less than one-half of the partners in the firm [Sec. 25(4)].

5.3.3 SHELF PROSPECTUS

The provisions of shelf prospectus have been incorporated in the Act for the convenience of certain class or classes of companies such as the public financial institutions, public sector banks, or scheduled banks. With the introduction of the provisions of shelf prospectus, they will not be required to prepare prospectus for every issue of securities and file it with the Registrar. This will save a lot of money and time required for complying with many formalities.

'Shelf prospectus' means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus [Explanation to Sec. 31].

Provisions Regarding Shelf Prospectus

The provisions with respect to shelf prospectus are as follows:

1. **Any Class of Companies to File:** Any class or classes of companies may file a shelf prospectus with the Registrar at the stage of the first offer of securities. The SEBI has been authorized to make regulations for preparing and filing a shelf prospectus.
2. **Validity Period:** The shelf prospectus shall indicate a period not exceeding one year as the period of validity of such prospectus. The period of validity shall commence from the date of opening of the first offer of securities under that prospectus.
3. **No Need to File Again during the Validity Period:** A company filing a shelf prospectus shall not be required to file a further prospectus in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus [Sec. 31(1)].
4. **Filing of an Information Memorandum:** A company filing a shelf prospectus shall be required to file an information memorandum containing the following information:
   (i) All material facts relating to new charges created.
   (ii) Changes in the financial position as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities.
   (iii) Such other changes as may be prescribed.
5. **Time of Filing Information Memorandum:** The information memorandum shall be filed within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus. [Sec. 31(2)].
6. **Applications for Securities Received before Making Such Changes:** Sometimes, a company may receive applications for the allotment of securities along with advance payments of subscription before the making of any such change through information memorandum. In such a

case, the company shall intimate the changes to such applicants. If they express a desire to withdraw their application, the company shall refund all the monies received as subscription within 15 days thereof [Sec. 31(2)].

7. **Information Memorandum and Shelf Prospectus to be Deemed Prospectus:** An information memorandum is filed at the time of making every offer of securities. Such memorandum together with the shelf prospectus shall be deemed to be a prospectus [Sec.31(3)].

5.3.4 RED HERRING PROSPECTUS

In the recent years, the issue of securities to the public is being made through the process of book building. In this process, the issuer company may file a red herring prospectus with the Registrar.

Red herring prospectus means a prospectus which does not have complete particulars on the quantum or price of the securities offered and the quantum of securities included therein [Sec. 32].

Provisions Regarding Red Herring Prospectus

The main provisions with respect to the red herring prospectus are as follows:

1. **Issue Prior to the Issue of Prospectus:** A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus [Sec. 32(1)].
2. **Filing with the Registrar:** A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer [Sec. 32(2)].
3. **Same Obligations as are Applicable to Prospectus:** A red herring prospectus shall carry the same obligations as are applicable to a prospectus.
4. **Highlighting the Variations in Prospectus:** Every company shall highlight the variations if any variation between the red herring prospectus and a prospectus as variations in the prospectus [Sec. 32(3)].
5. **Filing of Prospectus with the Registrar and SEBI:** Upon the closing of the offer of securities, a prospectus shall be filed with the Registrar and the SEBI. The prospectus shall state therein the following information:

   (i) The total capital raised whether by way of debt or share capital.

   (ii) The closing price of the securities.

(iii) Any other details as are not included in the red herring prospectus [Sec. 32].

The Golden Rule for Framing Prospectus

A prospectus is a document issued by a company inviting offers from the public for subscription of shares or debentures. Thus, it is a very important document. It may have far-reaching effects on the goodwill of the company as well as the relation between the company and its members. Such a document, therefore, must be complete and accurate in every respect and must not conceal or omit any material fact. In short, the 'golden rule' as to the framing of prospectus must be observed.

The 'golden rule' was enunciated by Kindersely, VC in New Brunswick etc. Co v. Muggeridge (1860) 3 LT 651. This was described as the golden legacy. The rule may be summed up in the following words:

Those who issue a prospectus hold out to the public are of great significance to the persons who will subscribe securities of the company. Public is invited to subscribe securities on the faith of representation made in the prospectus. The company and the persons who authorize the issue of a prospectus are therefore bound to state everything with strict accuracy. They must not omit any material fact within their knowledge which may adversely affect the nature, extent, or quality of the privileges and advantages which the prospectus assures to the subscribers.

5.4 MISSTATEMENT OR UNTRUE STATEMENT IN PROSPECTUS

A misstatement or an untrue or false statement is one which is misleading in the form and context in which it has been included in a prospectus. A prospectus shall also be deemed to have untrue statement or deemed to be misleading if any matter is omitted from it which should have been included in it. In simple words, a prospectus is said to be a 'misleading prospectus' in the following cases:

(i) Where a prospectus includes a statement which is untrue in the form and context in which it is included.

(ii) Where a prospectus omits any matter which is calculated to mislead those who act on the faith of the prospectus [Sec. 34].

Remedies or Consequences of Misleading Prospectus

If a prospectus issued by a company contains false or misstatement or omits to include any material fact in it, it is said to be a misleading prospectus. In case a company issues such a misleading prospectus and the subscribers acting on the faith of such prospectus subscribe for the securities of the company, it will give rise to many consequences. The aggrieved subscribers acting on the faith of such prospectus shall have remedies against the following entities:

A. Remedies against the company.

B. Remedies against the directors, promoters, experts etc.

A. Remedies against the Company

A company has civil liabilities towards the subscribers, who subscribed for securities of a company acting on the faith of its misleading prospectus. Therefore, aggrieved subscribers are entitled to the following remedies against the company:

1. Rescission of contract.

2. Compensation for damages.

1. Rescission of the Contract: A person who subscribes for securities on the faith of a misleading prospectus may apply for the rescission of the contract. On rescission, the subscriber returns the securities allotted to him and gets his money back with interest.

The aggrieved subscriber can exercise the right or remedy to rescind the contract, if the following conditions are satisfied:

(i) The prospectus must have been issued by the company or by someone on behalf of the company.

(ii) There must be an untrue or misleading statement in the prospectus or omission of a material fact from the prospectus. For instance, the prospectus of a company stated that it had paid dividends during the five years of economic depression. But it was not disclosed that the dividends were paid out of the realized capital profits whereas there were considerable trading losses during those years. The Court held that the prospectus was false in material particulars

(iii) The misstatement must relate to the material fact. The fact should not be of law. Even it should not be an expression of opinion. For instance, a prospectus of a company stated that two leading businessmen of repute have agreed to become directors of the company. In fact, they had only expressed their willingness to help the company. The Court held that the prospectus contained misstatement of fact and subscribers could rescind the contract.

(iv) The subscriber must have relied and acted on the misstatement in the prospectus. It must have induced him to subscribe for shares. If a person subscribes for securities of a company without reading its prospectus, he is not entitled to rescind the contract.

(v) The right of rescission is available to the original allottees of securities. If a person buys shares in the open market, he has no remedy against the company even though he might have bought relying on the prospectus.

(vi) The right of rescission must be exercised within a reasonable time, before any proceedings to wind up the company have been commenced.

Loss of right of rescission: The right of rescission of contract is lost in the following circumstances:

(i) If the subscriber affirms or adopts the contract for purchase of shares. For instance, if the subscriber attempts to sell the shares allotted, receives dividends, pays calls or attends general meeting; he is said to have affirmed the contract.

(ii) If the subscriber fails to exercise his right of rescission within a reasonable time after becoming aware of the misstatement in the prospectus. In a case, an applicant became aware of misstatement in prospectus in July. But he applied for rescission of the contract in December. The Court held that the unexplained delay of five months debars him from obtaining relief.

(iii) If the right of rescission is not exercised before the commencement of proceedings of winding up of the company. But where a subscriber has started proceedings for rescission of the contract of shares, the passing of the winding up order would not prevent him getting the relief.

(iv) When the restitution or restoring the original position of the parties becomes impossible.

(v) Where the misrepresentation is of law and not of facts. For example, a prospectus states that the shares shall be issued at a discount of 25 per cent. It is a misrepresentation of law because no company can issue shares at a discount [Sec. 53].

(vi) When the subscriber misreads the prospectus.

2. Compensation for Damages: Another remedy available to every aggrieved subscriber is to claim compensation for damages or loss sustained by him. For availing this remedy, the aggrieved subscribers will have to prove the following facts:

(i) That he acted on the misleading prospectus and subscribed for securities of the company.

(ii) That the prospectus was issued by the company or someone on behalf of the company.

(iii) That he has actually sustained/suffered a loss or damage due to such misleading prospectus.

(iv) That he has rescinded the contract for the purchase of securities, that is, he has returned the securities allotted by the company [Sec. 35(1)].

Thus, the right to claim compensation is available only when an aggrieved subscriber rescinds the contract for purchase of securities. He cannot retain the securities as well as claim the compensation of damages. He will have to rescind the contract before he can claim the compensation.

B. Remedies against the Directors, Promoters, Experts etc.

The Act lists the persons who are liable for misleading prospectus. They are as follows:

(a) Every person who is a director of the company at the time of the issue of the prospectus.

(b) Every person who 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.

(c) Every person who is a promoter of the company.

(d) Every person who has authorized the issue of the prospectus.

(e) Every person who is an expert and who is or has been engaged and interested in the formation, promotion, Or management of the company [Sec. 35(1)].

The liability of directors, promoters, experts etc. may be classified under the following two heads:

1. Civil liability.

2. Criminal liability.

Civil Liability: The directors, promoters, experts etc., (listed above) of the company shall have civil liability towards every person who subscribed for securities acting on the misleading prospectus. In other words, every aggrieved subscriber has the following remedies against the directors etc.:

1. Damages for misstatement and omission [Sec. 35(1)].

2. Unlimited personal liability for fraudulent prospectus [Sec. 3 5(2)].

1. Damages for Misstatement or Omission: Every aggrieved subscriber for securities of the company acting on any misleading prospectus (i.e. any misstatement included in the prospectus or omission of any matter from the prospectus) shall be entitled to hold liable every director, promoter, experts etc., (all listed above) to pay the compensation for any loss or damage sustained by him. To claim damages, the subscriber shall be required to prove the following facts:

(i) That he subscribed for the securities of the company acting on the misleading prospectus.

(ii) That he has suffered loss or damage due to such subscription [Sec. 35(1)].

Defences Available: No person shall be liable to pay compensation if he proves the following facts:

(i) **Withdrew Consent before Issue:** A director will not be liable, if he proves that he withdrew the consent to become director before the issue of the prospectus and the prospectus was issued without his authority or consent.

(ii) **Issued without Knowledge or Consent:** No person shall be liable, if he proves that the prospectus was issued without his knowledge or consent and on becoming aware its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent [Sec. 35(2)]

2. **Unlimited Personal Liability for Fraudulent Prospectus:** Sometimes, it is proved that a prospectus was issued with intent to defraud the applicants for the securities or any other person or for any fraudulent purpose. In such a case, every person who is director, promoter, expert, etc. shall be personally responsible without any limitation of liability. They shall be liable without any limit for all or any of the losses or damages that may have been sustained by any person who subscribed to the securities on the basis of such prospectus [Sec. 35(3)].

Criminal Liability: The criminal liability for a misleading prospectus is as follows:

Liability/Punishment for Misstatement or Untrue Statement in Prospectus: Where a misleading prospectus is issued, circulated, or distributed, every person who authorizes the issue of such prospectus shall be liable under Section 447 [Sec. 34].

According to Section 447, any person who is found to be guilty of fraud shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years. This apart, he shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years [Sec. 447].

Defences Available: A person shall not be held liable under Section 447, if he proves any of the following facts:

(i) That such statement or omission was immaterial.

(ii) That he had reasonable grounds to believe and did up to the time of issue of the prospectus believe that the statement was true.

(iii) That he had reasonable grounds to believe that the inclusion or omission of any matter was necessary [Proviso to Sec. 34].

OTHER IMPORTANT PROVISIONS

1. Entities Entitled to Take Action/Remedies: The Act lists entities that are entitled to take action or claim remedies [under Sections 34, 35, and 36] against the company or every person liable for issue, circulation, and distribution of misleading or fraudulent prospectus. Any of the following entities affected by any misleading statement or the inclusion or omission of any matter in the prospectus are entitled to file a suit or take any other action:

(a) Any group of persons.

(b) Any association of persons [Sec. 37].

(c) Any person.

2. Punishment for Fraudulently Inducing Persons to Invest Money: Sometimes, a person either knowingly or recklessly makes any statement, promise, or forecast which is false, deceptive, or misleading, or deliberately conceals any material facts. If he does so with a view to induce another person to enter into, or to offer to enter into any of the following agreements, he shall be liable for action under Section 447:

(a) Any agreement for acquiring, disposing of, subscribing for, or underwriting of securities.

(b) Any agreement (the purpose or the pretended purpose of which is) to secure a profit for any of the parties from the yield of securities or by reference to fluctuations in the value of securities.

(c) Any agreement for or to obtaining credit facilities from any bank or financial institution [Sec. 36].

3. Punishment for Personation for Acquisition, etc. of Securities: Any person who

(a) makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

(b) makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

(c) otherwise induces directly or indirectly a company to allot or register any transfer of, securities to him, or to any other person in a fictitious name shall be liable for action under Section 447.

Reproduction in Prospectus: The above provisions of shall be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

Disgorgement of Gain: Where a person has been convicted under this Section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of such person. The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund [Sec. 38].

5.5 CHECK YOUR PROGRESS

Fill in the blanks

1. ……. are the prospectus issued instead of full prospectus.
2. …….. prospectus were issued in order to test the market before finalizing issue size/price.
3. A company proposing to make an offer of securities may issue a ……… prior to the issue of a prospectus.
4. A document by which offer for sale of securities is made by a member of a company to the public is known as ……….. .
5. ………… is a document inviting deposits or offers from the public for the subscription of its securities.

5.6 SUMMARY

A prospectus is a document inviting deposits or offers from public for the subscription of its shares and debentures. Companies Act, 2013 does not contain any model prospectus but it only prescribes the contents of a prospectus. A prospectus can be issued only after its registration. If a company intends to alter or vary the terms of contract referred to in the prospectus or objects for which the prospectus was issued, it can do so if it has passed a special resolution, publish an advertisement of the notice in respect of such resolution and opportunity to exit to the dissenting shareholders has been given. A person who has been induced to subscribe the shares on the faith of misstatement made in a prospectus can sue the company, the directors and the promoters and experts, if any. Every company is entitled to commence its business as soon as it obtains its certificate of incorporation.

5.7 KEYWORDS

Prospectus: It is a document inviting deposits or offers from the public for the subscription of its securities.

Red Hearing Prospectus: A prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Public offer: An offer of securities made to the public through a prospectus.

Deemed Prospectus: A document by which offer for sale of securities is made by a member of a company to the public.

5.8 SELF ASSESSMENT TEST

1. What do you understand by prospectus of a company? What particulars are given in a company prospectus? Explain.
2. What is a prospectus? Is the issue of a prospectus obligatory for a public company? Discuss the consequences of misstatement in a prospectus.
3. 'It is not compulsory for a public company to issue a prospectus, while a private company is even not permitted to issue it.' Explain this statement. What are the consequences of misstatement in prospectus?
4. Discuss the consequences of omission, misrepresentation, and fraud in connection with prospectus of a company. Also narrate the circumstances under which a director may be absolved from the liability.
5. Clearly explain the provisions relating to the registration and issue of a prospectus.

5.9 ANSWERS TO CHECK YOUR PROGRESS

1. Abridged
2. Red Herring
3. Red Herring Prospectus
4. Deemed Prospectus
5. Prospectus

5.10 REFERENCES/SUGGESTED READINGS

- Avtar Singh, Company Law, Eastern Book Company, Lucknow.
- A.K. Mujumdar and G.K. Kapoor, Company law and Practice, Taxmann Publishing House, New Delhi.
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- D.K. Jain, Company Law, Ready Reckoner, Bharat Law House Pvt. Ltd., Delhi.

Subject: Company Law	
Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 06	
MEMBERSHIP OF A COMPANY	

STRUCTURE

6.0 Learning Objectives

6.1 Introduction

6.2 Member

6.2.1 Distinction between a Shareholder and a Member

6.2.2 Who can become a Member?

6.2.3 Methods of Becoming a Member

6.2.4 Termination of Membership

6.2.5 Rights and Liabilities of a Member

6.2.6 Register of Members

6.2.7 Closure of Register of Members

6.3 Check Your Progress

6.4 Summary

6.5 Keywords

6.6 Self-Assessment Test

6.7 Answers to Check your Progress

6.8 Reference/Suggested Readings

6.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define a member and make a distinction between a member and a shareholder.
- Explain the modes of acquiring membership of a company.

- Describe the situations where a person ceases to be a member of a company.
- Explain the rights and liabilities of a member.
- Discuss about the maintaining the Resister of Members.

7.1.1 INTRODUCTION

A company is composed of members, though it has its own separate legal entity. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. In case of a company limited by shares, the shareholders are the members. The terms “members” and “shareholders” are usually used interchangeably, being synonymous, as there can be no membership except through the medium of shareholding. Thus, generally speaking every shareholder is a member and every member is a shareholder. However, there may be exceptions to this statement, e.g., a person may be a holder of share(s) by transfer but will not become its member until the transfer is registered in the books of the company in his favour and his name is entered in the register of members. Similarly, a member who has transferred his shares, though he does not hold any shares yet he continues to be member of the company until the transfer is registered and his name is removed from the register of members maintained by the company

6.2 MEMBER

A person who, for the time being holds shares in his own name is a shareholder. A person whose name appears on the register of members of the company is a member. The Depositories Act, 1996 has inserted a new sub-section (3) to Section. 41. According to it, every persons holding equity share capital of a 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.

However, it should be noted that a holder of preference shares whose name is entered as beneficial owner in the records of the depository shall not be deemed a member of the concerned company. It should be noted further that the holder of equity shares whose name appears on the records of a depository is deemed to be a member of the concerned company even if his name does not appear on the register of members of the company.

A shareholder whose name appears on the register of members, is a member as well as a shareholder. But a shareholder may 1iot necessarily be a member and vice-versa. For example, X, a shareholder and a member of the company, transfers his share to Y. Until Y’s name is put on the register of members Y is only a shareholder and not a member. Y cannot claim dividend or attend company's meeting. Again, X will continue to be a member until 'V's name is registered as a member, although X ceases to be a shareholder. However, in practice, no such distinction is made and the words 'shareholder' and 'member' we used interchangeably [Howrah Trading Co. Ltd. v. Commr. of Income Tax (1959)29 Comp. Cas. 482].

6.2.1 DISTINCTION BETWEEN A SHAREHOLDER AND A MEMBER

Although in practice the terms 'shareholder' and 'member' are used interchangeably yet the distinction between the two is as follows:

a) A shareholder may be a member but a member may not be a shareholder where a company has no share capital (e.g., in a company limited by guarantee).
b) A holder of a share warrant is a shareholder but not a member as his name removed from the register of members soon after the share warrant is issued.
c) A member who has transferred his share ceases to be a shareholder as the property in the shares had passed to the buyer. However, he continues to be a member until his name is removed and the name of the buyer is entered on the register of members.
d) In case of death of a member his legal representative becomes a shareholder but he does not become a member until his name is entered on the register of members. A legal representative may hold shares and receive the dividend without his name being entered on the register of members.
e) Subscribers to the Memorandum become members of the company after they have signed the memorandum as their names are automatically entered on the register of members. However, they are not shareholders until the company has allotted shares to them.

6.2.2 WHO CAN BECOME A MEMBER?

The Companies Act, 2013 does not lay down any qualification for becoming a member of a company. However, to become a member a person has to enter into an agreement with the company. As such, only a person who is competent to contract according to the Indian Contract Act, 1872 can become a member of a company. However, this is subject to the Memorandum and the Articles of the company which may provide that certain persons cannot become member of the company.

1. Minor. A contract with a minor is absolutely void. As such, he cannot become a member of the company.

In Polaniappa Mudaliar v. Official Liquidator, Pashupathi Bank Ltd., A.I.R. (1942) Mad. 470, a father on behalf of his minor daughter signed an application for shares in the company. The company registered the shares in the name of the daughter describing her as minor. The company went into liquidation. Held, the father could not be liable as contributory since the contract with the minor was void and the father could not be deemed to have signed for the minor.

In case the directors, by mistake or due to the fraud of the minor, allot shares to him and put his name on the register of members, the company can cancel the allotment and remove his name from the register when it comes to know of the fact.

The minor may also repudiate the contract at any time during his minority. However, in either case, the company must return the money paid by the minor whether or not the minor should restore the benefits received will be decided by the Court or Tribunal on facts and circumstances of a particular case.

In case neither the company nor the minor repudiates the allotment and, the minor's name continues on the register of members, the minor is not liable to pay any call due on the shares. On attaining majority, if he does not want to continue as a member, he must repudiate his contract and take steps within a reasonable time to get his name removed from the Register of Members. In case he fails to do so, he will become liable as a member on the basis of the rule of estoppels [Fazulbhoy Jaffer v. Credit Bank of India (1914) I.L.R. 30 Bom. 331]. In this case a minor was allotted shares. After attaining majority he continued to receive dividend for three years. Later on he was not allowed to raise objection to be on the register of members.

However, in case the shares are fully paid, an application to take shares may be signed on behalf of the minor by his lawful guardian. Such shares can be registered in the name of the minor, acting through his or her legal guardian.

2. Insolvent. An insolvent, continues to be a member until his name is removed from the register of members, although his shares, vest in the Official Assignee. He is also entitled to vote at the meeting.

3. Foreigner. A foreigner can become a member, subject to general or special permission of the Reserve Bank of India, under the Foreign Exchange Management Act, 2,000. However, if he becomes an alien enemy his voting right and right to receive notice are suspended.

4. Partnership Firm. A partnership firm cannot become a member of a company as it is not a legal person. However, such a firm may hold shares in the individual names of partners as joint shareholders. Nevertheless, a partnership firm may become member of a non-profit making company licensed under Section 25 of the Act.

5. Company. A company is a legal person and as such it can become a member of another company provided it is authorised by its Articles. Now a company is permitted to buy its own shares [Sec. 77(A)]. However, it cannot lend money or give financial assistance directly or indirectly for the purchase of its own shares. Again, a subsidiary company, barring a few exceptions, cannot become a member of its holding company. Any allotment or transfer of shares from a holding company to its subsidiary company is void [Sec. 42(O)]. However, a subsidiary company may continue to be a member of its holding company if it became member before the commencement of the Act. But, the subsidiary company will not be able to exercise the voting right except where the subsidiary is a legal representative of a deceased member or a trustee for some other shareholders.

6. Hindu undivided family. A Hindu undivided family can purchase shares through its *Karta*. As such only the *Karta* shall become its member.

7. Trustee. A trustee cannot become a member in his capacity as a trustee because Sec. 153 provides that no notice of any trust (express, implied or constructive) shall be entered by the company on its register of members. As such, a trustee who buys shares will be treated as a member in his individual capacity.

8. Registered society. A society registered under the Societies Registration Act, 1860 is a legal person. As such, it can become a member of a company if it is authorised by its bye-laws or Articles pr Memorandum.

9. Joint holders. Shares may be held jointly by two or more members. In the case of a public company every joint holder is counted as a separate member. However, in case of a private company joint holders are counted as a single member.

6.2.3 METHODS OF BECOMING A MEMBER

Following are the methods of becoming a member in a company:

1. By Subscribing to the Memorandum: Sec. 2(55) of the Act provides that the subscribers to the Memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members. Thus, the signatories to the Memorandum automatically become members of the company just by having signed the Memorandum. In their case, neither application nor allotment of shares is necessary to make them members of the company. Even, an absence of entry in the register of members cannot deprive him of his status. He acquires, as soon as the company is registered, the full status of a member with all his rights and liabilities.

A subscriber to the Memorandum is bound to take the number of shares subscribed by him. He must take his shares directly from the company. His liability is very strict. He must pay for his shares in cash, even if he was promised shares by the promoters in consideration of services rendered by him in connection with the promotion of the company. He cannot avoid his liability on the ground of fraud or misrepresentation by the promoters. The reason for this rule is to instil confidence in the public so that they might rely with confidence on the subscribers of the Memorandum to become members of the company.

2. By agreeing in writing and registration: Every 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. However, any person whose name appears on the records of a depository and who holds equity shares of a company is deemed to be a member of the concerned company even if his name does not appear on the register of members of the company.

This second mode of membership, i.e., agreement in writing and registration may result from any of the following acts.

(i) By application and allotment. When a person applies for the shares of a company, he makes an offer to buy the shares. The company by allotting the shares accepts the offer and sends letter of allotment to the applicant. Thereafter, his name is entered on the register of members. In this case the general law of contract applies. As such, an applicant can withdraw his application before the shares are. allotted to him. An application to take shares may be absolute or conditional. In case the application is absolute, the applicant becomes a member as soon as shares are allotted and its notice is given to him. On the other hand, if the application is conditional, he will not become member unless the condition is fulfilled.

(ii) By transfer. Shares are easily transferable. A person may buy shares from the open market. The transfer of share is made by an instrument of transfer signed by both the transferor and the transferee. When the transfer is registered the transferee becomes a member of the company.

(iii) By transmission. On the death of a member of the company his legal representative is entitled to get his name entered in the register of members. The legal representative may also transfer the shares without getting himself registered as a member. In case of transmission, instrument of transfer is not necessary as the shares are transmitted by operation of law. In case of insolvency of a member his Official Receiver or Assignee is entitled to become a member in his place.

(iv) By taking qualification shares. Generally, the Articles of a public company require a person to take or sign an undertaking to take and pay for qualification shares if he wants to become a director of the company. Such a director is also in the same position as a subscriber is to the Memorandum. Thus, he becomes a member on his becoming a director of the company [Sec. 266(2)].

(v) By estoppel. Prior to the Companies (Amendment) Act, 1960 a person could also become member by estoppel. According to this rule, if a person's name is placed on the register even wrongly, and he does not object to it; he will be estoppel from denying the truth that be is a member.

This principal has lost much of its importance. Now the Companies Act, 2013 provides that a member means a person who agrees in writing to become a member and whose name is entered in the register of members of the company. This has been done to check improper implication of innocent persons as members of the company, particularly, at the time of winding of up the company.

6.2.4 TERMINATION OF MEMBERSHIP

A person ceases to be a member of the company in the following cases:

a) By transfer of his shares and its registration by the company.
b) By transmission of shares. When a shareholder dies his shares are transmitted to his legal heirs. However, the estate of the deceased continues to be liable until the transmission is registered with the company.
c) By forfeiture of his share for non-payment of calls due on his shares.
d) By a valid surrender of shares.
e) On the member being adjudged insolvent.
f) On the sale of shares by the company in exercise of its right of lien, after proper notice.
g) On rescission of a contract to buy the shares on the ground of fraud or misrepresentation.

h) On redemption of redeemable preference shares.

i) On winding-up of the company, although, he remains liable as a contributory and is also entitled to share the surplus arising out of the winding: up, if any.

6.2.5 RIGHTS AND LIABILITIES OF A MEMBER

A member of a company enjoys certain rights and also incurs certain liabilities.

Rights of Member

The important rights which a member has, are as follows:

1. To receive share certificate within the specified time.
2. To receive notices of, right to attend and vote at these meetings.
3. To appoint a person as proxy to attend and vote in these meetings on his behalf
4. To transfer his shares subject to the provisions of the Articles of the company.
5. To appeal to the Central Government, if a private company or deemed public company refuses to register the transfer of shares.
6. To appeal to the Company Law Tribunal for rectification of register of members.
7. To subscribe fresh issue of shares, if made after two years of formation or one year of the first allotment, whichever is earlier in preference to the general public.
8. To renounce the above preferential right to buy the shares to any other person.
9. A joint right (if a specified number of shareholder or holders of specified amount of share capital or voting rights agree) for requisition of an Extraordinary. General Meeting of the company or, to request the Company Law Tribunal to order investigation into the affairs of the company
10. A right to file petition in the Tribunal for winding-up the company.
11. A right to receive dividend, when declared.
12. A right to share in the surplus assets of the company on its winding-up.
13. A right to inspect and take copy of the Memorandum and Articles of Association, etc.

Liabilities of Members

The important liabilities are as follows:

1. A member is liable to pay the full nominal amount due (including premium, if any) on his shares.
2. He is also liable to observe the provisions of the Memorandum and Articles of Association.
3. In case of a company, limited by guarantee, he is liable to pay the guaranteed amount when the company goes into liquidation.
4. In case he is a joint share holder, his liability to pay the amount due on his share is joint and several.
5. In case a person ceased to be a member, within one year, prior to the winding-up of the company, he is liable to pay the amount due on the shares if the present members are not able to pay and, the debts exist, which were incurred while he was a member.

Share capital of producer company (Sec. 589)

a) The share capital of a Producer Company shall consist of equity shares only.
b) The shares held by a Member in a Producer Company, shall as far as may be, be in proportion to the patronage of that company.

6.2.6 REGISTER OF MEMBERS

Section 88 of the Companies Act, 2013 lays down:

(1) Every company shall keep and maintain the following registers in such form and in such manner as may be prescribed, namely:

(a) register of members indicating separately, for each class of equity and preference shares held by each member residing in or outside India;

(b) register of debenture-holders; and

(c) register of any other security holders.

(2) Every register maintained under sub-section (1) shall include an index of the names included therein.

(3) The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

(4) A company may, if so authorised by its articles, keep in any country outside India, in such manner as may be prescribed, a part of the register referred to in sub-section (1) of section 88 of the Act, called

"foreign register" containing the names and particulars of the members, debenture-holders, other security holders or beneficial owners residing outside India.

(5) If a company does not maintain a register of members, 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.

Declaration in respect of beneficial interest in any share (Sec. 89).

(1) Where the name of a person is entered in the register of members of a Company as the holder of shares in that company but who does not hold the beneficial interest in such shares, such person shall make a declaration within such time and such form as may be prescribed to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares.

(2) Every person who holds or acquires a beneficial interest in share of a company shall make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in books of the company and such other particulars as may be prescribed.

(3) Where any change occurs in the beneficial interest in such shares, the person referred to in sub-section (1) and the beneficial owner specified in sub-section (2) shall, within a period of thirty days from the date of such change, make a declaration to the company in such form and containing such particulars as may be prescribed.

(4) The Central Government may make rules to provide for the manner of holding and disclosing beneficial interest and beneficial ownership under this section.

Rectification of register of members (Sec. 59)

(1) If the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register, without sufficient cause, omitted therefrom, or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or the company may appeal 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 siding outside India, for rectification of the register.

(2) 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 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.

(3) The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(4) 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.

(5) 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 lath rupees but which may extend to five lath 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 lath rupees but which may extend to three lath rupees, or with both.

Foreign Register of Members (Sec. 59)

A company may, if so authorized by its articles, keep in any country outside India, in such manner as may be prescribed, a part of the register referred to in sub-section (1), called 'foreign register' containing the names and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India.

Investigation of beneficial ownership of shares in certain cases (Sec. 90)

Where it appears to the Central Government that there are reasons so to do, it may appoint one or more competent persons to investigate and report as to beneficial ownership with regard to any share or class of shares and the provisions of section 216, as far as may be, apply to such investigation as if it were an investigation ordered under that section.

6.2.7 CLOSURE OF REGISTER OF MEMBERS

Section 91 of the Companies Act, 2013 lays down:

(1) A company may close the register of members or the register of debentureholders or the register of other security holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time, subject to giving of previous notice of at least seven days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in such manner as may be prescribed.

(2) If the register of members or of debentureholders or of other security holders is closed without giving the notice as provide 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 everyday subject to a maximum of one lath rupees during which the register is kept closed.

Annual Return (Sec. 92)

Section 92 of the Companies Act states that:

(1) Every company shall prepare a return (here-in after referred to as the annual return) in the prescribed form containing the particulars as they stood on the close of the financial year regarding:

(a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(b) its shares, debentures and other securities and shareholding pattern;

(c) its indebtedness;

(d) its members and debenture-holders along with changes therein since close of the previous financial year;

(e) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

(f) meetings of m embers or a class thereof, Board and its various committees along with attendance details;

(g) remuneration of directors and key managerial personnel;

(h) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(i) matters relating to certification of compliances, disclosures as may be prescribed;

(j) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and

(k) Such other matters as may be prescribed, and signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice:

Provided that in relation to One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company

(2) The annual return, filed by a listed company or, by a company having such paid-up capital and turnover as may be prescribed, shall be certified by a company secretary in practice in the prescribed form, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of this Act.

(3) An extract of the annual return in such form as may be prescribed shall part of the Board’s report.

(4) Every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified, under section 403.

(5) If a company fails to file its annual return under sub-section (4), before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lath 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 fifty thousand rupees but which may extend to five lakh rupees, or with both.

(6) If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lath rupees.

Return to be filed with Registrar in case promoters stake changes. (Sec. 93). Every listed company shall file a return in the prescribed form with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders of such company, within fifteen days of such change.

6.3 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. A shareholder whose name appears on the register of members, is a member as well as a shareholder.
2. Every listed company shall file a return in the prescribed form with the Registrar with respect to change in the number of shares held by promoters.
3. The share capital of a Producer Company shall consist of equity and preference shares.
4. A subscriber to the Memorandum is not bound to take the number of shares subscribed by him.
5. A shareholder may be a member but a member may not be a shareholder where a company has no share capital.

6.4 SUMMARY

A company is composed of members, though it has its own entity distinct from members. Every shareholder is a member and every member is a shareholder, however, there may be exceptions to this statement. Section 2(55) of the Companies Act, 2013 provides the modes by which a person may acquire membership of a Company. The modes are by subscribing to the Memorandum, by agreeing in writing to become a member and by holding equity share capital of a Company as beneficial owner in the records of a depository. In accordance with Section 88, every Company shall keep register of its members. This register shall be kept at the registered office of the Company subject to the provisions of Section 94 of the Companies Act, 2013. On becoming member, a person is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Companies Act, 2013.

6.5 KEYWORDS

Member: 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.

Cessation of membership: A person ceases to be a member of a company when his name is removed from its register of members.

Joint Members: If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member.

6.6 SELF ASSESSMENT TEST

1. Who is a member of a company? How can a person become the member of a company?
2. Explain the rights and liabilities of members.
3. Who can become a member of a company? How he ceases to be a member?
4. Explain the provisions of Companies Act, 2013 regarding register of members.
5. What is index of members? Which companies are required to maintain the index of members?

6.7 ANSWERS TO CHECK YOUR PROGRESS

1. True
2. True
3. False
4. False
5. True

6.8 REFERENCES/SUGGESTED READINGS

1. Avtar Singh, Company Law, Eastern Book Company, Lucknow.
2. D K Jain, Company Law Ready Reckoner, Bharat Law House Pvt. Ltd., Delhi.
3. A K Majumdar, G K Kapoor, Sanjay Dhamija, Company law and Practice, Taxman, New Delhi.
4. H K Saharay, Company Law, Universal Law Publishing Co. Ltd, Delhi.
5. Anoop Jain, A Simplified Approach to Company Law, AJ Publications, Delhi.

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Lesson No.: 7	

MEETINGS OF A COMPANY

Structure

7.0 Learning Objectives

7.1 Introduction

7.1.1 Annual General Meeting

7.1.2 Extraordinary General Meeting

7.1.3 Requisites of a Valid Meeting

7.1.4 Minutes of Meetings

7.2 Voting

7.3 Proxies

7.4 Resolution

7.5 Check Your Progress

7.6 Summary

7.7 Keywords

7.8 Self-Assessment Test

7.9 Answer to Check Your Progress

7.10 References/Suggested Readings

7.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the various types of meetings.
- List the requisites of a valid meeting.

- Explain the different types of resolutions and the purposes for which they can be passed.

7.1 INTRODUCTION

The general meetings of members are of vital importance in the working of a company. For, although the general powers of management of a company are vested in the Board of Directors, the consent of members on such major issues as specified in Section 180 has to be obtained by a special resolution in their general meeting. Otherwise also, it is fair to provide an opportunity to the shareholders to come together and review the working of the company. Hence, the Companies Act has provided for various types of meetings of the shareholders of a company.

Types of General Meetings

There are two types of general meetings of shareholders:

(1) Annual general meeting.

(2) Extraordinary general meeting.

In addition to the above types of meetings, sometimes a meeting of a particular class of shareholders may also be held. Such meetings are called "class meetings". They are convened by the company to affect variations in the rights of that particular class of shareholders (Sec. 48) or in connection with a scheme of arrangement (Sec. 230) or at the time of winding up of the company. A 'class meeting' is not a general meeting but similar rules relating to convening and conducting of a meeting apply to it.

7.1.1 ANNUAL GENERAL MEETING

Every company must in each year hold in addition to any other meeting a general meeting as its annual general meeting (Sec. 96(1)]. It is the most important meeting of the members of a company. It is held each year with a view to reviewing and evaluating the overall progress of the company during a year. The annual general meeting is sometimes called ordinary general meeting as usually it deals with the so called 'ordinary business'. The following ordinary business must be transacted at the annual general meeting of every company [Sec. 102(2)].

(a) the consideration of financial statements and the Reports of the Board of Directors and Auditors;

(b) the declaration of any dividend;

(c) the appointment of directors in the place of those retiring; and

(d) the appointment of, and the fixation of the remuneration of the auditors.

Any other business on agenda except that listed above shall be considered as special business. It is to be noted that in the case of extraordinary general meeting all business shall be treated as 'special business' [Sec. 102(2)]. It is relevant to state that the ordinary business requires an ordinary resolution while the special business may require ordinary or special resolution as per Articles or the Companies Act.

It may be noted that a One Person Company is not required to hold annual general meeting [Sec. 96(1)]. This is for the reason that there is only one member in case of such a company.

Other Statutory Requirements

The Companies Act imposes the following obligations on every company, public or private, as regards convening of annual general meetings:

(1) The first annual general meeting of a company must be held within 9 months from the end of the first financial year, and if such general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation. It may be noted that there can be no extension of period beyond 9 months in case of this meeting even by the Registrar [Sec. 96(1)].

(2) Subsequent annual general meeting must be held each year within six months of the end of the company's financial year, but the interval between any two annual general meeting must not be more than fifteen months. The Registrar may, however, for any special reason extend the above time of six months by a period not exceeding three months [Sec. 96(1)].

In connection with subsequent annual general meetings it is worth nothing that the holding of an annual general meeting in each calendar year, i.e., latest by 31st December each year is a statutory necessity, and it is not enough that they are held within fifteen months of each other. "There should be one meeting per year and as many meetings as there are years" (Shri Meenakshi Mills Co. Ltd. vs Assistant Registrar of Joint Stock Companies). Further, though the annual general meeting of a company may be adjourned to a subsequent date and the adjourned meeting is to be deemed to be a continuation of the earlier meeting, the adjourned meeting too must be held within fifteen months of the previous meeting (Bejoy Kumar Karnani vs Asstt. Registrar of Companies).

(3) The annual general meeting must be held during business hours (that is between 9 a.m. and 6 p.m.) at the registered office of the company or at some other place within the city where the registered office of the company is situated. However, annual general meeting of an enlisted company me be

held at any place in India if consent is given in writing or by electronic mode by all the members in advance. Annual general meeting cannot be called on a National Holiday. It can be called on any day including Sunday and other public holiday which is not a National Holiday [Sec. 96(2), as amended by the Companies (Amendment) Act, 2017].

As per the explanation appended to this sub-section "National Holiday" means and includes a day declared as National Holiday by the Central Government.

(4) At least twenty-one clear days notice to call an annual general meeting must be given either in writing or through electronic mode to every shareholder, directors and auditors of the company, and to every such person on whom the shares of any deceased or insolvent member may have devolved. The meeting may be held with a shorter notice, if it is so agreed by at least 95% of the members entitled to vote in such a meeting (Sec. 101).

A copy of Directors' Report, audited Financial Statements and Auditor's Report must be annexed to every such notice [Sec. 136(1)].

The holding of annual general meeting is also governed by Sections 101 to 113 which contain provisions relating to convening and conducting of all types of general meetings under the Act. We shall be discussing these provisions later in the present chapter under the heading 'Requisites of a Valid Meeting'.

Default in holding the annual general meeting. If a company fails to call an annual general meeting within the prescribed time limits, the Tribunal may, on the application of any member of the company, call or direct the calling of the meeting and give such ancillary or consequently directions as it thinks expedient in relation to the calling, holding and conducting of the meeting. The directions that may be given by the Tribunal may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting (Sec. 97).

Further, the company and every officer who is in default is liable to a fine which may extend to Rs. 1 lakh and in the case of a continuing default, with a further fine which may extend to Rs. 5,000 for every day after the first during which such default continues (Sec. 99).

7.1.2 EXTRAORDINARY GENERAL MEETING

All general meetings other than the annual general meetings are called extraordinary general meetings. Regulation 42 of 'Table F' (given in Schedule I) defines: "All general meetings other than annual general meetings shall be called extraordinary general meetings". These meetings may be convened by the company at any time. The business transacted at an extraordinary general meeting comprises anything which cannot be postponed till the next Annual General meeting, e.g., changes in memorandum and articles of association, reduction and reorganisation of share capital, issue of dentures, etc. All business transacted at this meeting is called 'special business' [Sec. 102(2) (b)]. The convening and conducting of this meeting is governed, like the annual general meeting by Sections 101 to 113 which will be discussed under the heading 'Requisites of a Valid Meeting' later in the present chapter.

Who May Call Such Meetings?

Extraordinary general meetings may be called:

(1) By the Board of directors. The Board of directors, may, whenever they think fit, convene an extraordinary general meeting by passing a resolution to that effect in the Board's meeting [Sec. 100(1)].

(2) By the Board of directors on requisition of the members [Sec. 100(2)(3)]. The directors must convene an extraordinary general meeting on the requisition (written demand) of members holding not less than 1/10th of total voting rights on the matter of requisition. The requisition must state the matters for the consideration of which the meeting is to be called. It must be signed by the requisitionists and deposited at the registered office of the company. The directors should, within 21 days from the date of the deposit of a valid requisition, move to call a meeting and should give 21 days notice to the members for calling such a meeting and the meeting should actually be held within 45 days from the date of the requisition.

It may be noted that the requisitionists are not bound to disclose reasons for the resolution they propose to move at the meeting (*Life Insurance Corporation vs. Escorts Ltd.*). Further, no business other than the business for which the meeting has been expressly convened can be transacted at the requisitioned meeting.

(3) By the requisitionists themselves [Sec. 100(4),(5),(6)]. If the directors fail to call the meeting within aforementioned time limits, the requisitionists, or such of the requisitionists as represent not less than 1/10 th of the total voting rights of all the members, may themselves convene a meeting within three months of depositing the requisition. Such a meeting should be called in the same manner, as nearly as possible, as that in which meetings are called by the Board. Any reasonable expenses incurred by the requisitionists must be repaid to them by the company, and any sum so paid shall be retained by the company out of any sums due or likely to become due to the directors in default.

(4) By the Tribunal (Sec. 98). If for any reason it is impracticable to call or conduct or extraordinary general meeting, the Tribunal may, either of its own motion or on the application of any director or any member who would be entitled to vote, order a meeting to be called, held and conducted in such manner as the Tribunal thinks fit and may give such directions as it think expedient, including a direction that one member present in person or by proxy shall be deemed to constitute a meeting.

It may be noted that unlike an annual general meeting an extraordinary general meeting can be convened on 'national holiday' and at a place other than the registered office of the company or the city in which the registered office is situated.

However, extraordinary general meeting of wholly owned subsidiary of a company incorporated outside India can be held outside India [Proviso inserted in Section 100(1) by the Companies (Amendment) Act, 2017].

7.1.3 REQUISITES OF A VALID GENERAL MEETING

A general meeting of shareholders is said to be valid when is properly convened (i.e., when proper notice is issued by a proper authority to all those entitled to receive the notice) and legally constituted (i.e., when there is a proper person in the chair, requisite quorum is present and the provisions of the Companies Act and the Articles are complied with). For transacting legally binding business, the meeting must be validly held. Any irregularity in convening or conducting the meeting shall invalidate the proceedings of the meeting. Such an invalidation, however, does not affect the interests of third parties, who have no notice of the irregularity, on the 'Principle of Indoor Management' following the decision in *Royal British Bank vs Turquand*.

Sections 101 to 113 of the Companies Act contain provisions relating to the holding of valid general meetings which must be compulsorily followed by every company, in addition to any other rules provided in the articles of the company. However, the provisions of Section 98 and Sections 100 to 111 (both inclusive) shall not apply to One Person Company [Sec. 122(1)].

The following are the requisites of a valid general meeting as per the Companies Act:

(1) Proper convening authority. A valid general meeting should be called by a proper authority. The proper authority to convene a general meeting of shareholders is the Board of directors who should pass a resolution at a Board meeting for the same. Of course in the event of default by the directors, the requisitionists or the Tribunal shall become the proper authority to call such a meeting.

(2) Proper notice. The statutory provisions relating to 'notice' are as follows:

(a) Notice to whom. A proper notice of the meeting should be given to every member or shareholder (equity and preference), auditors of the company, each director of the company and to every such person who is entitled to attend the meeting, i.e., the legal representative of any deceased member or the assignee of an insolvent member. Deliberate omission to give notice to a single member may invalidate the meeting, although an accidental omission to give notice to, or the non-receipt of notice by, any member or other persons to whom it should be given shall not invalidate the proceedings of the meeting [Sec. 101(3)(4)].

(b) Length of notice [Sec. 101(1), as amended by the Companies (Amendment) Act, 2017]. The notice should be either in writing or through electronic mode. It must be given at least 21 clear days before the date of the meeting. Possibly, 'clear days' means that in calculating 21 days, 48 hours from the date of posting (transmission time) shall be excluded. Thus a valid notice must be sent at least 23 days before the date of the meeting so that 21 'clear days' notice may be given to the recipients. The meeting may be held with a shorter notice if it is so agreed by at least 95% of the members entitled to vote in such meeting.

A general meeting may be held at a shorter notice if consent, in writing or by electric mode, is given thereto:

(i) in the case of annual general meeting, by at least 95% of the members entitled to vote thereat; and

(ii) in the case of other general meetings:

- (a) If the company has share capital, consent is given by majority in number of members entitled to vote and who represent at least 95% of the paid-up share capital as gives a right to vote at the meeting; or
- (b) if the company has no share capital, consent is given by members having at least 95% of the total voting power exercisable at the meeting.

Where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, then his vote with respect to shorter notice shall only be counted for the purpose of the resolution on which he can vote.

(c) Contents of notice. The notice must specify the place, day and hour of the meeting, and must contain 'agenda' namely a statement of the business to be transacted at the meeting. [Sec. 101(2)]. The object of mentioning the various items of business in the Notice is to give the persons concerned sufficient opportunity to consider the different items before they come for discussion in the general meeting.

(d) Explanatory statement. In the case of 'special business', there must be annexed to the notice of the meeting an 'explanatory statement' mentioning all the material details concerning each such item of business, including in particular the nature of interest, if any, therein of every director and other key managerial personnel and their relatives. If any item of special business relates to or affects any other company, the extent of shareholding interest in that other company of every director and key managerial personnel shall also be disclosed in the explanatory statement if the extent of such shareholding is 2% or more of the paid up share capital of other company (Sec. 102).

The notice must also state that a member is entitled to appoint a proxy, where allowed under the Act or the Articles, and that a proxy need not be member [Sec. 195(2)].

(e) A notice sometimes includes, the expression like "any other business" or "any other matter with the permission of the Chair". These expressions simply indicate that a general discussion on any matter may be allowed by the Chairman or the members may agree that certain important matters be put on the agenda for the next meeting or a vote of thanks may be moved. Certainly no resolution can be passed under this heading in the absence of a proper notice (*Young vs Ladies Imperial Club*).

(f) The notice may be sent to a member by post or by courier or by such electronic or other mode as may be prescribed [Sec. 20(2)].

(3) Requisite quorum. The third important condition for a valid meeting is that the quorum must be present. A quorum is the specified minimum number of qualified person (members) whose presence is necessary for transacting legally binding business at the meeting. The members constituting the quorum must be effective members – entitled to vote at the meeting. Thus, if the agenda of the meeting does not include any item that will affect the rights of the preference shareholders, their presence should not be taken into account for purposes of determining the quorum but where the agenda includes any item directly affecting the rights of preference shareholders, their presence should be taken into the account for the purposes of the quorum. Where no quorum is present the meeting or any resolution passed thereat becomes invalid. However, third parties without notice are not affected by reason of any irregularity in the quorum (*Country of Gloucester Bank vs Rudry Merthyr*).

Unless the Articles provide for a larger number, –

(a) In case of a public company, quorum for a meeting shall be:

(i) 5 members personally present if the number of members as on the date of meeting is upto 1,000.

(ii) 15 members personally present if the number of members as on the date of meeting is more than 1,000 but upto 5,000.

(iii) 30 members personally present if the number of members as on the date of meeting exceeds 5,000.

(b) In the case of a private company, quorum for meeting shall be 2 members personally present [Sec. 103(1)].

Note that the articles cannot provide for a smaller quorum than fixed by the Act and only members present in person, and not proxies, can be counted for purposes of quorum. Further, joint-holders of shares are treated as one member for the purpose of quorum.

The Companies Act is silent on the point of 'time of presence' of the quorum at the meeting, Regulation 44(i) of 'Table F' (given in Schedule I), however, states: "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 follows from these wordings that quorum is required to be present at the beginning of meeting. It needs not be present throughout or at the time of taking votes on any resolution. Similar ruling was given in *Re Hartley Baird Ltd*., Case. It may be recalled that a quorum must be present throughout in the case of Board's meetings.

Regarding the procedure for observing quorum, Section 103(2) provides as follows:

(a) If within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand cancelled. In any other case, the meeting shall stand adjourned to the same day in the next week at the same time and place unless the Board of Directors determine otherwise.

(b) If at the adjourned or the reassembled meeting also, a quorum is not present within half-an-hour from the time appointed for holding the meeting, the members present shall be a quorum.

It may be noted that the attendance of one member only at the reassembled meeting, even though he holds proxies from other members, cannot from a quorum since the word ‘meeting’ *prima facie* means a coming together of more than one person. Sometimes, however, one member may form a quorum, e.g., in the case of a meeting of a particular class of shareholders, when one person holds all the shares of that particular class (*East vs Bennett Bros. Ltd*.,) or when the Tribunal orders for calling an annual general meeting or an extra-ordinary general meeting under Section 97 or Section 98 respectively and directs that one member present in person or by proxy shall be deemed to constitute a meeting.

Adjourned meeting. An adjourned meeting, as a rule, must be held in the next week on the same day and at the same time and place, unless declared otherwise by the chairman. However, the company is required to give at least 3 days notice of an adjourned meeting or of a change of day, time or place of adjourned meeting to the members either individually or by an advertisement in newspapers [Sec. 103(2)]. Of course at least 21 clear days fresh notice of the adjourned meeting must be given if the original 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. It may also be noted that if it is not possible to hold the meeting at the specified place for some valid reason, the meeting may be held at some other place if the members so agree and the business transacted at such a meeting shall be valid (*R. Chettiar vs M Chettiar*). Where a resolution is passed at an adjourned meeting, the resolution shall be treated as having be passed on the date on which it was in fact passed, and shall not be deemed to have been passed on any earlier date (Sec. 116).

(4) Proper Chairperson. The fourth requisite for a valid meeting is that there must be a Chairperson to preside over the proceedings of the meeting. In this regard Section 104 lays down:

(I) Unless the articles of a company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the chairperson thereof on a show of hands.

(2) If a poll is deemed on the election of the chairperson, it shall be taken forthwith in accordance with the provisions of this Act and the chairperson elected on a show of hands shall continue to be the chairperson of the meeting until some other person is elected as chairperson as a result of the poll.

(3) If some other person is elected chairperson as a result of the poll, he shall be chairperson for the rest of the meeting.

It may, however, be noticed that this Section leaves the appointment of the chairperson to be regulated by the articles of the company and the provisions of this Section shall apply only if the articles do not otherwise provide. The articles generally contain provisions on the lines 'Table F' – Regulations 45-47. These Regulations are reproduced below:

Reg. 45. The chairperson, if any, of the Board shall preside as chairperson at every general meeting of the company.

Reg. 46. If there is no such chairperson, or if he is not present within fifteen minutes after the time appointed for holding the meeting or is unwilling to act as chairperson of the meeting, the directs present shall elect one of their number to be chairperson of the meeting.

Reg. 47. If at any meeting no director is willing to act as chairperson or if no director is pre within fifteen minutes after the time appointed for holding the meeting, the members present shall choose one of their number to be chairperson of the meeting.

Duties and powers of the chairperson. The chairperson of a general meeting is responsible for conducting the business at the meeting successfully. He must preserve order in the meeting. He must ensure that the business is within the scope of the meeting and that the sense of the meeting is properly ascertained. He must act impartially and must not abuse his powers.

The chairperson has *prima facie* authority to decide all incidental questions which arise at the meeting. But he has no power to stop or adjourn a meeting unless there is absence of quorum or there is disorder or there remains some uncompleted business at the meeting or the meeting so directs in accordance with the articles. If he wrongly adjourns the meeting, the meeting may appoint another chairperson and continue the business (*Narayanan Chettiar vs Kaleshwqr Mills Ltd.*). He has also no power to change the order of the items of business to be transacted at the meeting as set out in the Agenda. However, the order of items on the Agenda may be changed with the consent of the meeting, if necessary. Again, the chairperson has no right to prevent discussion upon a matter which forms part of the notice convening the meeting. Of course he may refuse a member to talk as much as he likes.

Note that the chairperson is entitled to a casting or second vote in the case of an equality of votes, unless the articles of the company specifically provide otherwise.

7.1.4 MINUTES OF MEETINGS

The term ‘minutes’ means a concise and accurate official record of the business transacted at company meetings. It normally includes only the resolution actually passed. It is not necessary to record therein the discussion which preceded the adoption of a resolution.

As per Section 118 the provisions relating to minutes of proceedings of meetings are as follows:

Every company is required to keep minutes of the proceedings of both General and Board meetings and every resolution passed by postal ballot in books kept for the purpose within 30 days of every such meeting, or passing of resolution by postal ballot. The pages of the minutes books must be consecutively numbered and in no case there should be attached by pasting or otherwise any extra page. Each page of every such book shall be signed and the last page of the record of proceedings of each meeting in such books shall be dated and signed in such manner as may be prescribed.

The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat. All appointments made at any of the meetings shall be included in the minutes of the meeting. The Chairman shall, however, enjoy an absolute discretion in regard to non-inclusion of any matter in the minutes which in his opinion is defamatory of any person, is irrelevant or detrimental to the interests of the company. In the case of a meeting of the Board or of a Committee of the Board, the minutes must include the names of the directors present at the meeting and the names of the directors, if any, dissenting from the resolution passed at the meeting.

The minutes of meeting kept in accordance with the above provisions shall be evidence of the proceedings recorded therein, until the contrary is proved. The meeting to which such minutes relate shall be deemed to have been duly called and held, the proceedings to have duly taken place, and the resolutions passed by postal ballot to have been duly passed. The appointments of directors, key managerial personnel, auditors or company secretary in practice made at the meeting shall be deemed to be valid.

The minutes books of general meetings or of a resolution passed by postal ballot are to be kept at the registered office of the company and shall be open to inspection for at least two hours a day during business hours to any member without charge. Members are also entitled to obtain copies of minutes on request within seven days on payment of such fees as may be prescribed. The Tribunal is also empowered to order inspection of the minutes books or direct to deliver the copy required thereof, if the company fails to comply with the provisions of this Section (Sec. 119).

7.2 VOTING

The word ‘vote’ means an expression of a wish or opinion in an authorised formal way for or against any proposal. After a ‘proposed resolution’ or a ‘motion’ has been discussed in the meeting by the members it is put to vote for ascertaining the sense of the house. The ‘articles’ prescribe regulations and procedure for voting at general meetings subject to the provisions of the Act.

Voting Rights

Every holder of “equity shares with voting rights,” whose name appears on the register of members has a right to vote on every resolution placed before the company at a general meeting. In other words, the holder of such equity shares possesses *normal voting rights*. Further, his voting rights on a ‘poll’ (a method of voting) shall be in proportion to his share of the paid up equity capital of the company.

By amending Section 47(1), the Companies (Amendment) Act, 2017 provides that voting rights of members shall also be subject to voting rights restrictions in respect of “related party” transactions contained in Section 188(1). The second proviso to Section 188(1) provides that no member of the company shall vote on resolution to approve any related party transaction if such member is a related party. However, the aforestated voting restriction shall not apply where 90% or more members, in number, are related parties or are relatives of promoters [Third proviso to Sec. 188(1) inserted by the Companies (Amendment) Act, 2017].

The preference shareholders *do not possess normal voting rights*. They are, however, entitled to vote in the following two cases [Sec. 47(2)]:

(a) When any resolution directly affecting their rights is to be passed. It is worth noting here hat any resolution for winding up of the company or for the repayment or reduction of its equity or preference share capital is to be regarded as a resolution directly affecting the rights of the preference shareholders, and therefore, they are entitled to vote on such a resolution.

(b) When the dividend due (whether declared or not) on their preference shares or part thereof has remained unpaid for a period of 2 years or more.

It may be observed that when the dividend due on their preference shares has remained unpaid for a period of 2 years or more, the preference shareholders become entitled to vote on *every resolution* placed before the company at any general meeting.

The Act further provides that where a preference shareholder has a right to vote on any resolution in accordance with the provisions mentioned above, his voting right on a ‘poll’ (a method of voting) shall be in the same proportion as the capital paid up in respect of the preference shares bears to the total paid up equity capital of the company [Sec. 47(2)].

In the case of joint shareholders, the vote of the senior joint holder (whose name appears first in the register of members) shall be accepted. An insolvent shareholder is entitled to exercise the votes which are attributed to his status as a member provided his name appears on the register of members (*Morgan vs Gray*).

It may be noted that any restriction in the articles of the company on a member's right to vote, except on the ground of non-payment of calls or other sums due against him or lien on shares, shall be void (Sec. 106).

Methods of Voting

Voting at a general meeting takes place by: (1) show of hands, (2) poll, and (3) electronic means.

(1) Voting by show of hands. In the first instance voting on a proposed resolution takes place by show of hands unless a poll is demanded or voting is carried out electronically (Sec. 107). Those for and against a motion are requested in turn to indicate their opinion by raising their hands. Upon a show of hands a member present by proxy (authorized agent) has no right to vote [Sec. 105(1)], and each member present entitled to vote has one vote only without regard to his number of shares. Where a company is a member of another company or where Government (namely, President of India or the Governor of a State) is a member of a company, their properly appointed representative is deemed to be personally present and can vote on a show of hands [Sections 113 and 112].

Unless a poll is demanded, a declaration by the chairman of the result of voting by show a hands that the resolution has been carried or lost unanimously or by a particular majority and an entry to that effect in minutes books of the company shall be conclusive evidence of the fact without proof of the number of votes recorded in favour of or against such resolution (Sec 107).

(2) Voting by poll. If there is dissatisfaction about the results of voting by show of hands, a 'poll' can be demanded. A 'poll' may also be demanded even before the declaration of the result on show of hands (Sec. 109). The proper demand for a poll cancels the result of the previous voting on a show of hands. On a poll each member is entitled to record the number of votes in proportion to equity shares held by him on a 'vote card' for or against a resolution and voting by proxy is also allowed. Thus, on a poll both holding of proxies and the number of shares held by a member are important for voting purposes. The voting rights must be proportionate to investment on a poll. In the case of a company not having share capital every member is entitled to only one vote and voting by proxy is not allowed, unless provided by the articles, even on a poll. It may be noted that in the case of a company having share capital voting by proxy is allowed statutorily on a poll and this right does not depend upon the articles [Sec. 105(1)].

Who can demand a poll? A poll may be ordered by the chairman of his own motion. But he shall be bound to take a poll if demanded:

(a) in the case of a company having share capital, by any member or members, having the right to vote on the resolution and present in person or by proxy, holding at least 1/10th of the total voting power, or holding shares of the paid-up value of at least Rs. 5 lakh or such higher amount as may be prescribed;

(b) in the case of any other company by any member or members present in person or by proxy having at least 1/10th of total voting power in respect of the resolution.

The demand for a poll may be withdrawn at any time by the person or persons who made the demand [Sec. 109(2)]. When a poll is taken a member is free to split his votes for and against the same resolution. He has the right to distribute his votes in any manner he likes [Sec. 106(3)]. When more than one resolution is to be passed, a poll is to be taken on each separately.

A poll demanded on a question of adjournment or the election of a chairman must be taken forthwith. In any other case it must be taken within 48 hours of the demand for poll. When a poll is to be taken the chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinise the poll process and votes given on the poll and to report thereon to him. The chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken. The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken (Sec. 109). The declaration of the result by the chairman and an entry to that effect in minutes books of the company is conclusive and final (Sec. 118).

(3) Voting through electronic means. The Central Government may prescribe the class or classes of companies and manner in which a member may exercise his right to vote by electronic means (Sec. 108). This measure is expected to enhance participation of members in proceedings of general meeting and enable them to exercise their rights without being present at the meeting.

7.3 PROXIES

A proxy is a member's authorized agent to attend and vote at the meeting. The term is also applied to the instrument by which the appointment to act on his behalf is made by the member. As per Section 105 the provisions relating to proxies are as follows:

(1) Members of a company having share capital have a statutory right to appoint proxies, notwithstanding anything to the contrary in the articles. In the case of a company not having share capital proxies may be appointed if allowed in the articles.

(2) A proxy shall not have any right to speak at the meeting and shall not be entitled to vote except on a poll.

(3) The Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.

(4) A person can be appointed as a proxy for a member or such number of members not exceeding 50 and for such number of shares as may be prescribed.

(5) The instrument appointing a proxy must be in writing, in the proper form duly signed by the appointment and stamped. If the appointer is a body corporate the instrument of proxy should be under its seal and be signed by a duly authorised officer.

(6) The instrument appointing a proxy may be lodged at the company's office not later than 48 hours before the commencement of the meeting. If the articles of a company require a longer period than 48 hours, that will be inoperative and the shareholders will have the right to deposit proxies upto 48 hours before the meeting.

(7) For each meeting a separate proxy is required.

(8) A proxy need not be a member of the company.

(9) Every notice calling a general meeting of a company where voting by proxy is allowed, must state with reasonable prominence that a member is entitled to appoint a proxy and that the proxy need not be a member. If default is made in complying with this provision every defaulting officer is punishable with a fine up to Rs.5,000.

(10) No invitation to appoint any person as proxy shall be issued at company's expense and if any such invitation is issued every officer of the company who is knowingly in default shall be punishable with fine which may extend to Rs.1 lakh.

(11) After giving at least three days' notice to the company, members may inspect proxies lodged with the company during 24 hours (within business hours) before the time fixed for the meeting and till the conclusion of the meeting.

(12) Subject to the provisions in the articles, a proxy can be revoked by intimating the company, at any time, before it is acted upon. Death or insanity of the principal also revokes the authority of the proxy but proper intimation to the company is necessary. Moreover, a member can prevent the proxy from exercising the right to vote by himself attending and voting at the meeting [Reg. 59 of 'Table F' of Schedule I].

(13) Where a company is a member of another company or where Government is a member of a company, their properly appointed representative enjoys all the rights of a member. He can speak at the meeting and vote on a show of hands as well as on a poll [Secs. 113 and 112].

7.4 RESOLUTIONS

A 'Proposed Resolution' or 'motion' when passed by requisite majority of votes by the shareholders becomes a company resolution. Thus, a resolution may be defined as the formal decision of a meeting on any proposal before it.

The Companies Act provides for three kinds of resolutions that may be passed at the general meeting of a company:

(1) Ordinary resolution;

(2) Special resolution;

(3) Resolution requiring special notice.

The Companies Act and the Articles of Association lay down the type of resolution required for any particular matter.

1. Ordinary Resolution

A resolution shall be an ordinary resolution when the votes cast in favour of the resolution by members present in person or where proxies are allowed, by proxy, exceed the votes, if any, cast against the resolution [Sec. 114(1)]. In other words, this is a resolution passed by simple majority of votes of members present in person or by proxy. Those absenting or remaining neutral are not counted.

An ordinary resolution is normally used for the so-called 'ordinary business' done in the Annual General Meeting, e.g., to pass the annual accounts, to declare dividend, to appoint directors in the place of those retiring and to appoint auditors. Certain items of 'special business' also require ordinary resolutions under the Companies Act. For example: alteration of the share capital (Sec. 61), issue of fully paid bonus shares (Sec. 62), acceptance of deposits from members (Sec. 73), appointment of auditors (Sec. 139); appointment of managing/wholetime director/manager in accordance with Schedule V (Sec. 196).

It may be added that an ordinary resolution will suffice unless expressly provided otherwise is the Companies Act or the Articles of the company. An ordinary resolution usually does not require filing with the Registrar.

2. Special Resolution

A resolution shall be a special resolution when the votes cast in favour of the resolution by members present in person or, where proxies are allowed, by proxy, are not less than three times the number of votes, if any, cast against the resolution and the intention to propose the resolution as a special resolution has been duly specified in the notice calling the meeting [Sec. 114(2)]. In other words, this is a resolution passed by a majority of at least 75 per cent of votes of members present in person or by proxy (those absenting or remaining neutral are not counted) and a mention of the fact that the resolution shall be passed as a special resolution must have already been made in the notice of the meeting.

The articles of the company may specify purposes for which a special resolution is required. The Companies Act has also specified certain matters for which a special resolution must be passed, for example, (i) to alter the memorandum of the company (Sec. 13), (ii) to alter the articles of the company (Sec. 14), (iii) for variation in terms of contract mentioned in prospectus (Sec. 27), (iv) to issue further shares to non-members [Sec. 62(1)(c)], (v) issue of convertible debentures (Sec. 71), (vi) to reduce the share capital (Sec. 66), (vii) for variation of rights of shareholders (Sec. 48), (viii) for removal of auditor (Sec. 140), (ix) for investigation into affairs of a company (Sec. 210), (x) for increasing maximum number of directors beyond 15 directors [Sec. 149(1)(b)]. A copy of special resolution must be filed with the Registrar within 30 days of the date of its passing.

3. Resolution Requiring Special Notice

A ‘resolution requiring special notice’ is not actually an independent class of resolutions. It is a kind of ordinary resolution, with the difference that here the mover of the proposed resolution is required to give special notice of at least 14 ‘clear days’ before moving the resolution at the meeting. Such notice is to be given to the company by members holding at least one per cent of the total voting power or holding shares on which an aggregate sum of not less than 5 lakh has been paid up on the date of the notice. The company in turn, is required to give the notice of the proposed resolution to the members at least 7 days before the meeting either individually or through an advertisement in an appropriate newspaper [Sec. 115 read with Rule 23 of the Companies (Management and Administration) Rules, 2014].

It may be noted that this provision is a sort of concession to the mover of a proposed resolution, because otherwise he is required to intimate the company about the proposed resolution he intends to move before the company issues Notice of the meeting, so that the same may be included in the Notice and Agenda of the meeting as an item of business. It may be recalled that a notice of at least 21 ‘clear days’ is required for calling a general meeting.

The Companies Act or the articles of a company may specify purposes in respect of which special notice is required. Under the Act a special notice is required before moving a resolution relating to the following matters:

(a) Appointment of an auditor other than the retiring auditor [Sec. 140(4)].

(b) Provision that a retiring auditor shall not be re-appointed [Sec. 140(4)].

(c) Removal of a director before the expiry of his term [Sec. 169(2)].

(d) Appointment of another person as a director in place of the director removed [Sec. 169(2)].

Passing of Resolution by Postal Ballot

As per Section 2(65) ‘postal ballot’ means voting by post or through any electronic mode.

Section 110, as amended by the Companies (Amendment) Act, 2017, provides for passing of resolution by postal ballot. The provisions of this Section are as follows:

(1) The Central Government may declare by notification such items of business which must be transacted by means of postal ballot.

However, the company may transact an item, which is mandatorily required to be transacted through postal ballot, at a general meeting also where the company is mandatorily required to provide electronic voting facility; and

(2) All items of business, other than ‘ordinary business’ and any business in respect of which directors or auditors have a right to be heard at the meeting, may be transacted by means of postal ballot, in such manner as may be prescribed, instead of transacting such business at a general meeting.

If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

The following points need to be emphasized:

(1) In case of resolutions declared to be passed only be means of a postal ballot, the resolutions can be passed only by a postal ballot and not at a general meeting.

(ii) Items of ‘ordinary business’ and any business in respect of which directors or auditors have a right to be heard at the meeting cannot be transacted by means of postal ballot.

7.5 CHECK YOUR PROGRESS

Fill in the blanks:

1. _______ means voting by post or through any electronic mode.
2. All general meetings other than the annual general meetings are called ______ general meetings.
3. Every company must in each year hold in addition to any other meeting a general meeting as its ______general meeting.
4. A general meeting of shareholders is said to be valid when is properly convened and ______constituted.
5. A ______is the specified minimum number of qualified person (members) whose presence is necessary for transacting legally binding business at the meeting.

7.6 SUMMARY

The general meetings of members are of great importance in the working of the company. The members in the general meetings give the guidelines to the directors for carrying on the business of the company. The meeting of the members can be of two types: (a) annual general meeting and (b) extraordinary general meeting. An annual general meeting is required to be held each year to transact ordinary business, such as presentation of audited accounts, declaration of dividends, appointment of directors and auditors. The first annual general meeting must be held within a period of not more than 18 months from the date of incorporation. The time gap between two annual general meetings must not be more than 15 months. Every person entitled to receive the notice, must get a notice at least 21 clear days before the date of the meeting. Any meeting other than an annual general meeting is called an extraordinary general meeting. Such meetings may be convened at any time to transact some urgent business which cannot be postponed till the next annual general meeting. Such meeting can be convened by the directors either on their own motion or on requisition from members or by the requisitionists themselves on the failure of the Board to call the meeting. Unless the articles provide for a larger number, the quorum shall be two members personally present in the case of a private company and five members personally present in case of a public company. Members of a company having share capital have a statutory right to appoint proxies. A proxy need not be a member of the company. A proxy cannot speak at the meeting but he can vote at a poll. The voting at the general meetings may be either by show of hands or by taking a poll. The decisions in meeting are taken in the form of resolutions.

7.7 KEYWORDS

Notice: Intimation in writing about the date, place and time of the meeting.

Quorum: Minimum number of members who must be present at a meeting to transact a business.

Agenda: Matters to be discussed at the meeting.

Chairman: The person who presides over the meetings.

Proxy: A authority to represent and vote for another person at a meeting.

Minutes: Written record of the proceedings of a meeting.

7.8 SELF-ASSESSMENT TEST

1. State the provision of the Companies Act with regard to holding of an Annual General Meeting. What are the consequences of default in holding an Annual General Meeting?
2. What is Annual General Meeting? State the legal provisions regarding calling of such a meeting?
3. Explain the statutory provision with regard to holding of Extraordinary General Meeting.
4. Discuss the requisites of a valid general meeting as per the Companies Act, 2013.

5. Explain the different types of resolutions which may be passed in the general meeting of shareholders. Under what circumstances do special resolutions become necessary? Discuss.

7.9 ANSWERS TO CHECK YOUR PROGRESS

1. Postal ballot
2. Extraordinary
3. Annual
4. Legally
5. Quorm

7.10 REFERENCES/SUGGESTED READINGS

1. PPS Gogna, A Textbook on Compnay Law, S. Chand and Sons, Delhi.
2. D K Jain, Company Law Ready Reckoner, Bharat Law House Pvt. Ltd., Delhi.
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Subject: Company Law	
Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 8	
DIVIDEND, ACCOUNTS AND AUDIT	

STRUCTURE

8.0 Learning Objectives

8.1 Introduction

8.2 Meaning of Dividend

8.2.1 Rules Regarding Dividend

8.2.2 Unpaid Dividend Account

8.2.3 Investor Education and Protection Fund

8.2.4 Punishment for failure to Distribute Dividend

8.3 Some Related Terms

8.3.1 Books of Accounts

8.3.2 Annual return

8.3.3 Audit

8.4 Check Your Progress

8.5 Summary

8.6 Keyword

8.7 Self-Assessment Test

8.8 Answer to Check your Progress

8.9 References/Suggested Readings

8.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define the term ‘dividend’ and enumerate the rules regarding the payments of dividends.
- Identify the books of accounts to be kept.

- Fix the responsibilities of persons required to maintain the Books of Accounts.
- Specify the documents which are to be attached with the Annual accounts.
- Explain the provision as to appointment and removal of an auditor.

8.1 INTRODUCTION

Every Company requires funds to operate its business successfully. Shareholders are an integral part of every company where they raise funds and in the process of same become its stakeholders. They have a control over the share of profits in proportion to the money they invest. This share of profit by shareholders is termed as dividend.

8.2 MEANING OF DIVIDEND

A dividend is that part of divisible profit of a company which is distributed among the shareholders of the company. Ordinarily, dividends are the profits of a trading company divided among the shareholders in proportion to their shares and in accordance with rights as shareholder.

The Supreme Court in Commissioner of Income-tax Vs. Girdhardas & Co. (!967) S.C. 795, has observed that the expression ‘dividend’ has two meanings:

(1) “As applied to a company which is a going concern it ordinarily means the proportion of the profits of the company which is allowed to the holders of shares in the company.

(2) In the case of a winding-up, it means a division of the realized assets among the creditors and contributories according to their respective rights.”

In this Chapter the term ‘dividend’ has used in the first sense. The Companies Act, 2013 has not defined the term ‘dividend’. But it explains ‘dividend’ includes interim dividend. Thus, it is share of divisible profits given to the shareholders. Declaration of dividend is a part of the Board’s functions. The Board must keep in mind the legal rules regarding the dividend and its payment.

Interim Dividend

An interim dividend means, a dividend declared between the two annual general meetings of the company. Such dividend is declared by the directors of the company and there is no need to call the meeting of shareholders to get their approval. Such dividend is declared by the directors only when the Articles of Association of company authorises the declaration of such dividend. Such dividend is not regarded as debt against the company and it is not binding upon the company. If the directors feel the need of circumstances, they may, cancel their declaration of interim dividend.

Interim dividend should be declared by the company only when the Board of Directors feel that the company has made substantial profit during that part of the year and there exists good future prospects in the remaining part of the year also Directors must study the future prospects very carefully before declaring any interim dividend because if unfavourable circumstances during remaining part of the year lead towards a net loss for the year as a whole, the interim dividend would be deemed as paid out of capital. Any payment of dividend out of capital is completely illegal and the directors are responsible for such declaration. The directors will have to refund the money paid by them by way of interim dividend. The procedure for the declaring and payment of interim dividend is the same as in the case of final dividend except regarding the shareholders' approval in the annual general meeting

According to Section 2(35) of Companies Act, 2013, "The term dividend also includes interim dividend."

8.2.1 RULES REGARDING DIVIDENDS

Following are the rules governing dividends:

1. **Dividend can be Declared and Paid-out of Profits [See. 123(1)(a)] :** No dividend shall be declared or paid by a company for any financial year except: out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both.
2. **Dividend can be Paid-out of Money Provided by Government [Sec 123(1)(b)1:** Dividend can by paid out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government:

   Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf

   Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Provided also that no company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against the Profit of the company for the current year.

For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.

3. **'The Board of Directors may Declare Interim Dividend. [Sec. 123(3)]:** The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account and out of profits of the financial year in which such interim dividend is sought to be declared:

   Provided that in case the company has incurred loss during the current financial year upto the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

4. **Dividend and Interim Dividend to be Deposited in a Separate Bank Account [Sec. 123(4)] :** The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend.

5. **Dividend to be Paid after Transfer of Prescribed Percentage to the Reserve [Sec. 123(1)(b)] :** A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company

6. **Dividend to be Paid in Cash [See, 123(5)] :** No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash:

   Provided that nothing in this sub-section shall be deemed to prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

   Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholders entitled to the payment of the dividend.

7. **Company not to Declare Dividend on Equity Shares if the Company Fails to Comply with Sections 73 and 74 [Sec. 123(6)] :** A company which fails to comply with the provisions of sections 73 and 74 shall not, so long as such failure continues, declare any dividend on its equity shares.

8. **Dividend to be Paid within 30 days of Declaration:** Dividend must be paid within 30 days of its declaration. Dividend after declaration becomes a statutory liabilities. In case of non-payment of dividend on due time, shareholders can sue the company.

8.2.2 UNPAID DIVIDEND ACCOUNT

The provisions of Companies Act, 2013 regarding Unpaid Dividend Account are as under:

(1) Where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration to or by any shareholder entitled to the payment of the dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf any scheduled bank to be called the Unpaid Dividend Account.

(2) The company shall, within a period of 90 days of making any transfer of an amount under sub-section (1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, If any, and also on any other website approved by the Central Government for this purpose, in such form, manner and will other particulars as may be prescribed.

(3) If any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12 percent per annum and the interest accruing on such amount shall accrue to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(4) Any person claiming to be untitled to any money transferred under sub-section (1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

(5) Any money transferred to the Unpaid Dividend Account of a company inc pursuance of this section which remains unpaid or unclaimed for a period of 7 years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under

sub-section (1) of section 125 and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

(6) All shares in respect of which dividend has not been paid or claimed for seven consecutive years or more shall be transferred by the company in the name of investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

Explanation: "For the removal of doubts it is hereby clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall be transferred to Investor Education and Protection Fund."[2]

(7) If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than Rs. 5,00,000 but which may extend to Rs. 25,00,000 and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 5,00,000.

8.2.3 INVESTOR EDUCATION AND PROTECTION FUND

(1) The Central Government shall establish a Fund to be called the Investor Education and Protection Fund (herein referred to as the Fund).

(2) There shall be credited to the Fund:

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;

(d) The amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956; as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies,

(k) interest accrued on the amounts referred to in clauses (h) to (j);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) such other amount as may be prescribed:

(3) The Fund shall be utilized for:

(a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(b) promotion of investors' education, awareness and protection;

(c) distribution of any disgorged amount among eligible. and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made b the Court which had ordered disgorgement;

(d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(e) any other purpose incidental thereto, Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of 7 years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

Explanation: The disgorged amount refers to the amount received through disgorgement or disposal of securities

(4) Any person claiming to be entitled to the amount referred in sub-section (2) may apply to the authority constituted under sub-section (5) for the payment of the money claimed

(5) The Central Government shall constitute, by notification, an authority for administration of the Fund consisting of a chairperson and such other members, not exceeding 7 and a chief executive officer, as the Central Government may appoint.

(6) The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.

(7) The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.

(8) The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor General of India

(9) It shall be competent for the authority constituted under sub-section (5) to spend money out of the Fund for carrying out the objects specified in sub-section (3).

(10) The accounts of the Fund shall be audited by the Comptroller and Auditor General of India at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government

(11) The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor General of India to be laid before each House of Parliament.

8.2.4 PUNISIIMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS

Where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to 2 years and with fine which shall not be less than Rs. 1,000 for every day during which such default continues and the company shall be liable to pay simple interest at the rate of 18 percent per annum during the period for which such default continues:

Provided that no offence under this section shall be deemed to have been committed:

(a) where the dividend could not be paid by reason of the operation of any law;

(b) where a shareholders has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;

(c) where there is a dispute regarding the right to receive the dividend;

(d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

8.3 SOME RELATED TERMS

8.3.1 BOOKS OF ACCOUNTS

The Companies Act, 2013 requires every company to keep proper books of account relating to its transactions and to make the greatest possible disclosure of its financial position in the published accounts so that an intelligent appraisal of its state of affairs may be made.

The Companies Act does not expressly mention as to what particular books of account a company must maintain. But under Section 2(13) the expression “books of account” has been defined as follows:

“Book of account” includes records maintained in respect of:

(a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(b) all sales and purchases of goods and services by the company;

(c) the assets and liabilities of the company; and

(d) in the case of such class of companies engaged in production of such goods or providing such services as may be specified under Section 148, such particulars relating to utilization of material or labor or other items of cost as may be prescribed under that Section, provided the Central Government so directs to any such class of companies or any particular company.

Section 128(1) provides that every company must keep proper 'books of account' with respect to matters specified above and other relevant books and papers, and these can be kept in electronic mode.

It shall be deemed that proper books of account have not been kept (a) if there are not kept books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions; and (b) if such books are not kept on accrual basis and according to the double entry system of accounting [Sec. 128(1)]. Again, in the case of a company whose business involves dealing in goods, it has been made obligatory to maintain, in addition to the usual financial accounts, 'proper stores and stock records' 'statements of annual stock taking.' and (except in the case of goods sold by way of ordinary retail trade). 'statements of all goods sold and purchased' ,showing the goods and the buyers and sellers thereof in sufficient detail so that they may be identified [Sec. 338(2)].

Place of keeping. All or any of the books of account aforesaid may be kept either at the company's registered office or at such other place in India as the Board of Directors may decide. If the Board decides to keep books of account at some place other than the registered office, the address of that place must be filed with the Registrar within seven days of any such decision [Proviso to Sec. 128(1)].

Where a company has a branch office, whether in or outside India, proper books of account relating to the transactions affected at the branch office should be kept there. The branch offices are required to send summarized returns periodically to the company at its registered office or the other place where the company's books of account are kept [Sec. 128(2)].

Period of preservation. The books of account of every company relating to a period of not less than eight years immediately preceding the current year together with the relevant vouchers must be preserved in good condition. However, where an investigation has been ordered under Section 210, the Central Government may direct that the books of account may be kept for such longer period (instead of eight years) as it may deem fit [Sec. 128(5)].

Power of inspection. The books of account and other books and papers shall be open to inspection by any director during business hours. Inspection in respect of any subsidiary of the company shall be done only by the person authorized for the purpose by a resolution of Board of Directors [Sec. 128(3)].

The Central Government may direct inspection of books of account and papers of a company by an inspector appointed by it for the purpose. The Central Government may also authorize any statutory authority (usually the Registrar of Companies) to carry out the inspection of books of account of a company or class of companies [Sec. 206(5)(6)].

Penalty for non-compliance. The responsibility for the maintenance of proper books of account is laid upon the managing director, the whole-time director incharge of finance, the Chief Financial Officer-or any other person to whom the Board of Directors have entrusted the job. If he fails to take all reasonable steps to ensure compliance by the company with the requirements of this Section (i.e. Sec. 128), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakh, or with both [Sec. 128(6)].

Financial Statement

Definition. Section 2(40) defines the expression "financial statement" as follows: 'Financial statement' in relation to a company, includes:

(i) a balance sheet at the end of the financial year;

(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in the above clauses.

However, the financial statement, with respect to One Person Company, Small Company and Dormant Company, may not include the cash flow statement.

Briefly stated 'financial statement' means Balance Sheet and Statement of Profit and Loss of a company. The provisions relating to Financial Statement as laid down in Section 129, as amended by the Companies (Amendment) Act, 2017, are as follows:

(1) The financial statement must give a true and fair view of the state of affairs—assets and liabilities—of the company as at the end of financial year. ‘Window Dressing’, that is, showing a position better than it actually is or the othèr way—creating secret reserves— would be contrary to the spirit of law.

(2) The financial statement must comply with the “accounting standards”. The items contained in the financial statements must be in accordance with the accounting standards. If there is any deviation from the prescribed standards, the company must disclose in its financial statements the following:

(a) the fact that there has been a deviation from the accounting standards;

(b) the reasons for such deviation; and

(c) the financial effect, if any, arising out of such deviation.

The phrase “accounting standards” means the standards of accounting recommended by the Institute of Chartered Accountants of India, as may be prescribed by the Central Government in consultation with National Financial Reporting Authority (Sec. 133).

(3) The financial statement must be in the ‘forms’ set-out in Schedule III of the Companies Act, However, this provision, does not apply to an insurance or a banking company or an electricity company (company engaged in the generation or supply of electricity) or to any other class of companies for which a form of financial statement has been specified under the special Acts governing such class of companies.

(4) At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the ‘financial year’.

The period to which financial statements of any company relates is referred to in the Companies Act as a ‘financial year’. The concept of uniform financial year of 1st April to 31st March has been made mandatory for companies under the Companies Act, 2013 [Sec. 2(41)].

(5) If a company has one or more subsidiaries or associate companies, it shall, in addition to financial statements of the company, prepare a consolidated financial statement of the company and of all the subsidiaries arid associate companies in the same form and manner as that of its own and in accordance with the applicable accounting standards, which shall also be laid before the annual general meeting of the company along with its financial statement. The company shall also attach along with its financial statement, a separate statement containing the salient features of the

financial statement of its subsidiary or subsidiaries and associate company or companies in such form as may be prescribed.

The Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed.

Rule 6 of the Companies (Accounts) Rules, 2014 lays down the manner of consolidation of accounts. Accordingly, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and applicable accounting standards.

Explanation added to this clause provides that the word "subsidiary" shall include associate company and joint venture.

National Financial Reporting Authority [Sec. 132, as amended by the Companies (Amendment) Act, 2017]

The Central Government may, by notification, constitute a National Financial Reporting Authority (NFRA) to provide for matters relating to accounting and auditing standards. The functions of this Authority are as follows:

(a) to make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;

(b) to monitor and enforce the compliance with accounting standards and auditing standards in such manner as maybe prescribed;

(c) to oversee the quality of service of the professionals (CAs) associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

(d) to perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

The National Financial Reporting Authority is to consist of such number of members possessing such qualifications, and appointed on such terms and conditions as have been specified in sub-section (3) of this Section (Sec. 132).

The head office of the NFRA shall be at New Delhi and it may meet at such other places in India as it deems fit.

To ensure independence of NFRA members from audit firms over whom they will exercise jurisdiction, it has been provided that the chairperson and members of NFRA, who are in full-time employment with National Financial Reporting Authority shall not be associated with any audit firm (including related consultancy firms) during the course of their appointment and two years after ceasing to hold such appointment.

The National Financial Reporting Authority shall have the power to investigate the matters of professional or other misconduct committed by any member or firm of Chartered Accountants.

No other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this Section.

NFRA, while trying a suit, shall enjoy powers of a civil court to discover and inspect documents producible as evidence, to enforce the attendance of witness and production of documents, examining witness on oath, etc., and also to provide for punishment for its contempt.

Where professional or other misconduct is proved, NFRA shall have the power to make order for:

(A) imposing penalty of (i) not less than Rs.1 lakh, but which may extend to five times of the fees received, in case of individuals, and (ii) not less than Rs.5 lakh, but which may extend to ten times of the fees received, in case of firms;

(B) debarring the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountants of India for a minimum period of six months or for such higher period not exceeding ten years.

Appeal against the orders of NFRA. The Section further provides that an aggrieved person may file an appeal against any order of the NFRA before the National Company Law Appellate Tribunal in the prescribed manner.

The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as may be prescribed.

The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

Authentication of Financial Statement [Sec. 134(1)]

The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board. These shall be signed on behalf of the Board, for submission to the auditor for his report thereon, by the chairperson of the company where he is authorized by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the Company Secretary of the company, wherever they are appointed. In the case of a One Person Company, these shall be signed only by one director.

The auditors' report shall be attached to every financial statement [Sec. 134(2)].

Board's Report or the Directors' Report [Sec. 134 (3), as amended by the Companies (Amendment) Act, 2017]

The main objective of the Board's Report is to provide authentic meaningful information to the shareholders and others, viz., employees, creditors, society, etc., regarding the state of company's affairs and the result of year's working along with the future prospects. It must be attached to the financial statements laid before a company in general meeting. The Report of the Board of Directors shall include the following:

(a) the web address, if any, where Annual Return has been placed;

(b) number of meetings of the Board; .

(c) Directors' Responsibility Statement;

(c) details in respect of frauds which have been reported by the auditors to the Audit Committee or the Company's Board of Directors and those that are reportable to the Central Government [Clause inserted by the Companies (Amendment) Act, 2015];

(d) a statement on declaration given, by independent directors under sub-section (6) of Section 149;

(e) in case of a listed company and prescribed class of companies, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under Section 178(3);

(f) explanation or comments by the Board on. every qualification, reservation or adverse remark or disclaimer made:

(i) by the auditor in his report; and

(ii) by the company secretary in practice in his secretarial audit report;

(g) particulars of loans, guarantees or investments under Section 186;

(h) particulars of contracts or arrangements with related parties referred to in Section 188(1) in the prescribed form;

(i) the state of the company's affairs; .

(f) the amounts, if any, proposed to be carried to any reserves;

(k) the amount, if any, recommend to be paid by way of dividend;

(1) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

(m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;

(n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

(o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;

(p) in case of a listed company and every other public company having such paid-up share capital. as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its committees and of individual directors has been made;

(q) such other matters as may be prescribed.

Where, the disclosures referred to in aforestated clauses have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report.

Where the complete text of policies referred to in Clauses (e) and (o) above is made available on company's website, if any, then only the key features of the policies along with the web address at which the complete policy is available are specified in the Board's report.

Abridged Board's report. The Central Government may prescribe abridged Board's report for One Person Company or Small Company [Sec. 143(3A), inserted by the Companies (Amendment) Act, 2017].

In case of One Person Company, the Board's report shall contain explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report [Sec. 134(4)].

It may be mentioned that the Companies Act, 2013 has made the Directors' Report more informative by prescribing enhanced disclosures.

Directors' Responsibility Statement. As stated above, the Board's Report shall also include a "Directors' Responsibility Statement", which, as per Section 134(5), shall state:

(i) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(ii) that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) that the directors had prepared the annual accounts on a going concern basis; and

(v) that in the case of a listed company, the directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation. For the purposes of this clause, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(vi) that the directors had devised proper system to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

The aforestated requirement is a welcome step. This will make directors accountable so as to ensure good corporate governance. However, it casts too heavy responsibility upon the part-time directors as they do not take part in conducting day to day affairs of the company.

The Board's report and any annexures thereto shall be signed. by the chairperson of the company if he is authorized by the Board and where he is not so authorized, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

(a) any notes annexed to or forming part of such financial statement;

(b) the auditor's report; and

(c) the Board's report.

Penalty for non-compliance. If a company contravenes the provisions of this Section (Sec. 134), the company shall be punishable with fine which shall not be less than Rs.50,000 but which may extend to Rs. 25 lakh and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs.50,000 but which may extend to Rs.5 lakh, or with both [Sec. 134(8)].

Copies of audited Financial Statements to be sent to numbers etc. [Sec. 136, as amended by the Companies (Amendment) Act, 2017]. A copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be attached thereto, which are to be laid before a company in its general meeting, must be sent at least 21 days before the Annual General Meeting to every member of the company, to every trustee of debenture holders and to the auditors of the company. They are also entitled to inspect the documents stated above at the company's registered office during business hours.

The copies of audited financial statements and other documents can be sent at shorter notice:

(a) in the case of a company having share capital, if consent is given by majority in number of members entitled to vote and who represent at least 95% of such part of the paid up share capital as gives a right to vote at the meeting; or

(b) in the case of a company having no share capital, if consent is given by members having at least 95%' of the total voting power exercisable at the meeting.

The Central Government may prescribe the manner of circulation of financial statements of companies having such net worth and turnover as may be prescribed.

A listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website.

Every listed company having a subsidiary or subsidiaries shall also place separate audited accounts in respect of each of its subsidiary on its website, if any;

Further, a listed company which has a foreign subsidiary:

(a) where such foreign subsidiary is statutorily required to prepare consolidated financial statement under any law of the country of its incorporation, the requirement of posting audited accounts of subsidiary shall be met if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company.

(b) where such foreign subsidiary is not required to get is financial statement audited, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English shall also be placed on the website.

If any default is made in complying with the provisions of this Section, i.e., (Sec. 136), the company shall be liable to a penalty of Rs.25,000 and every officer of the company who is in default shall be liable to a penalty of Rs.5,000.

Filing of Financial Statements, etc., with the Registrar (Sec. 137). A copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be attached to such financial statements, duly adopted at the Annual General Meeting of the company, shall be filed with the Registrar within thirty day of annual general meeting.

If the financial statements, as above, are not adopted at Annual General Meeting or adjourned Annual General Meeting, such unadopted financial statements along with the required documents shall be filed with the Registrar within thirty days of Annual General Meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned Annual General Meeting. The financial statements adopted in the adjourned Annual General Meeting shall be filed with the Registrar within thirty days of such adjourned Annual General Meeting.

A One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year.

A company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India.

Where the Annual General Meeting of a company for any year has not been held, the financial statements along with the documents required to be attached thereto, duly signed along with the statement of facts and reasons for not holding the Annual General Meeting shall be filed with the Registrar within thirty days of the last date before which the Annual General Meeting should have been held.

Filing of Balance Sheet and Profit and Loss Account in Extensible Business Reporting Language (XBRL) mode. The Ministry of Corporate Affairs have mandated the notified class of companies to file Balance Sheets and Profit and Loss Accounts along with Director's and Auditor's Report by using XBRL taxonomy only. The Ministry shall specify the manner of such filing under notification for such class of companies.

XBRL is a standardized language for the electronic communication of business and financial data which is revolutionizing business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. XBRL stands for Extensible Business Reporting Language. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world.

Taxonomy can be referred as an electronic dictionary of the reporting concepts. Taxonomy consists of all the data, definitions, the basic XBRL properties and the inter-relationships amongst the concepts.

8.3.2 ANNUAL RETURN

As per Section 92, as amended by the Companies (Amendment) Act, 2017, every company is required to prepare an 'Annual Return' in the prescribed form containing the particulars as they stood on the close of the financial year regarding the following:

(a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(b) its shares, debentures and other securities and shareholding pattern;

(c) its members and debenture holders along with changes therein since the close of the previous financial year;

(d) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

(e) meetings of members or a class thereof, Board and its various committees along with attendance details;

(f) remuneration of directors and key managerial personnel;

(g) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(h) matters relating to certification of compliances, disclosures as may be prescribed;

(i) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and

(j) such other matters as maybe prescribed.

The Central Government may prescribe abridged form of Annual Return for One Person Company (OPC), Small Company and such other class of classes of companies as may be prescribe.

Signing of annual return. The annual return must be signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice.

Annual return of One Person Company and small company must be signed by the company secretary, or where there is no company secretary, by the director of the company.

Certification of annual return. The annual return, filed by a listed company or, by an unlisted company having such paid-up capital and turnover as may be prescribed, must also be certified by a company secretary in practice in the prescribed form, stating

(i) that the annual return discloses the facts correctly and adequately, and

(ii) that the company has complied with all the provisions of this Act.

If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this Section or the rules made there under, he shall be punishable with fine ranging from Rs.50,000 to Rs.5 lakh.

Filing of annual return with ROC. Every company shall file with the Registrar of Companies a copy of the annual return, within 60 days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within 60 days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting.

A copy of Annual Return shall be uploaded on the website of the company, if any, and its web-link shall be disclosed in the Board's Report.

Place of keeping. The original copies of Annual Return shall be kept at the company's registered office and they shall be open to inspection during business hours by any member or debenture holder without fee and by other persons on payment of such fees as may be prescribed. They may, however, be kept at any other place in India in which more than 10% of the total number of members entered in the Register of Members reside, provided such place has been approved by a special resolution. The company is also required to supply to any person copies of Annual Returns on request, after charging the prescribed fee. The Central Government is also empowered to order inspection of the document or direct to deliver the copy required thereof, if the company fails to comply with the above provisions [Sec. 94, as amended by the Companies (Amendment) Act, 2017].

Copies of Annual Return along with documents annexed thereto shall be preserved for a period of 8 years from the date of filing with Registrar of Companies [Rule 15 of the Companies (Management and Administration) Rules, 2014].

The Annual Returns shall be prima facie evidence of any matter directed or authorised to be inserted therein by the Act (Sec. 95).

8.3.3 AUDIT

The inherent complex nature and constitution of a company necessitates the compulsory audit of its accounts since the shareholders, the real proprietors (loosely though), are in general the absentee owners of the company. It is for this reason that the audit of the books of account of a company has been made compulsory by the Companies Act. Further, in order to ensure the independence of the company auditors, so that they may act as a check on directors and may be able to serve the interests of the shareholders well, Sections 139 to 148 of the Companies Act contain various provisions relating to appointment, removal, qualifications, powers and duties, etc. of a company auditor.

Appointment of Auditors (Sec. 139)

The first auditor or auditors of a company shall be appointed by the Board of Directors within one month of registration of the company and the auditor or auditors so appointed shall hold office until the conclusion of the first Annual General Meeting. In case the first auditor of the company is not appointed by the directors as provided, the members shall, within 90 days at an extraordinary general meeting, make an appointment [Sec. 139(6)].

The subsequent auditor or auditors of a company are appointed at the first Annual General Meeting by passing an ordinary resolution for his appointment. Such an auditor will hold office from the conclusion of that meeting until the conclusion of the sixth Annual General Meeting. In other words, appointment of auditors shall be for 5 years term. The auditor so appointed shall be informed of his appointment within 15 days of the appointment and a notice of such appointment shall also be filed with the Registrar within 15 days [Sec. 139(1) as amended by the Companies (Amendment) Act, 2017].

The manner and procedure of selection of auditors by the members of the company at Annual General Meeting shall be such as may be prescribed.

Rule 3 of the Companies (Audit and Auditors) Rules, 2014 lays down the manner and procedure of selection and appointment of Auditors.

It has further been provided that before any appointment of auditor or auditors is made by any company it must obtain his written consent to such appointment. A certificate must also be obtained from him to the effect that the appointment, if made, will be in accordance with the conditions as may be prescribed and that he satisfies the criteria provided under Section 141 [Sec. 139(1)]. Section 141 contains provisions regarding eligibility, qualifications and disqualifications of auditors. These provisions are discussed later in this Chapter.

Note the following facts.

(1) The word "auditor" includes a firm of auditors or an audit firm. The term 'audit firm' includes a Limited Liability Partnership (LLP) incorporated under the LLP Act, 2008.

(2) It will not be required to reappoint auditor every year. The auditor can be appointed or re-appointed after a term of 5 years.

(3) Where a company constitutes an Audit Committee as required under Section 177, all appointments, including the filling of a casual vacancy, of an auditor shall be made after taking into account the recommendations of the Audit Committee [Sec. 139(11)].

(4) Where at any Annual General Meeting, no auditor is appointed or reappointed, the existing auditor shall continue to be the auditor of the company [Sec. 139(10)].

Compulsory rotation of auditors by listed companies, etc. [Sec. 139(2)]. There shall be compulsory rotation of auditors by listed companies and such classes of companies as may be prescribed. The auditors shall rotate as follows:

(1) An individual auditor cannot be appointed for more than 1 term of 5 consecutive years.

(2) An audit firm including LLP (Limited Liability Partnership) cannot be appointed as auditor for more than 2 terms of 5 consecutive years. \

Individual auditor/audit firm is not eligible for re-appointment as auditor for 5 years from the completion of the term as above. In other words, there shall be cooling off period for rotated auditor/ firm of 5 years from the completion of their term.

During the cooling off period of 5 years, even an audit firm having one or more common partners with the audit firm being rotated is not eligible to be appointed auditor of the same company.

Every existing company which is required to comply with the provisions of this sub-section shall with the requirements of this sub-section within 3 years from the date of commencement of the Companies Act, 2013.

Enabling provisions for members to resolve rotation of auditing partner and his team [Sec. 139(3)]. The members of a company may resolve to provide that:

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

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

Appointment of auditors by Government company [Sec. 139(5)(7)]. In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor- General of India (CAG) within 60 days from the date of registration of the company. If CAG does not appoint such auditor within the said period, the Board of Directors shall appoint such auditor within the next 30 days. In the case of failure of the Board to appoint such auditor, the members of the company shall appoint such auditor within 60 days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

The subsequent auditor or auditors of Government companies (as above) shall be appointed by the CAG of India within 180 days from the commencement of the financial year who shall hold office till the conclusion of the Annual General Meeting.

Any casual vacancy in the office of auditor of Government company shall be filled by the CAG of India within 30 days. If the CAG fails to do so, the Board of Directors shall fill it tip within next 30 days [Sec. 139(8)(ii)].

Casual vacancy. An auditor in a casual vacancy may be appointed by the Board of Directors within 30 days. But where such vacancy is caused by the resignation of an auditor, approval of the members in general meeting convened within 3 months of the recommendation of the Board would be required. Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next Annual General Meeting [Sec. 139(8)].

A retiring auditor may be re-appointed at an Annual General Meeting, if:

(a) he is not disqualified for re-appointment;

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

(c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed [Sec. 139(9)].

Removal and Resignation of Auditor (Sec. 140)

An auditor may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government. But before taking any action, the auditor concerned must be given a reasonable opportunity of being heard.

Resignation of auditor. The auditor who has resigned from the company shall file within 30 days from the date of resignation, a statement in the prescribed form with the company and the Registrar, and in case of government companies, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. If the auditor does not comply with this requirement, he shall be punishable with fine which shall not be less than Rs.50,000 or the remuneration of the auditor, whichever is less.

A 'special notice' shall be required for moving a resolution at an Annual General Meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years in the case of audit firm. On receipt of notice of such a resolution, the company shall forthwith send a copy thereof .to the retiring auditor who shall be entitled thereupon to make a written representation of reasonable length. The auditor while making the representation may request the company to notify the fact of such representation to the members of the company. The company shall state the fact of the representation having been made in any notice of the resolution given to the members and send a copy of the representation to every member of the company to whom the notice of the meeting is sent. In case a copy of representation could not be sent as aforesaid, it should be read out at the meeting and a copy thereof shall be filed with the register. If the Tribunal is satisfied that the rights conferred by this Section are being abused by the auditor to secure needless publicity of defamatory matter, it may order that copies of the representation need not be sent out nor read out at the meeting.

Tribunal may direct the company to change its auditors [Sec. 140(5)]. The Tribunal, may, by order direct the company to change its auditors if it is satisfied that the auditor of a company has:

(a) acted in a fraudulent manner, or

(b) abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

The Tribunal may so direct either *suo motu* or an application made to it by the Central Government or by any person concerned. If the application is made by the Central Government and the Tribunal is satisfied that a change of the auditor is required, it shall within 15 days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

An auditor (whether individual or firm) against whom on order has been passed by Tribunal, shall not be eligible to be appointed auditor of any company for 5 years from the date of passing of the order. In case of a firm of auditors, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

Qualifications and Disqualifications of Auditors

Qualifications

A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant in practice. A firm, whereof majority of partners are practising chartered accountants, may be appointed by its firm name to be auditor of a company. If a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm [Sec. 141(l)(2)].

Disqualifications [Sec. 141(3)]

The following persons shall not be eligible for appointment as an auditor of a company, namely:

(a) A body corporate other than a Limited Liability Partnership registered under the Limited Liability Partnership Act, 2008;

(b) An officer or employee of the company;

(c) A person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) A person who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company (that is co-subsidiary), provided that the relative may hold security or interest in the company of face value not exceeding Rs.1 lakh.

(e) A person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company (that is co-subsidiary), in excess of Rs.5 lakh[1].

(f) A person who, or his relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company (that is co-subsidiary), in excess of Rs.l lakh[1].

(g) A person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company (that is co-subsidiary) or associate company of such nature as may be prescribed.

(h) A person whose relative is a director or is in the employment of the company as a director or key managerial personnel.

(i) A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies.

(j) A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

(k) A person, who directly or indirectly, renders any service referred to in Section 144 (discussed later) to the company or its holding company or its subsidiary company [Sec. 141 (3)(i) as substituted by the Companies (Amendment) Act, 2017].

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

It may be noted that very stringent disqualifications have been prescribed under the Companies Act, 2013 so as to ensure integrity and independence of an auditor. For example, disqualification is now attracted even if a relative of CA (e.g., wife) holds security in the company or is indebted to the company or its subsidiary as above.

Ceiling on Audit

No person can be an auditor of more than twenty companies at a time. The restriction applies to all types of companies, namely, public, private and one person companies [Sec. 141(3)(g)].

Remuneration of Auditors (Sec. 142)

The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as the company in general meeting may determine.

The Board of Directors may fix remuneration of the first auditor appointed by it.

The remuneration shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service' rendered by him at the request of the company, e.g., for advising on company law and taxation matters etc.

Rights and Powers of Auditors

The Companies Act, 2013, confers the following rights and powers on auditors:

1. The auditor has a right of access at all times to the books and accounts and vouchers of the company whether kept at the registered office or elsewhere [Sec. 143(1)].
2. He is entitled 'to require from the officers of the company such information and explanations as he may consider necessary for the performance of his duties as auditor [Sec. 143(1)].
3. The auditor of a holding company has also the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries and associate companies [Proviso to Sec. 143(1), as amended by the Companies (Amendment) Act, 2017].
4. He has the following rights under Section 146:
   (a) To receive all notices of and other, communications relating to any general meeting of a company;
   (b) To attend and to be heard at any general meeting on any part of the business which concerns him as an auditor.
5. He is entitled to get his remuneration on the completion of his work.

Duties of Auditors

The auditors have the following statutory duties in addition to any other duties which may be imposed upon them by the articles of the company:

(1) Under Section 143(1), the auditor is required to enquire inter alia into the following matters, namely:

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

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

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

(iv) whether loans and advances made by the company have been shown as deposits;

(v) whether personal expenses have been charged to revenue account;

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

(2) Under Section 143(2) and (3), the auditor is further required to make a report (known as Auditor's Report) to the members of the company: (a) on the accounts examined by him, (b) on every balance sheet and profit and loss account, and (c) on every other document which is annexed to the balance sheet or profit and loss account, which are laid before the company in general meeting during the tenure of his office.

The auditor in his Audit Report must, inter alia, expressly state:

(i) whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give a 'true and fair view 'of the company's state of affairs;

(ii) whether he has obtained all, the information and explanations, which to the best it his knowledge and belief were necessary for he purposes of his audit and if not, the details thereof and the effect of such information on the financial statements;

(iii) whether proper books of accounts as required by law have been maintained by the company;

(iv) whether in his opinion the profit and loss account and balance sheet complied with the 'accounting standards' prescribed by the Central Government;

(v) the observations or comments of the auditors on financial transactions which have any adverse effect on the functioning of the company; and

(vi) whether any director is disqualified from being appointed as director under Section 164(2).

(vii) whether the report on the accounts of any branch office audited by a person other than company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report;

(viii) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(ix) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

(x) such other matters as may be prescribed.

Where the auditor affirms the above facts without any qualification, reservation or adverse remarks, his report is termed 'clean' or 'unqualified', otherwise it is a 'qualified report'. The auditor must not hesitate to bring to the notice of the shareholders of the company any irregularity in the books of accounts which he might come across during the course of his audit work.

Signing of Audit Report (SecS. 145 and 146)

Only the person appointed as auditors of the company, or where a firm is so appointed, only the partners in the firm who are chartered accountants, may sign the auditor's report or sign or authenticate any other document of the company required by law to be signed and authenticated by the auditor. The auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company. The auditor shall attend general meeting and shall have a right to be heard at such meeting on any part of the business which concerns him as the auditor.

Auditor is a watchdog but not a bloodhound

It must, however, be noted that an auditor must act honestly and with reasonable skill, care and caution in the discharge of his duties. "He is a watchdog but not a bloodhound.""He is not bound to be a detective.""He is not an insurer." To quote Chakravarty, C. J., "An auditor does not certify the absolute accuracy of the accounts which he audits and approves of, but only says that he has taken all possible care and exercised reasonable skill and, having done so, he has arrived at the conclusions which are recorded in his certificate" (Controller of lnsurance vs H.C. Das). The auditor is not bound to be suspicious unless there is something to arouse suspicion. He is justified in believing tried servants of the company in whom the company has placed its confidence. In certain matters of technical nature, for example, valuation of stock-in-trade, the auditor may rely on some skilled person and he was not held guilty of breach of duty when he relied for this purpose on the statement of the manager of a cotton mill (Re Kingston Cotton Mill Co).

"But if an auditor is merely to accept whatever the directors say as final his appointment serves no purpose at all" (Ganesan vs Joscelyn). Quoting Romer J. in Re City Equitable Fire Insurance Co. ; "If the statements of the very persons who constitute the management were to be accepted in all matters, even in the matters capable of direct verification, an audit will be an ideal farce." Thus, the auditor should not merely check the arithmetical accuracy of the books of accounts but he must also see that the books show the true financial position of the company. He must personally verify the matters capable of direct verification. For example, the auditor must see that securities of the company exist in fact and they are in proper custody. He must check cash in hand and the balance at the Bank as on the date on which the Balance Sheet is being prepared (Dy. Secretary, Ministry of Finance vs S.N. Das. Gupta).

The auditor is, however, not concerned with policy or management. He has simply to bring to the notice of the shareholders any irregularities affecting their interests. It may further be noted that the auditors owe their duty to the shareholders and the company only. They are not liable to third parties, e.g., a potential investor, with whom they had no contract, unless they made a fraudulent report and the outsider has been deceived by it.

Auditor not to render Certain Services (Sec. 144)

An auditor shall provide to the company only such other services as are approved by the Board of Directors or the audit committee.

However, the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company) shall not be rendered, namely:

(a) accounting and book keeping services;

(b) internal audit;

(c) design and implementation of any financial information system;

(d) actuarial services;

(e) investment advisory services;

(f) investment banking services;

(g) rendering of outsourced financial services;

(h) management services; and

(z) any other kind of services as may be prescribed.

Punishment for Contravention [Sec 14, as amended by the Companies (Amendment) Act, 2017]

Section 147 provides for heavy penalties for contravention of provisions relating to audit and auditors (Sections 139 to 146) The Section provides that:

(1) If any of the provisions of Sections 139 to 146 is contravened, the company shall be punishable with minimum fine of Rs.25,000 and maximum fine of Rs.5 lakh In addition, every officer who is in default shall be punishable with imprisonment upto 1 year or with minimum fine of Rs.l0,000 and maximum fine of Rs.l lakh or with both.

(2) If an auditor contravenes any of the provisions of Section 139 (appointment of auditors), Section 143 (contents of audit report), Section 144 (not to render prohibited non-audit services) or Section 145 (signing of audit report), he shall be punishable with minimum fine of Rs.25,000 and maximum fine of Rs. 5 lakh or four times the remuneration of the auditor, whichever is less If contravention is willful or knowingly with intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment upto l year and with minimum fine of Rs. 50,000 and maximum fine of Rs. 25 lakh or eight times the remuneration of the auditor, whichever is less.

Further, the convicted auditor is also required to:

(i) refund the remuneration received by him to the company, and

(ii) pay damages to the company, statutory bodies or authorities or to members and creditors of the company for loss arising out of incorrect or misleading statements made in his audit report

(3) Where the auditor of the company is an audit firm and it is proved that the audit partner or partners has or have:

(a) acted in a fraudulent manner, or

(b) abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability for such act would be of the audit partner or partners concerned and of the audit firm jointly and severally. In ease of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner of abetted or, as the case may be, concluded in any fraud shall be liable.

8.4 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. A dividend is that part of divisible profit of a company which is distributed among the shareholders of the company.
2. The remuneration of the auditor of a company shall be fixed by the Board of Directors.
3. The original copies of Annual Return shall be kept at the company's registered office.
4. Dividend must be paid within 60 days of its declaration.

8.5 SUMMARY

Dividend refers to that portion of profit that is paid to the shareholders of the company. It is often paid in one financial year to the shareholders after the final accounts of profit are ready and the same has to be distributed. The rights of shareholders on profits as dividends only arise after the declaration of dividends by the company done generally on the approval of board of directors. The amount paid of the dividend is in proportion to the amount paid on the share by the shareholder as provided in section 51 of the Act. There are two types of dividends: Interim dividends and Final dividends. Maintaining of company Book of Accounts is mandatory for all types of companies under the Companies Act, 2013. Private Limited Company, One Person Company and Limited Company including Small Companies are required to maintain proper book of accounts. Further, the Books of Accounts of a Company is the basis on which financial statements of a Company are prepared for company annual return filing. Therefore, maintenance of proper company account is both mandatory and necessary. Having an effective audit system is important for a company because it enables it to pursue and attain its various corporate objectives. Business processes need various forms of internal control to facilitate supervision and monitoring, prevent and detect irregular transactions, measure ongoing performance, maintain adequate business records and to promote operational productivity.

8.6 KEYWORDS

Dividend: A distribution to shareholders out of profits or reserves available for this purpose.

Dividend Fund: Profit out of which dividends can be declared.

Profit: Excess of revenue over related cost is called as profit.

Annual Accounts: It includes the Profit and Loss Account and Balance Sheet along with the statutory reports of a company.

Audit: Verification of books of accounts with the documents and vouchers to check their accuracy or otherwise.

8.7 SELF ASSESSMENT TEST

1. What are the provisions of Companies Act, 2013 for payment of dividend and unpaid dividend?
2. State the statutory provisions in respect of unpaid dividend.
3. Discuss the provisions of Companies Act, 2013 relating to appointment of auditors and rotation of auditors.
4. What are the provisions of Companies Act, 2013relating to qualification and disqualifications of auditors? Discuss.
5. Discuss the provisions of Companies Act, 2013 regarding remuneration, removal and resignation of auditors.
6. Explain the rights, powers and duties of auditors as per Companies Act, 2013.
7. "An auditor is a watchdog not a blood hound". Comment on the statement.
8. Discuss the provisions of Companies Act, 2013 relating to audit.

8.8 ANSWERS TO CHECK YOUR PROGRESS

1. True
2. False
3. True
4. False

8.9 REFERENCES/SUGGESTED READINGS

1. Anoop Jain, A Simplified Approach to Company Law, AJ Publications, Delhi.
2. R Suryanarayanan, Company Law Ready Reckoner, Commercial law Publishers, Delhi.

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4. A K Majumdar, G K Kapoor, Sanjay Dhamija, Company law and Practice, Taxman, New Delhi.

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Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 9	
COMPANY MANAGEMENT & ADMINISTRATION I: DIRECTORS	

STRUCTURE

9.0 Learning Objectives

9.1 Introduction

9.2 Directors

9.3 Some Related terms with Director

9.4 Check Your Progress

9.5 Summary

9.6 Keywords

9.7 Self-Assessment Test

9.8 Answer to Check your Progress

9.9 References/Suggested Readings

9.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Describe the legal position of director.
- Outline the qualifications and disqualifications of director.
- Explain the director remuneration.
- Discuss the powers and duties of directors.

9.1 INTRODUCTION

Proper management of companies is a matter of public interest because on the one hand the interest of countless persons in the capacity of a shareholder or an employee or a creditor is involved in their efficient working and on the other; there are unscrupulous people who are bent upon to exploit the innocent members of the society. It is perhaps for this reason that the Companies Act contains stringent provisions regarding appointment, powers and functions of the managerial personnel of a company. The expression ‘key managerial personnel’ (KMP) in relation to companies means (i) the Chief Executive Officer or the managing director or the manager; (ii) the company secretary; (iii) the whole time director; (iv) the Chief Financial Officer; and (v) such other officer as may be prescribed [Sec. 2(51)]

Under the Companies Act while the Board of Directors is a must for the management and administration of a company, other kinds of managerial personnel – managing director(s) or manager – are only optional; the company may or may not have them. The companies can be managed either by the Board of Directors itself, or by the Board of Directors with the help of managing director(s) or manager. Of these two modes of management, the companies prefer the latter mode of management.

9.2 DIRECTORS

It is surprising that the law does not precisely define the term director, Section 2(34) defines a director as “a director appointed to the Board of a company”. This is not a satisfactory definition. We can define him thus, ‘a director is one of those persons, who are responsible for directing, governing or controlling the policy or management of a company’. Directors collectively are called as “Board of Directors” or “Board” [Sec. 2(10)]. The board of directors is the top administrative organ of the company. If company is the body, then directors are the brain of the company and the company can and does act only through them. Section 179 expressly vests the management of the business of a company in its directors. The task of the shareholders is almost over with the selection of directors. Only the most important matters of the Board’s policy may be referred to the shareholders for decision at the periodical general meetings. In fact the “Board” is the supreme policy framing and decision making organ of a company.

It may be mentioned that the term ‘director’ signifies a person who is a ‘part time directors’. Individual directors have no authority to bind the company and they have to act as Board in a meeting for exercising their powers. The directors assemble to attend the Board Meetings for transacting the business and taking policy decisions.

9.3 SOME RELATED TERMS WITH DIRECTOR

9.3.1 LEGAL POSITION OF DIRECTORS

It is difficult to define the exact legal position of the directors of a company. In *Imperial Hydropathic Co. vs Hampson* case, Bowen L.J., observed, “Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may for the moment and for the particular purpose be considered." We shall, therefore, examine their position in detail.

As agents. Cairns, L.J., in *Ferguson vs Wilson's* case, while commenting upon the position of sectors of a public company observed, "They are merely agents of the 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 the principal only, the liability is the liability of the company…" Directors are, therefore, termed as agents of the company. As agents, they must conduct the business with reasonable care and diligence, and abide by the memorandum and articles of association. Their acts, within the scope of their authority, are acts of the company itself, and the company is liable for them. They enter into contracts and put their signatures on behalf of the company like an agent.

But then, why should they owe their office to election? Agents are not elected but appointed. Why they are expected to work without reward? This would make us believe that directors are not agents in the true sense but in fact proprietors or managing partners.

As managing partners. Directors are elected representatives of the shareholders and therefore they are in the position of managing partners. The fact that they themselves are important shareholders also make them partners with other shareholders. Moreover, they do almost all the proprietorial functions like allotting shares, making calls, forfeiting shares, etc

But why then a director has no authority to bind the other directors and shareholders like partners in a firm? Why should the question of retirement arise in the case of a proprietor? Directors are subject to retirement. This shows that they are not managing partners or proprietors in the full sense.

As trustees. In certain respects directors are in the position of trustees for the company. As Bacon, V. C. observed in Syke case, "It is the plain duty of the directors, who are trustees for the company, to deal in all matters of business with which the company is concerned for the benefit of the company, and not with regard to their own particular interests". Almost all the powers of directors, e.g., of allotting shares, making calls, accepting or rejecting transfers, etc., are powers in trust. "They have been made liable to make good moneys which they have misapplied, upon the same footing as if they were trustees" (*Re*

Lands Allotment Co.). They stand in fiduciary capacity to protect the interests of the company. It must be noted, however that directors are not in the position of trustees for the shareholders individually (*Percival vs Wright'*) or for the third persons who have made contracts the company (*Re City Equitable Fire Insurance Co.*).

But why then is a director never allowed to enter into a contract for himself? He enters into contracts for his principal, i.e., the company. Why can he not sue on such contracts nor be sued on km while acting intra vires? Whereas a trustee in the legal sense is one who is the owner of property which he holds in trust and contracts with third parties in relation to trust property in his own name as principal or owner, subject only to an equitable obligation to account to those (beneficiaries) to whom he stands in the relation to trustee (*Smith Vs Anderson*). In fact a director does not hold any property in trust for the company, for the company itself is the legal owner.

Thus, the directors are neither agent for managing partners or proprietors, nor trustees, in the full sense of the term. They combine in themselves all these positions. In fact they stand in a fiduciary position towards the company and at best may be termed as "officers" of the company [Sec. 2(59)]. As officers they may be held responsible for their faults of omission.

9.3.2 NUMBER OF DIRECTORS

Every public company must have at least three directors, every private company must have at least two directors and one person company is required to have minimum one director. The limit of maximum number of directors has been fixed at fifteen. This limit can be further increased by passing a special resolution in the general meeting. [Sec. 149(1)].

9.3.3 WOMAN DIRECTOR

Such class or classes of companies, as may be prescribed, shall have at least one woman director. Existing companies are required to comply with this provision within one year from the date of commencement of the Companies Act, 2013 [Sec. 149(1)(2)].

As per Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following case of companies shall appoint at least one woman director:

(i) every listed company

(ii) every other public company having:

(a) paid up share capital of Rs. 100 crore or more; or

(b) turnover of Rs. 300 crore or more.

A company incorporated under the Companies Act, 2013 is to comply with this provision within a period of 6 months from the date of its incorporation.

9.3.4 INDEPENDENT DIRECTOR

The concept of "independent director" is being introduced for the first time in Company Law by the Companies Act, 2013. The purpose of appointing "independent directors" on the Board of Directors of listed companies is to ensure adherence to good corporate governance standards. They are expected to ensure that Promoters/Management do not enrich themselves through unfair means. With a view to achieving this objective it is essential that "Independent directors" must be men of outstanding merit and integrity having no pecuniary relationship with the company, or its promoters or directors, so that they can really act independently and need not blindly toe the line suggested by promoters/management.

Definition. Independent director has been defined exhaustively as under:

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

1. who, is the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
2. (a) who is or was not a promoter of the company or its holding, subsidiary or associate company;

   (b) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
3. who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
4. none of whose relatives:

(a) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year. Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(b) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year ;

(c) has given a guarantee of provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(d) has any other pecuniary transaction or relationship with the company, or its subsidiary or its holding or associate company amounting to two per cent or more of its gross turnover or total income singly or in combination with the transaction referred to in sub-clause (a), (b) or (c) above.

5. who, neither himself nor any of his relatives –

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

(b) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –

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

(ii) any legal or consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to 10% or more of the gross turnover of such firm;

(c) holds together with his relatives 2% or more of the total voting power of the company; or

(d) is a Chief Executive or director, by whatever name called, or any non-profit organization that receives 25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or

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

It is evident from the perusal of the above definition that a Jot of precautions have been taken in the definition of “independent director” to weed out chances of possible financial gain by the “independent director” either by himself or indirectly through his relatives or associates.

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

The other provisions of Sections 149 and 150 of the Companies Act, 2013 relating to “independent directors” may be stated as follows:

(1) Every listed public company shall have at least 1/3 of its total number of directors as independent directors.

(2) The Central Government may prescribe minimum number of independent directors in case of any class of unlisted public companies as well.

(3) Every existing company, which is required to have independent directors, shall appoint such, directors within one year from the date of commencement of the Companies Act, 2013 or from the date of notification of Section 149.

(4) Every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year give a declaration that he meets the criteria of independence as provided in sub-section (6) of Section 149 (discussed above).

(5) An independent director shall not be entitled to any remuneration or stock option. But he may receive sitting fee, reimbursement of expenses for participating in the Board or other meetings and profit related commission as approved by the members of the company.

(6) Independent director shall be appointed at a general meeting for a term upto 5 consecutive, years.

(7) Independent director is eligible for re-appointment for another term of upto 5 years subject to performance evaluation by the entire Board of Directors and passing of a special resolution by members and disclosure of such appointment in the Board’s report.

(8) No independent director shall hold office for more than two consecutive terms. But such independent director shall be eligible for appointment after the expiration or cooling period of 3 years, provided he is not associated with the company in any other capacity during this 3 years period, either directly or indirectly.

(9) An independent director or a non-executive director, not being promoter or key managerial personnel, shall be held liable only in respect of such acts of commission or commission by a

company or any officer of the company, which has occurred with his knowledge, attributable through Board processes and with his consent or connivance or where he had not diligently.

(10) The provisions of retirement of directors by rotation shall not be applicable to appointment of independent directors. Section 152(6) provides that not less than two-thirds of the total number of directors of a public company shall be persons who shall retire by rotation. Hence, the independent directors should be excluded while computing the number of directors liable to retire by rotation. In other words the number of directors liable to retirement by rotation shall be two-thirds of the non-independent directors.

(11) An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by notified institute or association having expertise in creation and maintenance of such data bank. The Central Government may prescribe the manner and procedure of selection of independent directors.

(12) Detailed code of conduct to be followed by companies and their independent directors has been specified in Schedule IV appended to the Act. Schedule IV, *inter-alia*, includes guidelines for professional conduct by independent directors, their role, functions and Schedule IV may be referred with advantage.

It is worth mentioning here, that prior to enactment of the Companies Act, 201 3, the concept of independent directors was applicable to Listed Companies only through Clause 49 of the Listing Agreement with Stock Exchanges which dealt with Corporate Governance.

9.3.5 SMALL SHAREHOLDERS' DIRECTOR

A listed company may have one director elected by small shareholders in such manner and with such terms and conditions as may be prescribed. For this purpose "small shareholder" means a shareholder holding shares of nominal value of not more than Rs.20,000 or such other sum as may be prescribed.

In the light of the above provisions, the following points may be inferred:

(1) In the case of a listed company, out of the minimum three directors (or such higher number of directors as prescribed by the Articles), there may be one director, elected by small shareholders from amongst them, i.e., who shall also be a small shareholder of the company. As such, the appointment of a director representing small shareholders is optional.

(2) Only ‘small shareholders’ can vote on the election of the nominee director of small shareholders and they shall include both equity shareholders as well as preference shareholders, because the expression ‘nominal value of share capital’ includes equity share capital and preference share capital.

The Central Government has notified the Rules called the “Companies (Appointment and Qualification of Directors) Rules, 2014”. These Rules have been made effective from 1st April, 2014. Rule 7 of these Rules, *inter-alia,* provides as follows.

(i) A listed company may act *suo-moto* to elect a small shareholders’ director from amongst small shareholders or upon the notice in writing of at least one-tenth of total small shareholders or 1,000 small shareholders, whichever is lower, proposing the name of a small shareholder for the post of director. The notice must be given at least 14 days before the meeting.

(ii) The tenure of such small shareholders’ director shall be for a maximum period of 3 years and he shall not be subject to retirement by rotation.

(iii) Such a director shall be treated as director for all other purposes except for appointment as whole time director or managing director.

(iv) No person shall hold office at the same time as small shareholders’ director in more than two companies.

9.3.6 QUALIFICATIONS OF DIRECTORS

The Companies Act does not lay down any academic or shareholding qualifications for a director. There is a widespread misconception that a director must necessarily be a shareholder of the company. But it is not so. Unless the articles provide otherwise, a director need not be a shareholder of the company. If the articles provide for certain qualification shares for a director, the nominal value of such shares could be kept low so that even an ordinary shareholder may think of becoming a director. Usually, technical, special or nominee director is exempted from possessing qualification shares, if any.

9.3.7 DISQUALIFICATION OF DIRECTORS

Section 164 states that a person shall not be eligible for appointment as a director of a company, if –

(1) he has been adjudged to be of unsound mind,

(2) he is an undischarged insolvent,

(3) he has applied to be adjudged insolvent,

(4) he has been convicted by a court and sentenced to at least six months of imprisonment for an offence involving moral turpitude or otherwise, and five years have not elapsed form the date of expiry of the sentence;

(5) he has been convicted of an offence and sentenced in respect thereof to imprisonment for a period of 7 years or more;

(6) he has failed to pay any call on his shares for six months;

(7) he has been disqualified by an order of a court or Tribunal for appointment as a director the order is in force;

(8) he has been convicted of an offence dealing with 'related party transactions' under Section 188 at any time during the preceding 5 years;

(9) he has not complied with Section 152(3), i.e., Director Identification Number (DIN) has not been allotted to him;

(10) he is or has been a director of a company which

(a) has not filed financial statements or annual returns for any continuous period of three financial years with Registrar of Companies; or

(b) has failed to repay its deposits or interest thereon on due date or redeem its debenture on due date or pay interest thereon or pay any dividend declared and such failure continues for one year or more;

such director shall not be eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date of default committed by the said company..

The provison inserted by the Companies (Amendment) Act, 2017 provides that where a person is appointed as a director of a company which is in default of the above clauses (a) or (b), then such director shall not incur the disqualification for a period of six months from the date of his appointment.

The disqualifications mentioned in clauses (4) (7) and (8) above shall continue to apply even the appeal or petition has been filed against the order of conviction or disqualification.

The Section further authorizes a private company *to add* any other additional disqualifications in its articles for appointment as a director. Implicitly, it means that a public company cannot prescribe additional. disqualifications in its articles, for appointment as a director [Sec. 164(3), as amended the Companies (Amendment) Act, 2017].

9.3.8 DIRECTOR IDENTIFICATION NUMBER

According to the Companies (Appointment and Qualification of Directors) Rules, 2014, "Director Identification Number" (DIN) means an identification number allotted by the Central Government to any individual, intending to be appointed as director or to any existing director of a company for the purpose of his identification as a director of a company. A reference to DIN allotted to a Director is a mandatory field in e-filing in respect of certain filings. The Companies Act, 2013 has inserted Sections 153 to 159 which contain provisions regarding the allotment of a unique "Director Identification Number" (DIN). These Sections provide as follows:

1. Every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number (DIN) to the Central Government in such form, and manner and along with such fee, as may be prescribed. However; the Central Government is empowered to recognize any other identification number to be treated as Director Identification Number [Sec. 153, as amended by the Companies (Amendment) Act, 2017].
2. The Central Government shall, within one month from the receipt of the application under Section 153, allot a DIN to an applicant, in such manner as may be prescribed (Sec. 154).
3. No individual, who has already been allotted a DIN under Section 154, shall apply, obtain or possess another Director Identification Number (Sec. 155).
4. Every existing director shall, within one month of the receipt of DIN, intimate his DIN to the company or all companies wherein he is a director (Sec. 156).
5. Every company shall, within 15 days of the receipt of intimation under Section 156, furnish the DIN of all its Directors to the Registrar of Companies or any other officer or authority as may be specified by the Central Government with such fees as may be prescribed. If a company fails to finish DIN as required, the company and every officer who is in default shall be punishable with fine as prescribed (Sec. 157).
6. Every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall quote the DIN in such return, information or particulars in case they relate to the director or contain any reference of any director (Sec. 158).

7. If any individual or director of a company contravenes any of the provisions of Sections 152, 155 and 156 referred above, such individual or director of the company shall be punishable with imprisonment upto 6 months and with fine upto Rs.50,000 and where the contravention is a continuing one, with a further fine which may extend to Rs.500 for every day after the first during which the contravention continues (Sec. 159).

It has been clarified by the Ministry of Corporate Affairs (MCA) that on resignation of the director from a company, the DIN obtained does not have to be cancelled. The DIN will remain with the individual. Only a single DIN is required for an individual irrespective of number of directorships held by him. All the directorships of an individual would be mapped in the database through that DIN.

With the introduction of the concept of DIN legal action against the directors can be taken immediately keeping in view the possibility of fraud by companies and the phenomenon of companies raise funds from the public and vanish thereafter. DIN will help the Government to keep track of the people who run the companies. Now a defaulting director cannot join the Board of another company after hiding his past deeds as all the 20 offices of the Registrars of Companies in the country have been networked. DIN may be obtained by following the notified procedure in this regard.

The Central Government has notified the Companies (Appointment and Qualification of Directors) Rules, 2014. These Rules, *inter-alia,* provide rules regarding Application for Allotment of DIN and Allotment of DIN.

9.3.9 APPOINTMENT OF DIRECTORS

Legally, no firm or association or company can be appointed as director, only individuals can be so appointed provided he has been allotted a Director Identification Number under Section 154 or any other number as may be prescribed under Section 153 [Secs. 149(1) and 152(3)]. At least one of the directors shall be a person who stays in India for a total period of not less than 182 days during financial year. In case of newly incorporated companies, the requirement of period of 182 days shall apply proportionately at the end of the financial year in which it is incorporated [Sec. 149(3), as amended by the Companies (Amendment) Act, 2017]. Existing companies to comply with this provision within one year from the date of commencement of the Companies Act, 2013 [Sec. 149(5)]. Any individual competent to contract who is not disqualified under Section 164 (discussed earlier) may be appointed as director of a company.

First directors. The first directors of a company are appointed by the subscribers to the memorandum their names are mentioned in the articles. If this is not done, the articles may prescribe the method of appointing them. If the articles neither contain the names of the first directors nor any provision for appointing them, the subscribers to the memorandum, who are individuals, shall be deemed to be the first directors. Such directors shall retire at the first annual general meeting of the company, when directors will be duly appointed in accordance with the provision of Section 152(6). In case of a One Person Company, where the first director is not appointed by the articles, the individual member shall be deemed to be its first director until a director or directors are duly appointed by the member [Sec. 152(1)].

No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN) or any other number as may be prescribed under Section 153 [Sec. 152(3)].

Every person proposed to be appointed as a director in general meeting or otherwise, shall furnish his DIN or such other number as may be prescribed under Section 153 and a declaration that he is not disqualified to become a director under the Act [Sec. 152(4), as amended by the Companies (Amendment) Act, 2017].

Subsequent directors. Regarding the appointment of subsequent directors Section 152(6) states that unless the articles provide for the retirement of all the directors at every annual general meeting at least two-thirds of the total number (any fraction to be rounded off as one) of directors of a public company shall be rotational directors, i.e., liable to retire by rotation and shall be appointed by the shareholders in general meeting. The remaining directors, not exceeding one-third of the total number, in the case of any such company, and all the directors in the case of a private company may be appointed on non-rotational basis in such manner and for such duration of time as provided in the articles of the company. In the absence of any regulations in the articles in this regard, these directors shall also be appointed by the shareholders in general meeting.

It may thus be noted that Section 152(6) permits one-third of the total number of directors of a public company and all the directors of a private company to be appointed, otherwise than by the shareholders at a general meeting, in such manner as provided in the articles. It follows that within the aforesaid limit as to the number of directors, a power of appointment of directors can be validly conferred by the articles on a third party, e.g., debentureholders or other specified creditor or any other specified person, and such nominee directors may be appointed on a non-rotational basis for any duration of time, even for life as permanent directors.

At every subsequent annual general meeting, out of the two-thirds directors liable to retire by rotation, one third or the number nearest to one-third must retire. The directors longest in office shall retire in the first place, but as between persons who became directors on the same day, those who are to retire shall be determined by lot, if there is no agreement among them [Sec. 152(6)].

Explanation. For the purpose of this sub-section, “total number of directors” shall not include “independent directors”. In other words, the number of directors liable to retirement by rotation shall be two-thirds of the non-independent directors.

The retiring directors shall be eligible for re-election. If a new person, i.e., one who is not a retiring director, is to be appointed, a notice in writing must be given to the company at least 14 days before the meeting. The notice must be given by the person seeking appointment as director or by some member intending to propose him as director, provided the said member is eligible to vote on the resolution of such appointment. The person sending such notice must also deposit Rs.1 lakh or such higher amount as maybe prescribed with the company. The company is then required to inform the members about the candidature in such manner as may be prescribed. The deposit referred to above shall be refunded to the depositor if the person succeeds in getting elected as a director, or gets more than 25% of total valid votes cast on such resolution, otherwise it would be forfeited by the company. The requirement of deposit of rupees one lakh mentioned above shall not be applicable in case of appointment of an independent director or a director recommended by Nomination and Remuneration Committee, if any, or a director recommended by the Board of Directors of the Company, in the case of a company not required to constitute Nomination and Remuneration Committee [Sec. 160, as amended by the Companies (Amendment) Act, 2017].

Section 160 does not apply to a private company.

The vacancies thus created must be filled up the same meeting but if the company fails to do this, the meeting shall be deemed to have been adjourned for a week. If at the reassembled meeting also, the places of retiring directors are not filled up, the retiring directors shall be deemed to have been re-elected automatically, unless:

(a) it is resolved not to fill the vacancy, or

(b) a resolution for his re-election is lost, or

(c) he has expressed in writing his unwillingness to continue, or

(d) he has incurred a disqualification, or

(e) a special or ordinary resolution is required for his appointment or reappointment by virtue of any provisions of the Act.

It should, however, be noted that each director has to be elected through a separate resolution passed by simple majority, unless the meeting unanimously resolves otherwise [Secs. 152(2) and 162]. Again, the appointment of a director, who is not a retiring director will not be valid unless written consent to act as a director is filed with the Registrar within 30 days of appointment [Sec. 152(5)].

Option to adopt principle of proportional representation. Since directors are appointed by simple majority, a substantial minority, as high as 49 per cent, cannot even place a single director on the Board. In order to enable the minority shareholders to have proportionate representation on the Board, Section 163gives an option to companies to appoint directors through a system of proportional representation. The Section provides that the articles of a company may provide for the appointment of at least two-thirds of the total number of directors of a company in accordance with the principle of proportional representation, whether by the single transferrable note or by a system of cumulative voting or otherwise. Such appointments are to be made once in every three years.

(i) Single Transferable Vote. Under the system of single transferrable vote, a quota of votes is fixed. A person gets elected if he gets the required number of votes fixed as quota. Quota is fixed in the following manner:

Suppose in an election 1000 votes are cast and there are 4 seats. The quota shall be obtained by dividing the total number of votes cast by the total number of seats plus one and adding one to the result. Thus, the quota in this case will be 201 votes calculated as follows:

$$\frac{1000}{4+1} + 1 = 201$$

(ii) Cumulative Voting. As per the cumulative voting system, the total number of votes cast would be equal to the total number of shares multiplied by the number of directors to be elected. Thus if there are 1000 shares carrying one vote each and 5 directors are to be elected, the total number of votes cast would be equal to 5,000. A candidate getting 1000 votes shall be declared elected. Now assuming that the minority holds 20 per cent of shares, i.e., 200 shares. The total votes which the minority can therefore cast in favor of one or more candidates would be equal to 200 ×5 = 1,000. In case, the minority is bent upon having at least one of its representatives on the Board, it can do so by casting in a combined resolution all the votes in favor of that single candidate and in its representative would get elected.

Appointment of Directors by the Board

The Board of Directors may appoint directors in the following circumstances:

(i) Casual vacancies. If the office of a director falls vacant for some reason (i.e., death or resignation etc.) before his term expires, the resulting casual vacancy may, subject to any regulations articles, be filled by the Board of Directors at a meeting of the Board, which shall be subsequent approved by members in the immediate next general meeting. But the director, so appointed will cease to act the moment the term of the original director is completed [Sec. 161(4), as amended by the Companies (Amendment) Act, 2017].

(ii) Additional director. The articles may empower the Board of Directors to appoint additional director, who shall hold office up to the date of next annual general meeting. However, the Board cannot appoint a person who fails to get appointed as a director in a general meeting as an additional director [Sec. 16 1(1)].

(iii) Alternate director. Similarly, the articles may empower the Board to appoint a person, not being a person holding any alternate directorship for any other director in the company, or holding directorship in the same company, to act as an alternate director for a director during his absence for more than three months from India. Such an alternate director shall vacate office either on expiry of the original director's term or on return of the original director to India. However, no person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director [Sec. 161(2), as amended by the Companies (Amendment) Act, 2017].

(iv) Nominee director. Subject to the articles, the Board may appoint a person as a director nominated by any institution in pursuance of any agreement, or by the Central Government or the State Government by virtue of its shareholding in the company [Sec. 161(3)].

Directors nominated by IDBI, UTI, LIC and State Finance Corporations, etc. In the case of aforesaid financial institutions, the relevant Acts by which they have been constituted, provide for the right of nomination of one or more directors by them to all assisted companies with a view to securing that the financial assistance granted by them is put to best use by the industrial concerns. These special Acts (namely, IDBI Act, UTI Act, LIC Act and SFC Act) also provide that any appointment of directors made in pursuance of the right of nomination conferred by the relevant Act shall be valid and effective notwithstanding anything to the contrary contained in the Companies Act, and in the Memorandum/Articles of Association of the assisted companies in regard to the appointment of directors, retirement of directors, etc.

It may thus be noted that the directors nominated by the said special financial institutions shall neither be included in the total number of directors for the purpose of counting two-thirds or any other proportion nor they shall be subject to retirement by rotation. It follows from the above that the nominee directors of these institutions together with non-rotational directors may constitute more than one-third of the total membership of the Board and this will not be treated as contravention of the provisions of Section 152 of the Companies Act.

Appointment of Directors by Third Parties

As observed earlier Section 152 provides that one-third of the total number of directors of a public company and all the directors of a private company may be non-rotational directors and such directors may be appointed by third parties, if the Articles so authorise. The Articles may give such a right to debentureholders or other specified creditor, if for any reason the non-rotational directors have to be increased beyond one-third of the total number of directors, then the number of rotational directors shall also have to be increased so as to comply with the requirement as regards the two-thirds proportion of the rotational directors.

9.3.10 NUMBER OF DIRECTORSHIPS

No person can be a director of more than 20 companies at the same time. The limit of 20 will include alternate directorship but will exclude directorship in a dormant company. However, the maximum number of public companies (including private companies that are either holding or subsidiary company of a public company) in which a person can be appointed as a director cannot exceed 10.

The members of a company may, by special resolution, specify any lesser number of companies beyond which a director of the company shall not act as director. Any person holding office of director in more than the specified number of companies immediately before the commencement of the Companies Act, 2013 shall, within a period of one year from such commencement, choose not more than the specified limit of companies and resign in other companies and he shall intimate his choice to each of the companies and the concerned Registrar of Companies.

Any person who acts as a director in contravention of the above provisions shall be punishable with fine ranging from Rs.5,000 to Rs.25,000 for everyday, after the first, during which the contravention continues.

9.3.11 VACATION OF OFFICE OF DIRECTOR

The Office of a director shall become vacant automatically if:

(1) he incurs any of the disqualifications specified in Section 164 (discussed earlier). However, if he incurs disqualification under Section 164(2), the office of director shall become vacant in all the companies, other than the company which is in default;

(2) 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;

(3) 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;

(4) 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;

(5) he becomes disqualified by an order of a court or the Tribunal;

(6) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced to imprisonment for at least six months. The office shall not be vacated by the director in certain cases where an appeal is preferred;

(7) he is removed in pursuance of the provisions of this Act;

(8) 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.

Where all the directors of a company vacate their offices under any of the disqualifications specified above, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

A private company may provide additional grounds in its articles for the vacation of office of director.

If a person functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified above, he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than Rs.1 lakh but which may extend to Rs. 5 lakh, or with both.

9.3.12 RESIGNATION OF DIRECTOR

A director may resign from his office by giving a notice in writing to the company. The company shall take note of the resignation and intimate the Registrar of Companies. A director may also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within thirty days of resignation in such manner as may be prescribed. The requirement of forwarding a copy of resignation by the director to the Registrar shall be optional.

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, without any need for its acceptance by the Board of Directors. However, the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

Where all the directors of a company resign from their offices, or vacate their offices under any of the disqualifications specified in Section 167 (discussed under preceding heading), 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.

9.3.13 REMOVAL OF DIRECTORS

The removal of directors can take place in the following ways:

(1) Removal by shareholders (Sec. 169). A company (whether public or private) may, by giving a special notice of at least 14 days and passing an ordinary resolution, remove a director before the expiry of his period of office. In case some of the shareholders want to move the resolution for the removal of a director, they must give a special notice to the company at least 14 days before the meeting, specifying the intention to move the resolution so that proper notice may be sent to the director concerned and other members. The director sought to be so removed shall have the right of being heard at the general meeting.

Where notice is given of a resolution to remove a director, the director concerned has a right to make with respect thereto representation in writing to the company and may request that the same be notified to the members of the company. The company then becomes bound to send a copy of the representation to every member of the company to whom notice of the meeting is sent except where relieved by the Tribunal on reasonable grounds, e.g., the Tribunal may exempt the company if it is satisfied that rights conferred by this Section are being used to secure needless publicity of defamatory matter. The application to the Tribunal for the purpose may be made by the company or by any person who claims to be aggrieved.

A vacancy so created, may either be filled at the same meeting provided special notice of the intended appointment has been given or it may be filled as a casual vacancy. A director, so appointed will vacate office on the expiry of removed director's term. A removed director cannot be reappointed, but he can claim compensation, if any, in respect of the termination of his appointment. The amount of compensation will be calculated with reference to his lost income of the office of director as also of any other office which will terminate along with that office, such as that of managing director.

The shareholders, however, cannot remove the following types of directors:

(a) A director appointed by the Tribunal under Section 242.

(b) A director appointed according to the principle of proportional representation under Section 163.

(2) Removal by Tribunal (Sec. 242). The Tribunal also has the power to remove a director on an application made to it for prevention of oppression or mismanagement (under Section 241). The person so removed is disabled from holding a managerial office in the company for a period of five years without the leave of the Tribunal. Further, he cannot claim compensation for the termination of his appointment (Sec. 243).

9.3.14 REMUNERATION OF DIRECTORS

We have already seen that directors are officers and agents of the company. They are elected representatives of the shareholders and are not employed by the company. Accordingly they are not servants of the company and have no right to remuneration unless there is specific provision to that effect in the articles or the shareholders resolve for the same in general meeting. The articles, however, generally provide for directors' remuneration which is in the nature of honorarium. With a view to understanding fully the legal provisions relating to the remuneration of directors, we shall be studying the provisions concerning managerial remuneration as a whole.

Maximum and Minimum Managerial Remuneration

At the very outset it is important to note that for the purpose of limits on 'managerial remuneration' payable by a public company, the expression 'managerial personnel' refers to directors (part-time directors), managing director or manager (chief executive officer) or a whole time director', and the expression 'managerial person' refers to a managing director or manager (CEO) or whole time director. It needs to be emphasized that no other executive is to be included under these expressions irrespective of salary paid to him.

Overall limit to managerial remuneration. According to Section 197(1), in the case of a public company total managerial remuneration payable to the 'managerial personnel', namely, directors, managing director(s) or manager and whole time director(s) in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year. For payment of remuneration exceeding 11% of the net profits of the company, the company is required to pass a resolution in general meeting. But this is subject to the provisions of Schedule V annexed to the Act.

The limit mentioned above shall be exclusive of any sitting or attendance fees payable to directors for attending meetings of the Board or Committee thereof [Sec. 197(2)].

If, in any financial year, a public company has no profits or its profits are inadequate, the company may pay remuneration to its 'managerial person' in accordance with the provisions of Schedule V annexed to the Act [Sec. 197(3)].

9.3.15 POWERS OF DIRECTORS

Nature and Extent of Directors' Powers

Subject to the articles of the company and to the provisions of the Companies Act, the directors of a company have the power to do all such acts as the company is authorized to do [Sec. 179(1)]. Once the articles set out their powers, only they may exercise them. The shareholders of the company cannot interfere and control the way in which the directors choose to act, provided they act within the scope of the authority conferred upon them and exercise the powers *bonafide* in the best interests of the company. If the shareholders disapprove the Board's actions strongly enough they can alter the articles to restrict the Board's power or they can refuse to re-elect the directors of whose action they disapprove, but they cannot themselves unlawfully seize and possess those powers which by the articles are vested in the directors.

There are certain exceptional cases, however, where the majority of shareholders in a general meeting may intervene and exercise a power vested in the Board–

(a) Mala fide. When the directors act for their own personal interests in complete disregard to interests of the company

(b) Hoard incompetent. When the Board has become incompetent to act, e.g., where all the "rectors are interested in a dealing.

(c) Dead lock. When the directors are either unable or unwilling to act (*Barron vs Potter*).

It is to be remembered that individual directors have no authority to bind the company and they have to act as Board in a meeting for exercising their powers, unless the articles provide otherwise.The articles, however, usually authorize the Board of Directors to delegate some of their powers to a committee of directors or to the managing director or manager.

Statutory Provisions Regarding Directors' Powers

Section 179(3) provides that subject to any restriction placed by the articles, the following powers, can be exercised by the Board only by means of resolutions passed at meetings of the Board and not by circulation.

(1) the power to make calls;

(2) the power to authorize the company to buy back its own shares or other specified securities upto 10% of the total of its paid-up equity capital and free reserves,

(3) the power to issue shares or debentures;

(4) the power to borrow moneys otherwise than on debentures;

(5) the power to invest the funds of the company;

(6) the power to grant loans or give guarantee or provide security in respect of loans;

(7) the power to approve financial statement and the Board of Directors report;

(8) the power to diversify the business of the company;

(9) the power to approve amalgamation, merger or reconstruction,

(10) the power to take over a company or acquire a controlling or substantial stake in another company;

(11) any other matter which may be prescribed.

The Board may, however, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company, the powers to borrow money, to invest the funds and to grant loans. The resolution should specify, the extent, nature and purpose in each case.

Besides the above mentioned powers, the Companies Act, under several other Sections, provides some other powers which must also be exercised at the Board Meetings only. For example:

(i) The power to approve the Corporate Social Responsibility Policy (Sec. 135).

(ii) The power to fill up casual vacancies among directors, to appoint alternate directors, and to appoint additional directors (Sec. 161), subject to any regulations in the Articles.

(iii) The power to make contribution to political party (Sec. 182).

(iv) The power to enter into any contract or arrangement with a ‘related party’ (Sec. 188).

(v) The power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.

(vi) The power to appoint the first auditors of the company and to fill any casual vacancy in the office of the auditor unless such a vacancy is caused by resignation of the auditor. (Sec. 139)

(vii) The power to fill the vacancy in the office of key managerial personnel [Sec. 203(4)].

In the exercise of certain powers, however, unanimous consent of all the directors present at the Board meeting and entitled to vote thereon is required, for example –

(a) The power to appoint a person as ‘managing director’ who is already the ‘managing director or ‘manager’ of one other company [Sec. 203(3)].

(b) The power to grant loans to, or to invest in any shares and debentures of any other body corporate [See. 186(5)].

Restrictions on the Powers of Directors

The Board of Directors of a company (whether public or private) cannot exercise any of the following powers without the consent of the shareholders by a special resolution:

(1) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company;

The explanation added to this clause defines the expressions “undertaking” and “substantially’ the whole of the undertaking”. “Undertaking” shall mean an undertaking in which investment of the company exceeds 20% of its net worth or an undertaking which generates 20% of the total income of the company during the previous financial year. “Substantially the whole of the undertaking” shall mean 20% or more of the value of the undertaking as per previous year Balance Sheet.

Under sub-section 3(a) it has been further provided that the title of innocent purchasers and lessees who have acted in good faith and after exercising due care and caution (i.e., who have acted without the knowledge of non-compliance of the above restriction) will not be affected. Moreover, this restriction does not apply to the case of a company whose ordinary business is to sell or lease property [Subsection 3(b)].

(2) investment of the amount of compensation received by the company as a result of any merger or amalgamation in securities other than trust securities;

(3) to borrow moneys exceeding the aggregate of the paid-up capital of the company, free reserves (i.e., reserves which are available for distribution as dividend) and securities premium. Borrowing here, does not include temporary loans from the company’s bankers.

Sub-section 5 grants protection to a lender who has advanced the loan, in excess above limit, in good faith and without knowledge that the limit had been exceeded.

(4) to remit, or give time for the repayment of, any debt due from a director;

The above powers of the shareholders cannot be curtailed by the articles of the company. If the directors exceed their powers, their acts shall bind the company only after the shareholders have ratified them by passing a special resolution, provided that such acts are within the scope of the memorandum.

9.3.16 DUTIES OF DIRECTORS

Keeping in view the fiduciary capacity of the directors, the duties of the directors have been provided under Section 166 for the first time. The previous Companies Act, 1956 did not specifically provide any such duties. The various duties of directors as given in the Section are as follows:

(1) They must act in accordance with the company’s Articles.

(2) They must act in good faith for the benefit of the company's members as a whole and in the best interests of the company, its employees, the community and the environment.

(3) They must exercise their duties with due and reasonable care, skill and diligence.

(4) They must exercise independent judgment.

(5) They must not involve in a situation in which they may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(6) They must not achieve or attempt to achieve any undue gain or advantage either to themselves or their relatives, partners or associates and if any director is found guilty of making under gain, he shall be liable to pay an amount equal to that gain to the company

(7) They must not assign their office and any assignment so made shall be void. A few more duties of directors under the general law may be summarized as follows.

    (1) They must not be negligent. The directors must attend Board's meeting unless impossible otherwise.

    (2) They must perform their duties personally. The maxim "*delegatus non potest delegare*" (a delegate cannot delegate further) applies to them like all agents. Hence, unless permitted by the articles specifically, the directors must not delegate any of their powers to some other person.

Officer in Default. In all the penal provisions of the Act, the person sought to be made liable is described as an 'officer who is in default'. The expression 'officer in default' means any of the following officers of a company, namely: (a) the Chief Executive Officer; (b) the managing director(s); (c) the whole time director(s); (d) the manager; (e) the secretary; (f) the Chief Financial Officer; (g) any person charged by the Board with the responsibility of complying with that provision. In case of a Board managed company (i.e., where there are no managing or whole time director(s) or manager), the Board may specify any director(s) in this behalf, failing which all the directors will be held liable. In respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer shall be regarded as 'officers in default' [Sec. 2(60)].

It must, however, be noted that a director against whom an action is brought is entitled to contribution from as many of his co-directors as were equally at fault.

9.4 CHECK YOUR PROGRESS

Fill in the blanks:

1. A director is one of those persons, who are responsible for______, governing or controlling the policy or management of a company.
2. Every public company must have at least ____ directors.
3. ________in relation to a company, means a director other than a managing director or a whole-time director or a nominee director.
4. The ________ of a company are appointed by the subscribers to the memorandum their names are mentioned in the articles.
5. The articles may empower the Board of Directors to appoint _______, who shall hold office up to the date of next annual general meeting.

9.5 SUMMARY

To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors. Directors of a company are its eyes, ears, brain, hands and other essential limbs. Directors are trustees for the company i.e. the directors are persons selected to manage the affairs of the company for the benefit of the shareholders. Every public company shall have at least three directors and every private company shall have at least two directors and every one person company shall have at least one director as per section 149. As per Section 152, only an individual can be a director. Section 164 lays down disqualifications of directors. Maximum Number of Director is 15, which can be increased by passing a special Resolution. Certain prescribed class or classes of companies is required to have at least one woman director. This is a mandatory provision. Every company including one person company shall have at least on director who stays in India for a period of not less than 182 days in the previous calendar year. Maximum limit on total number of directorship has been fixed at 20 companies including sub limit of 10 for public companies. The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director. A director may be removed from the office by giving a special notice. A director may resign his office in the manner provided by the articles.

9.6 KEYWORDS

Director: An individual elected by the shareholders to manage the affairs of a company.

Independent Director: It means a director other than a managing director or a whole time director or a nominee director.

Small Shareholder: A shareholder holding shares of nominal value of not more than Rs. 20,000 or such other sum as may be prescribed.

Director Identification Number: Means an identification number allotted by the Central Government to any individual, intending to be appointed as director or to any existing director of the company.

9.7 SELF ASSESSMENT TEST

1. Who are directors? What are the various modes of appointing the directors?
2. What is the position of directors? Explain their duties.
3. What are the various restrictions imposed by the Companies Act on the appointment of directors? When can a director be removed from his office?
4. State the powers and duties of the directors. Under what circumstances a director is deemed to have vacated his office?
5. Discuss the provisions of Companies Act relating to Independent Directors.

9.8 ANSWERS TO CHECK YOUR PROGRESS

1. directing
2. three
3. An independent director
4. first director
5. additional director

9.9 REFERENCES/SUGGESTED READINGS

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Subject: Company Law	
Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 10	

COMPANY MANAGEMENT & ADMINISTRATION II: MANAGERIAL PERSONNEL

STRUCTURE

10.0 Learning Objectives

10.1 Introduction

10.2 Definition of Managerial Personnel

10.2.1 Characteristics of Managing Director

10.2.2 Characteristics of Manager

10.2.3 Appointment of Managing Director, Whole-time Director or Manager

10.2.4 Overall Maximum Management Remuneration

10.2.5 Compensation for Loss of Office of Managing or Whole-time Director or Manager

10.2.6 Appointment of Key Personnel Manager

10.2.7 Secretarial Audit for Bigger Companies

10.2.8 Difference between a Manager and a Managing Director

10.3 Check Your Progress

10.4 Summary

10.5 Keywords

10.6 Self-Assessment Test

10.7 Answer to Check Your Progress

10.8 References/Suggested Readings

10.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Know the characteristics of Managing Director and Manager of a company.

- Describe the procedure of appointment of Managing Director, Whole-time Director and Manager of a company.
- Explain the difference between a manager and a Managing Director.

10.1 INTRODUCTION

The executive management of a company is responsible for the day to day management of a company. The Companies Act, 2013, has used the term key management personnel to define the executive management. The key management personnel are the point of first contact between the company and its stakeholders. While the Board is responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation.

Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of key managerial personnel including managing director, whole-time director or manager, managerial remuneration, secretarial audit etc.

10.2 DEFINITION OF MANAGERIAL PERSONNEL

The definition of managerial personnel as per Companies Act, 2013 are as follows:

Managing Director: As per Section 2(54) of the Companies Act, 2013, '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 director occupying the position of managing director, by-whatever name called.

Whole-time Director: As per Section 2(94) of the Companies Act, 2013, 'whole-time director' includes a director in the whole-time employment of the company.

Manager: As per Section 2(53) of the Companies Act, 2013, '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 me called, whether under a contract of service or not.

10.2.1 CHARACTERISTICS OF MANAGING DIRECTOR

The definition of managing director reveals the following characteristics of the office of managing director:

1. A managing director must be an individual. A person, who is not a director can not be appointed as a managing director. His appointment is automatically terminated if he ceases to be a director. Hence, the managing director has necessarily to be a director.
2. A managing director can be appointed under:
   (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 Director; or
   (d) the Memorandum of Association of the company; or
   (e) the Articles of Association of the company
3. He must have substantial powers of management. He must have powers other than the administrative acts of routine nature because the routine nature acts are done by the director. In order to make director a managing director, it is necessary that the powers exercisable by him constitute substantial power of management which consists of laying down board policies and objectives of the company.
4. A managing director of a company has to exercise his powers subject to the superintendence, control and direction of the Board of Directors. The managing director is servant of the company and remuneration payable to him is salary. But he is not a clerk or a servant as to be entitled to preferential payment.

10.2.2 CHARACTERISTICS OF MANAGER

The important features of a manager are as follows:

1. Only an individual can be a manager. The Act provides that a company (whether public or private) must not appoint any firm, body corporate or an association of person as its manager.
2. The manager is liable for the management of the whole or substantially the whole of the affairs of the company. A mere head of a department or a branch manager would not be a manager.
3. It is not necessary that a manager is appointed under a contract of service, it may be or may not be so.

4. A manager is subject to the superintendence, control and direct of the Board of Directors.
5. A director can also work as 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 a managing director.

DIFFERENCE BETWEEN MANAGING DIRECTOR AND WHOLE-TIME DIRECTOR

Managing Director	**Whole-time Director**
1. A managing director is entrusted with the substantial powers of management. He enjoys the powers other than those of routine nature.	1. A whole-time director does not enjoy the substantial power of the management. He is just an ordinary officer of the company. He does not enjoy any discretionary powers to take the decision on policy matter.
2. The appointment of managing director is done by passing a resolution at the meeting of Board of Directors; it does not require the consent of shareholders	2. The appointment of whole-time director must be approved by the shareholders by means of special resolution passed at their meeting except when he is appointed as a trustee for the shareholders.
3. A managing director and a manager cannot exist simultaneously in any company.	3. There is no such restriction regarding a whole-time director. A whole-time director may be appointed along with managing director as well as manager.
4. A managing director can be appointed as a managing director in more than one company at the same time.	4. A whole-time director cannot work as a whole-time director in more than one company because he is a whole-time employee of the company.
5. A managing director can be appointed for a maximum term of five years at one time in a public company or in a subsidiary of a public company.	5. There is no restriction regarding the term of appointment of a whole-time director, he may be appointed for any term.

MANAGER

The manager is a chief executive officer of a company and is appointed as a chief manager. The term 'manager' means the manager to supervise and to control the activities of a company. Section 2(53) defines a manager, "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 the 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."

10.2.3 APPOINTMENT OF MANAGING DIRECTOR, WHOLE-TIME DIRECTOR OF MANAGER

According to Section 196 of the Companies Act, 2013

(1) No company shall appoint or employ at the same time a managing director and a manager.

(2) No company shall appoint or re-appoint any person as its managing director, whole- time director or manager for a term exceeding five years at a time:

Provided that no re-appointment shall be made earlier than one year before the expiry of his term.

(3) No company shall appoint or continue the employment of any person as managing director, whole-time director or manager who:

(a) is below the age of 21 years or has attained the age of 70 years:

Provided that appointment of a person who has attained the age of 70 years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person;

(b) is an undischarged insolvent or has at any time been adjudged as an insolvent;

(c) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

(d) has at any time been convicted by a Court of an offence and sentenced for a period of more than 6 months.

(4) Subject to the provisions of section 197 and Schedule V, a managing director, whole- time director or manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a

resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in that Schedule:

Provided that a notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or director in such appointment, if any:

Provided further that a return in the prescribed form shall be filed within 60 days of such appointment with the Registrar.

(5) Subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid.

10.2.4 OVERALL MAXIMUM MANAGERIAL REMUNERATION

Section 197 of the Companies Act, 2013, lays down the provisions for overall maximum managerial remuneration and managerial remuneration. The overall managerial remuneration to the Directors including managing director, whole time director and manager is summarized as under:

(1) 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 percent 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:

Provided that the company m general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding 11 percent of the net profits of the company, subject to the provisions of Schedule V:

Provided further that, except with the approval of the company in general meeting:

(i) the remuneration payable to any one managing director or whole-time director or manager shall not exceed 5 percent of the net profits of the company and if there is more than one such director remuneration shall not exceed 10 percent of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole- time directors shall not exceed:

(A) one percent of the net profits of the company, if there is a managing or whole-time director or manager;

(B) three percent of the net profits in any other case.

(2) The percentages aforesaid shall be exclusive of any fees payable to directors under sub-section (5).

Managerial remuneration in case of absence or inadequacy of profits

(1) Notwithstanding anything contained in sub-section (1) and (2), but subject to the provisions of Schedule V, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole- time director or manager, by way of remuneration any sum exclusive of any fees payable to directors under sub-section (3) hereunder except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government.

(2) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either 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 general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity:

Provided that any remuneration for services rendered by any such director in other capacity shall not be so included if:

(a) the services rendered are of a professional nature; and

(b) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

(3) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board:

Provided that the amount of such fees shall not exceed the amount as may be prescribed:

Provided further that different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed.

(4) A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

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

(6) The net profits for the purposes of this section shall be computed in the manner referred to m section 198.

(7) If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company.

(8) The company shall not waive the recovery of any sum refundable to it under subsection (9) unless permitted by the Central Government.

(9) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's Memorandum or Articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

(10) Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

(11) Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for

indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel:

Provided that if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

(12) Subject to the provisions of this section, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

(13) If any person contravenes the provisions of this section, he shall be punishable with fine which shall not be less than Rs.1,00,000 but which may extend to Rs.5,00,000.

CALCULATION OF PROFIT

(1) In computing the net profits of a company in any financial year for the purpose of section 197:

(a) credit shall be given for the sums specified in sub-section (2), and credit shall not be given for those specified in sub-section (3); and

(b) the sums specified in sub-section (4) shall be deducted, and those specified in subsection (5) shall not be deducted.

(2) In making the computation aforesaid, credit shall be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

(3) In making the computation aforesaid, credit shall not be given for the following sums, namely:

(a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company;

(b) profits on sale by the company of forfeited shares;

(c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;

(d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets.

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value;

(e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in Profit and Loss Account on measurement of the asset or the liability at fair value.

(4) In making the computation aforesaid, the following sums shall be deducted, namely:

(a) all the usual working charges;

(b) directors' remuneration,

(c) bonus or commission paid or payable to any member of the company's staff or to any engineer, technician or person employed or engaged by the company, whether on a whole- time or on a part-time basis;

(d) any tax notified by the Central Government as being in the nature of a tax on excess abnormal profits;

(e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;

(f) interest on debentures issued by the company;

(g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;

(h) interest on unsecured loans and advances;

(i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;

(j) outgoing inclusive of contributions made under section 181,

(k) depreciation to the extent specified in section 123;

(1) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of

this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;

(m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;

(n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);

(o) debts considered bad and written off or adjusted during the year of account.

(5) In making the computation aforesaid, the following sums shall not be deducted, namely:

(a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of subsection (4);

(b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4);

(c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;

(d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in Profit and Loss Account on measurement of the asset or the liability at fair value.

Recovery of remuneration in certain cases [section 199]

Without prejudice to any liability incurred under the provisions of this Act or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement under this Act and the rules made thereunder, the company shall recover from any past or present managing director or whole-lime director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per re-statement of financial statements.

Central Government or company to fix limit with regard to remuneration [section 200]

Notwithstanding anything contained in this Chapter, the Central Government or a company may, while according its approval under section 196, to any appointment or to any remuneration under section 197 in respect of cases where the company has inadequate or no profits, fix the remuneration within the limits specified in this Act, at such amount or percentage of profits of the company, as it may deem fit and while fixing the remuneration, the Central Government or the company shall have regard to:

(a) the financial position of the company;

(b) the remuneration or commission drawn by the individual concerned in any other capacity;

(c) the remuneration or commission drawn by him from any other company;

(d) professional qualifications and experience of the individual concerned;

(e) such other matters as may be prescribed.

Forms of and procedure in relation to certain applications [Section 201]

(1) Every application made to the Central Government under this Chapter shall be in such form as may be prescribed.

(2) (a) Before any application is made by a company to the Central Government under any of the sections aforesaid, there shall be issued by or on behalf of the company a general notice to the members thereof, indicating the nature of the application proposed to be made.

(b) Such notice shall be published at least once in a newspaper in the principal language of the district in which the registered office of the company is situate and circulating in that district, and at least once in English in an English newspaper circulating in that district.

(c) The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

10.2.5 COMPENSATION FOR LOSS OF OFFICE OF MANAGING OR WHOLE-TIME DIRECTOR OF MANAGER

(1) A company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

(2) No payment shall be made under sub-section (1) in the following cases, namely:

(a) where the director resigns from his office as a result of the reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation;

(b) where the director resigns from his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid;

(c) where the office of the director is vacated under sub-section (1) of section 167;

(d) where the company is being wound-up, whether by an order of the Tribunal or voluntarily, provided the winding-up was due to the negligence or default of the director;

(e) where the director has been guilty of fraud or breach of trust in relation to, or of gross negligence in or gross mismanagement of the conduct of the affairs of the company or any subsidiary company or holding company thereof; and

(f) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

(3) Any payment made to a managing or whole-time director or manager in pursuance of sub-section (1) shall not exceed the remuneration which he would have earned if he had been in office for the remainder of his term or for 3 years, whichever is shorter, calculated on the basis of the 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 than 3 years, during such period

Provided that no such payment shall be made to the director in the event of the commencement of the winding-up of the company, whether before or at any time within 12 months after, the date on which he ceased to hold office, if the assets of the company on the winding-up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

(4) Nothing in this section shall be deemed to prohibit the payment to a managing or whole-time director or manager, of any remuneration for services rendered by him to the company in any other capacity

10.2.6 APPOINTMENT OF KEY PERSONNEL MANAGER

(1) 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 Officer or Manager and in their absence, a whole-time director;

(ii) Company Secretary; and

(iii) Chief Financial Officer:

Provided that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the Articles 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 unless:

(a) the Articles of such a company provide otherwise; or

(b) the company does not carry on multiple businesses:

Provided further that nothing contained ii) the first proviso shall apply to such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as maybe notified by the Central Government.

(2) 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.

(3) A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time:

Provided that nothing contained in this sub-section shall disentitle a key managerial personnel from being a director of any company with the permission of the Board:

Provided further that 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 6 months from such commencement, choose one co9pany, in which he wishes to continue to hold the office of key managerial personnel:

Provided also that a company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

(4) 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 6 months from the date of such vacancy.

(5) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than Rs.1,00,000 but which may extend to Rs. 5,00,000 and every director and key managerial personnel of the company who is in default shall be punishable with fine which may extend to Rs.50,000 and where the contravention is a continuing one, with a further fine which may extend to Rs.1,000 for every day after the first during which the contravention continues.

10.2.7 SECRETARIAL AUDIT FOR BIGGER COMPANIES

According to Section 204 of the companies Act, 2013:

(1) It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

(2) The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).

(3) If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be punishable with fine which shall not be less than Rs.1,00,000 but which may extend to Rs.5,00,000.

Functions of Company Secretary [Section 206]

(1) 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 thereunder 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 may be prescribed.

Explanation: For the purpose of this section, the expression secretaria1 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.

(2) The provisions contained in section 204 and section 205 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or whole- time director under this Act, or any other law for the time being in force.

10.2.8 DIFFERENCE BETWEEN A MANAGER AND A MANAGING DIRECTOR

Manager and managing director, both are the key officers of the company. They are called the Chief Executives of the company. A manager and a managing director have some common features:

(1) Both the managers and managing directors are the officers of the company.

(2) Only the individuals can be appointed for both the posts.

(3) Both the officers perform their duties in accordance with the instructions of the Board of Directors.

(4) Both the officers have substantial powers for the management of the company.

(5) Provisions of the Indian Companies Act apply to both of them but there are some important difference between the managing director and a manager.

Managing Director	**Manager**
1. Managing director must be a director of the company.	1. Manager may not be a director.
2. There may be more than one managing director in a company.	2. There can be more than one manager in a company.
3. Managing director may be appointed by virtue 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 Articles of company.	3. A manager may be appointed under a contract of service or otherwise.
4. Grounds of disqualification remain effective for the whole of life.	4. Grounds of disqualifications remain effective only for 3 years.
5. Conviction for moral turpitude by any Court in	5. Conviction for moral turpitude by any Court

India or abroad is a disqualification.	by foreign Court is not a disqualification.
6. Managing director has substantial powers of management which would not otherwise be exercisable by him.	6. The manager has power of management over whole or substantially the whole of the affairs of the company. Hence, the powers of a manager are wider than that of the powers of managing director.
7. Where more than one managing director is working in the same company, the maximum salary limit is fixed at 10% of the net profits.	7. The maximum remuneration payable to a manager cannot exceed 5% of net profits.

10.3 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. Whole-time director do not include a director in the whole-time employment of the company.
2. Managing director must be a director of the company.
3. It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.
4. Section 190 of the Companies Act, 2013, lays down the provisions for overall maximum managerial remuneration and managerial remuneration.
5. No company shall appoint or employ at the same time a managing director and a manager.

10.4 SUMMARY

Under Section 2(51) a Key Managerial Personnel is defined as the Chief executive officer or managing director or the manager or, a company secretary or the whole time director and the chief financial officer in relation to a company. As per Section 203, every listed Company having a paid up share capital of Rs. 10 crore or more is compulsorily required to have a key managerial personnel. The whole time key managerial personnel is to be appointed by the Board and shall not hold office in more than one company except in its subsidiary company at the same time. However, with the permission of Board he can be a director in any other company. If a company makes a default in complying with provisions of Section 203, every director or the key managerial personnel who is in default shall be punishable with a fine which may extend to 50,000 rupees and a further fine which may be extended to 1,000 rupees for every day during which the default continues. Company secretary has been covered under section 203 i.e., appointment of key managerial personnel. A Company Secretary exercises supervisory and checking role so as to prevent any chance of negligence in implementing various laws applicable to a particular company.

10.5 KEYWORDS

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 director occupying the position of managing director, by-whatever name called.

Manager: 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 me called, whether under a contract of service or not.

Whole-time Director: Whole-time director includes a director in the whole-time employment of the company.

Turnover: Turnover means the gross amount of revenue recognized in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.

10.6 SELF-ASSESSMENT TEST

1. State the provisions of the Indian Companies Act in regard to the appointment, qualifications, duration of office, and compensation on termination of appointment of a managing director.
2. Discuss the restrictions imposed on the appointment and payment of remuneration of managing director.
3. How is the managing director appointed? What are his duties and responsibilities? Discuss the role and powers of the Central Government in regard to the appointment of managing director.
4. State the procedure for the appointment of a managing director of a public limited company.
5. Discuss the provisions of the Companies Act relating to appointment of a manager. What are the disqualifications for the office of a manager?
6. Who is a manager of a company? How can he be appointed? What is the difference between a manager and managing director?

7. Distinguish between: (a) Managing director and whole-time director, (b) Managing director and manager.

8. 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?

10.7 ANSWERS TO CHECK YOUR PROGRESS

1. False
2. True
3. True
4. False
5. True

10.8 REFERENCES/SUGGESTED READINGS

1. A K Majumdar, G K Kapoor, Sanjay Dhamija, Company law and Practice, Taxman, New Delhi.
2. PPS Gogna, A Textbook on Compnay Law, S. Chand and Sons, Delhi.
3. H K Saharay, Company Law, Universal Law Publishing Co. Ltd, Delhi.
4. Anoop Jain, A Simplified Approach to Company Law, AJ Publications, Delhi.

Subject: Company Law	
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Lesson No.: 11	

COMPROMISE, ARRANGEMENT, RECONSTRUCTION AND AMALGAMATION

STRUCTURE

11.0 Learning Objectives

11.1 Introduction

11.2 Concept of Compromise and Arrangement

11.2.1 Powers to Compromise or make arrangement with creditors and members

11.2.2 Procedure for Compromise and Arrangement

11.3 Concept of Reconstruction and Amalgamation

11.4 Merger and Amalgamation of Company

11.5 Check Your Progress

11.6 Summary

11.7 Keywords

11.8 Self-Assessment Test

11.9 Answer to Check your Progress

11.10 References/Suggested Readings

11.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Understand the meaning of compromise, arrangement, reconstruction and amalgamation.
- State the procedure involved in for a compromise and arrangement.
- Explain the steps involved in amalgamation of a company.

11.1 INTRODUCTION

The company wished to avoid being wound up and negotiated a scheme in which the existing shareholdings in the company would be transferred to a new company which would take over the company's undertaking and assets as well as its debts. This was to be affected by a scheme for reconstruction which would result in the old company's shareholders holding the shares in the new company.

Notwithstanding the heritage of schemes of arrangement which can be traced back to the United Kingdom in the 1860s, and the common origins of schemes in Australia and Singapore and an established body of legal principles, there is a notable degree of inconsistency in the line of judicial authorities on the nature of schemes of arrangements.

An arrangement embraces such diverse schemes as conversion of debt into equity, subordination of secured or unsecured debt, conversion of secured claims into unsecured claims and vice versa, increase or reduction of share capital and other forms of reconstruction and amalgamation.

11.2 CONCEPT OF COMPROMISE AND ARRANGEMENT

Compromise: The term 'Compromise' means a settlement of dispute or controversy by the method of making mutual concession. Compromise implies the parties agree not to try it out but to settle in-between themselves by a give and take arrangement. It may be noted that compromise presupposes the existence of some dispute as there can be no compromise unless there is some dispute.

Arrangement: An arrangement of rights or liabilities of the members or creditors is possible even without the existence of any dispute. It is wider in scope than the word Compromise. Sec. 390 provides that 'the expression arrangement' includes a reorganization of the share capital of the company by the consolidation of shares of different classes or by the division of shares into different classes of shares or by both those methods.

The scheme of arrangement may include any one or by both those methods.

(1) Reorganisation the share capital of the company,

(2) Reduction of share capital not involving cancellation of liabilities or paying off a part of capital fresh issue of shares,

(3) Issue of shares to creditors in lieu of debts,

(4) Sales, lease or other variation of property rights, and

(5) Conversion of one class of shares into loan capital.

11.2.1 POWER TO COMPROMISE OR MAKE ARRANGEMENT WITH CREDITORS AND MEMBERS

(1) Where a compromise or arrangement is proposed:

(a) between a company and its creditors or any class of them, or

(b) between a company and its members or any class of them,

The Tribunal may, on the application of the company or of any creditor or members of the company, or in the case of a company which is being wound-up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

Explanation: For the purpose of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of these methods.

(2) The company or any other person, by whom an application is made under sub-section (1), shall disclose to the Tribunal by affidavit:

(a) all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

(b) reduction of share capital of the company, if any, included in the compromise or arrangement;

(c) any scheme of corporate debt restructuring consented to by not less than 75 per cent of the secured creditors in value, including:

(i) a creditor's responsibility statement in the prescribed form;

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt, restructuring guidelines specified by the Reserve Bank of India, a statement of that effect; and

(v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

(3) Where a meeting is proposed to be called in pursuance of an order of the Tribunal under sub-section (1), a notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by a statement disclosing the details of the compromise or arrangement, a copy of the valuation report, if any, and explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and such other matters as may be prescribed:

Provided that such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and Stock Exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed:

Provided further that where the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

(4) A notice under sub-section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice:

Provided that any objection to the compromise or arrangement shall be made only by persons holding not less than 10 per cent of the shareholding or having outstanding debt amounting to not less than 5 per cent of the total outstanding debt as per the latest audited financial statement.

(5) A notice under sub-section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective Stock Exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them

shall be made within a period of 30 days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

(6) Where, at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound-up, on the liquidator and the contributories of the company.

(7) An order made by the Tribunal under sub-section (6) shall provide for all or any of the following matters, namely:

(a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in case or accept equity shares equal to the value of the dividend payable;

(b) the protection of any class of creditors;

(c) if the compromise or arrangement results in the variation of the shareholders rights, it shall be given effect to under the provisions of section 48;

(d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

(e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

Provided that no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

(8) The order of the Tribunal shall be filed with the Registrar by the company within a period of 30 days of the receipt of the order.

(9) The Tribunal may dispense with calling of a meeting of creditors or class of creditors where such creditors or class of creditors, having at least 90 per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

(10) No compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

(11) Any compromise or arrangement may include takeover offer made in such manner as may be prescribed:

Provided that in case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

(12) An aggrieved party may make an application to the Tribunal in the event of any grievances with respect to the takeover offer of companies other than listed companies in such manner as may be prescribed and the Tribunal may, on application, pass such order as it may deem fit.

Explanation: For the removal of doubts, it is hereby declared that the provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

11.2.2 PROCEDURE FOR COMPROMISE AND ARRANGEMENT

The procedure for both, compromise and arrangement is the same. It may be noted that the compromises and arrangements are made in case of companies which is liable to be wound-up.

1. Application to the Tribunal: Compromise and arrangement may be proposed.

(a) Between a company and its creditors or any class of them; or

(b) Between a company and its members or any class of them.

To make such compromise or arrangement effective, an application shall be -made to the Tribunal by the company or by the creditor or by the members of the company and by the liquidators if the company is wound-up.

2. Meeting of the Members or Creditors: The Tribunal being satisfied that the scheme is reasonable and implementable by the company, it shall direct the company to bold a meeting of each class of creditors or members. The Tribunal can also direct the manner in which such meeting shall be conducted.

It should be noted that the word ‘class’ implies a group of persons having similar interest. Observations of Justice Bowen in this respect are worth noting:

“It seems plain that we must give meaning to term ‘class’ as will prevent the section being so worked as to result in confiscation and injustice and that in must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with the view of their common interest” [Sovereign Life Assurance Co. vs. Dodd (1892) 2 R.B. 5731] along with the notice calling the meeting for discussing compromise schemes, the company is required to send a statement setting forth the terms of the proposed compromise or arrangement and explaining its effect particularly on the interests if any, of the directors or managing director or manager of the company in their capacity, as such or otherwise.

3. Notice to the Central Government: On receipt of the application, the Tribunal must also give the notice of every such application to the Central Government and before passing any order on such application, the Tribunal shall take into consideration any representation made to it by the Central Government [Sec. 394A].

4. Approval by Three-fourth Majority: Where a majority in number representing three-fourth in value of creditors, or class of creditors or class of members present in person or by proxy agree to compromise or arrangement, then the compromise or arrangement will be binding on:

(a) All the creditors and members, and

(b) Company or if the company is being wound-up, on the liquidators or contributories of the company.

The Chairman will report the scheme to the Tribunal within a prescribed time on Form No. 39. The decision shall be taken by voting by polls.

5. Sanction of the Tribunal: Before the Tribunal sanctions of scheme it will be satisfied on the following matters:

1. The statutory provisions must be compiled with.
2. That the class of creditors or members affected by the scheme has been properly represented.
3. That the scheme should be bonafide to save the company from liquidation.
4. That the company and other person by whom application has been made has disclosed to the Tribunal all material facts relating to company such as latest financial positions of the company, latest auditor’s report and the pendency of any investigation proceedings in relation to company.

5. That the scheme is fair and reasonable and made in good faith for the benefit of each class of the members or creditors concerned.

An order made by the Tribunal shall have no effect until a certified-copy of the order has been filed with the Registrar.

A copy of every such order shall be annexed to every copy of Memorandum issued by a company so that person dealing with the company have notice of the scheme.

Default in this regard shall make the company and every officer of the company who is in default, punishable with fine upto Rs.100 for each copy is respect of which default is made.

POWER OF TRIBUNAL TO ENFORCE COMPROMISE AND ARRANGEMENT [Section 231]

(1) Where the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it:

(a) shall have power to supervise the implementation of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

(2) If the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up the company and such an order shall be deemed to be an order made under section 273.

(3) The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act sanctioning a compromise or an arrangement.

Effect of Scheme: The effect of a scheme between a company and its creditors is that so long as it carried out by the company by regular payments in terms of the scheme, creditors are bound by the scheme and cannot maintain a petition for winding-up. But if the company commits a default, a petition for winding-up can be filed as there is a debt presently due.

11.3 CONCEPT OF RECONSTRUCTION AND AMALGAMATION

Reconstruction: Reconstruction means the formation of a new company to take over the assets of an existing company with the idea that the persons interested and nature of business remains the same. It is thus a scheme under which an old company goes into liquidation for the specific purpose of selling its assets to a new company. The new company is formed with precisely with the same objects, the similar name and composed of the same shareholders. The object of reconstruction is usually to recognize capital, or to compound with creditors or to effect economies.

Purpose of Reconstruction: Reconstruction of a company is done with the following objects:

(1) To strengthen the financial position of the company.

(2) To overcome the defects of over capitalisation.

(3) To collect additional capital.

(4) To enlarge the area of business activities.

(5) To change the place of business.

Amalgamation: An amalgamation is the merger of two or more companies into one. "Amalgamation is a state of thing under which either two companies are so joined as to form a third entity or one is absorbed into or blended with another." Thus under amalgamation, two or more companies are merged either de-jure by consolidation or either undertakings or de facto by the acquisition of the controlling interest in the share capital one by the other or capital of both by a new company.

Reasons for Amalgamation: It may be for large scale production and there by achieving economies or it may be to get assured supply of raw materials or channels of marketing. A amalgamation may also be to eliminate competition from the market. It may be also for diversification of the activities and for expansion of the business. A scheme of merger or amalgamation is put through sometimes for acquiring the assets of another company at a low price.

11.4 MERGER OF AMALGAMATION OF COMPANY

Section 232 provides for facilitating arrangements for the purposes of 'Merger' or 'Amalgamation' of companies. The terms 'Merger' and 'Amalgamation' are taken to, mean as the union of two or more companies, so as to form a third entity, or one company is absorbed into another company. Thus, the formation of a new company is not absolutely necessary for merger or amalgamation.

If looked at from a closer angle, 'amalgamation' is union of two or more companies so as to form a third entity. On the other hand, 'merger' is a form of 'amalgamation' where one company is absorbed into another company, i.e., where all the properties and liabilities of one company (Transferor Company) get merged with the properties and liabilities of another company (transferee company).

Section 232 lays down that, where, on an application under Section 230, it is shown to the Tribunal that the scheme of Arrangement or Compromise has been proposed for the purpose of Reconstruction of the company or for the Amalgamation of two or more companies, and the whole or part of the undertaking, property or liabilities of one company (hereinafter referred to as the transferor company) is to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies, the Tribunal may either by order sanction the Compromise or Arrangement or by a subsequent order, provide for all or any of the following matters: .

(1) transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a specified date;

(2) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which are to be allotted or appropriated under the contract;

(3) the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company;

(4) the dissolution, without winding up, of the transferor company;

(5) the provision to be made for any person who dissents from the scheme of Compromise or Arrangement;

(6) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;

(7) the transfer of the employees of the transferor company to the transferee company;

(8) where the transferor company is a listed company and the transferee company is an unlisted company:

   (a) the transferee company shall remain an unlisted company until it becomes a listed company;

   (b) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal. The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board of India under any regulations framed by it;

(9) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

(10) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out.

It may be noted that no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under Section 133.

Where an order under this Section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have affect.

Every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

Every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar of Companies every year duly certified by a practising chartered accountant or a cost accountant or a company secretary, indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

Explanation – For the purposes of this Section (Sec. 232):

(i) in a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to he transferred to a new company, whether or not a public company, it is a merger by formation of a new company;

(ii) references to merging companies are in relation to a merger by absorption, to the transferor and transferee companies, and in relation to a merger by formation of a new company, to the transferor companies;

(iii) property includes assets, rights and interests of every description, while liabilities include debts and obligations of every description.

Merger or Amalgamation of Certain Companies

Section 233 provides for simplified procedure for merge or amalgamation between (i) two or more small companies, or (ii) between a holding company and its wholly-owned subsidiary company, or (iii) such other class or classes of companies as may be prescribed. The Section lays down that for any scheme of merger or amalgamation:

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators or persons affected by the scheme is issued both by the transferor company and the transferee company;

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members at a general meeting holding at least ninety per cent of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

The transferee company shall file a copy of the scheme so approved with the Central Government, Registrar and the Official Liquidator. If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme and the Central Government shall register the same and issue a confirmation thereof to the companies.

If the Central Government is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application, before the Tribunal within a period of sixty days of the receipt of the scheme stating its objections and requesting that the Tribunal may consider the scheme under Section 232. If the Tribunal is of the opinion that the scheme should he considered as per the procedure laid down in Section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing an order.

A copy of the order of the Tribunal confirming the scheme shall be, filed with the Registrar having jurisdiction over the transferee company and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be filed with the Registrars where Transferor Company or companies were situated.

The registration of the scheme shall be deemed to have the effect of dissolution of the transferor company without the process of winding-up. The effects of the registration of the scheme with the Registrar shall be as follows:

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

(d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

Merger or Amalgamation with a Foreign Company

Section 234 provides that the provisions relating to schemes of mergers and amalgamations shall apply, subject to necessary modifications, to schemes of mergers and amalgamations with foreign companies incorporated in such countries as may be notified from time to time by the Central Government. However, the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with such mergers and amalgamations.

A foreign company may with the prior approval of the Reserve Bank of India, merge into a company registered under the Companies Act or *vice versa*. The terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

Acquisition of Shares of Dissenting Shareholders in Case of Takeover Bid

The method of amalgamation by takeover bid is quite common. A ‘takeover bid’ means an offer to acquire shares of a company with a view to obtaining legal control of the company. Such offer to purchase shares may be either for cash or in exchange for the shares of the offer or company. The company taken over remains in existence unless an amalgamation is carried out for acquisition of the shares of one company (called the transferor company) by another company (called the transferee company). The transferee company may make an offer to the transferor company, so that the scheme or contract may be placed before the shareholders of the transferor company. If the offer is accepted by all the shareholders of the transferor company, there is no problem. If the specified percentage of the transferor company’s shareholders accept, the transferee company will then purchase their shares and then proceed to acquire the shares of dissentient shareholders in the manner provided in Section 235.

Section 235 provides for compulsory acquisition of the shares of the dissenting minority by the transferee company, on the terms on which the shares of the approving shareholders are to be transferred to it. Thus, this Section aims to prevent a small minority from demanding an unreasonably high price for their shares. In this connection the provisions of Section 235 are as follows:

(1) The offer of the transferee company to acquire the shares or any class of shares must be placed before the shareholders of the transferor company.

(2) The shareholders have the option to approve the offer within four months, Approval must be accorded by the holders of at least 90 per cent in value of the shares whose transfer is involved (other than shares already held by the transferee company at the date of the offer or by its nominees or by its subsidiary).

(3) If the scheme is so approved, the transferee company may, at any time, within two months, after the expiration of the above four months, give notice to the dissenting shareholders, if any, stating that it desired to acquire their shares.

(4) The dissenting shareholders can, within one month of the receipt of such a notice, apply to the Tribunal for annulling the scheme on the grounds that there has been some misrepresentation which has influenced the view of the majority or there has been gross undervaluation of the assets of the Transferor Company, etc. Thus, onus of proving this lies on the dissenting shareholders. Where, however, the scheme is in reality a mere device to enable the majority shareholders to expropriate the minority, the burden of proof is reversed and it is up to the offer or to show that the scheme is fair. The facts of Re Bugle Press Ltd. are interesting in this connection.

B.P. Ltd., had an issued capital of 10,000 £1 shares, of which Jackson held 4,500, Shaw held 4,500, and Terby held 1,000 Jackson and Shaw then incorporated a new company, called Jackson and Shaw (Holdings) Ltd., with an issued capital of 100 shares, of which each of them held 50. This company then made an offer to the shareholders of B.P. Ltd. Jackson and Shaw naturally accepted the offer, but Terby refused it on the grounds that the price was too low. Held: Terby was not bound to sell on that price. Where "as a matter of substance the persons who are putting forward the offer are the majority shareholders, it is up to them to show that the scheme is fair and not to the dissenting shareholder to show that it is unfair.

(5) If the Tribunal refuses to issue the order annulling the scheme of Amalgamation or if no application is made to the Tribunal, the transferee company shall be entitled and bound to acquire the shares of the dissenting shareholders on same terms as those accepted by the approving shareholders.

(6) The transfer of shares pursuant 'to the notice given by the transferee company, or after the disposal of the appeal filed by the dissenting shareholders, shall be, by means of an instrument of transfer, executed on behalf of the shareholder by any person appointed by the transferor company and on its own behalf by the transferee company, and pay the amount or other consideration to the transferor company, who shall thereupon register the transfree company as the holder of these shares.

(7) Any sums which are so received by the transferor company must be paid into a separate bank account and this amount or any other consideration received must be held in trust for dissenting shareholders and shall be disturbed to the entitled shareholders within 60 days.

Purchase of Minority Shareholding

Section 236 provides for the 'squeeze out provisions'. These provisions confer upon the majority shareholders a statutory right to squeeze out the minority, i.e., to acquire minority shareholding at a price to be determined by a registered valuer. This Section seeks to provide the procedure and manner in which the majority holders of at least 90% shares shall notify the company of their intention to buy the equity shares of minority holders, by virtue of amalgamation, share exchange, etc. The price of the shares will be determined by the registered valuer in accordance with such rules as may be prescribed.

Amalgamation of Companies in Public Interest

Under Section 237 of the Act, the Central Government is given power to order Amalgamation of two or more companies in public interest. This Section provides as follows:

(1) If the Central Government is satisfied that it is in public interest that two or more companies, should be amalgamated, it may by a notification in the Official Gazette, order amalgamation of those companies into one company, with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

(2) The aforesaid order may provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and may also contain such consequential and supplemental provisions as may be necessary to give effect to amalgamation.

(3) Every member, debenture-holder or any other creditor of the transferor companies, continues to have the same interest in the transferee company, as he had before amalgamation in one of the amalgamating companies. In case amalgamation affects his interests or rights adversely, he is entitled to compensation which is to be assessed by such authority as may be prescribed by the Government and every such assessment is to be published in the Official Gazette. Any person aggrieved by any assessment of compensation made by the aforesaid prescribed authority is entitled to prefer an appeal to the Tribunal and thereupon the Tribunal shall reassess the compensation. The amount of compensation shall be paid by the transferee company.

(4) No order under this Section shall be made by the Central Government unless –

(a) a draft copy of the proposed order has been sent lo each of the companies concerned in order to enable such companies to file their objections and suggestions. The period of filing objections shall be fixed by the Government, but should not be less than 2 months from the date of receipt of draft copy;

(b) the time for preferring an appeal to Tribunal has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and

(c) it has considered and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any company concerned, or from shareholders therein, or from any creditors thereof,

(5) Copies of the order made by the Government in this connection, must, as soon as possible, be laid before both the Houses of Parliament.

Preservation of Books and Papers of Amalgamated Companies

In order to prevent the destruction of incriminating evidence in the accounts and records of the company which has amalgamated with another, Section 239 provides that the books and papers of amalgamated companies shall not be destroyed without the prior permission of the Central Government. The Central Government, before granting the permission, may appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation or the management of the affairs of the transferor company.

11.5 CHECK YOUR PROGRESS

Fill in the blanks:

1. ______ means a settlement of dispute or controversy by the method of making mutual concession.
2. Compromises and arrangements are made in case of companies which is liable to be__________.
3. __________means the formation of a new company to take over the assets of an existing company with the idea that the persons interested and nature of business remains the same.
4. An ________is the merger of two or more companies into one.
5. Section ____ provides for facilitating arrangements for the purposes of ‘Merger’ or ‘Amalgamation’ of companies.

11.6 SUMMARY

The Companies Act, 2013 contains provisions relating to various methods of reorganisation of companies under Sections 230 to 240 of the Act. i. e. Compromise, Arrangements, Reconstruction, Amalgamation and Mergers. Compromise implies the existence of a dispute such as relating to rights. It indicates the settlement of claims in disputes by mutual concession. Arrangement is of wider connotation because rights and liabilities may be re-arranged even when there is no dispute. Thus, the term 're-arrangement' includes all modes of reorganising the share capital including interference with preferential and other special rights attached to shares. As per Section 230 a compromise or arrangement can be proposed between a company and its creditors or between a company and its members. Such a compromise would also cover any scheme of amalgamation or merger of one company with another and reconstruction. Amalgamation occurs when two or more companies are joined to form a third entity or one is absorbed into or blended with another. So, amalgamation includes absorptions. Absorption means one powerful company takes control over the weaker company. The new company comes into existence having all the property, rights and powers and subject to all the duties and obligations, of both the constituent companies. A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. Reconstruction is an exercise of restating assets & liabilities by company whose financial position as reflected by its balance sheet is not healthy but future is promising. This exercise is done to gain the confidence of different stakeholders (creditors, lenders, customers, share holders etc) whose support is required for revival of the operations.

11.7 KEYWORDS

Compromise: An amicable settlement of differences by mutual concessions by the parties to the dispute.

Arrangement: All modes of reorganizing the share capital including interferences with preferential and other special rights attached to the shares.

Reconstruction: It refers to reorganization of company which has suffered heavy losses or which is over-capitalized.

Amalgamation: It means taking over business of two or more companies by a newly formed company for this purpose.

11.8 SELF-ASSESSMENT TEST

1. What is an arrangement in respect of a company? How may it be effected and by whom? How may it he enforced and by whom? Discuss.
2. Summarize the provisions of the Companies Act pertaining to merger and amalgamation of companies.
3. Explain the statutory provisions and simplified procedure regarding amalgamation between two or more small companies.
4. Explain clearly the meaning of 'compromise'. What procedure must a company adopt to give effect to a compromise, when such a company is a going concern? Discuss.
5. What is a takeover bid? What is the procedure to be followed, under Company Law, in such a case? Can takeover be challenged by any one, and if so, on what grounds?
6. Explain the provisions of the Companies Act regarding amalgamation of companies in public interest.

11.9 ANSWERS TO CHECK YOUR PROGRESS

1. Compromise
2. Wound-up
3. Reconstruction
4. Amalgamation
5. 232

11.10 REFERENCES/SUGGESTED READINGS

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Course Code: BCOM 404	Author: Prof. Mahesh Chand Garg
Lesson No.: 12	

WINDING UP

STRUCTURE

12.0 Learning Objectives

12.1 Introduction

12.2 Meaning of Winding Up

12.2.1 Winding Up Vs. Dissolution

12.2.2 Mode of Winding Up

12.2.3 Winding Up by the Tribunal

12.2.4 Miscellaneous Provisions Relating to Winding Up

12.3 Check Your Progress

12.4 Summary

12.5 Keywords

12.6 Self-Assessment Test

12.7 Answer to Check Your Progress

12.8 Suggested Readings

12.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Understand the concept of winding up of a company.
- Explain the different modes of winding up of a company.
- Explain the procedure of winding up of a company by the Tribunal.

12.1 INTRODUCTION

A company being an artificial person cannot die a natural death. A company comes into existence by a legal process known as incorporation and likewise ceases to exist also by another legal process called dissolution.

12.2 MEANING OF WINDING UP

The 'winding up' or 'liquidation' of a company is a process to bring about an end to the life of company. In the words of Professor Gower, "Winding up of a company is the process whereby its life is ended and its property administered for the benefits of its creditors and members. An administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights." Thus the process of winding up involves the realisation of the assets, payment of the liabilities and distribution of surplus, if any, amongst the members of the company.

12.2.1 WINDING UP VS. DISSOLUTION

Winding up should not be taken to mean the same thing as dissolution of the company. Winding up of a company precedes its dissolution. Prior to dissolution and after winding up the legal entity of the company remains and it can be sued in a Court of Law. On dissolution, the company ceases to exist, its name is actually struck off the Register of Companies by the Registrar and the fact is published in the Official Gazette.

On completion of the winding up process, certain formalities prescribed by the Act are to be performed for the dissolution of the company. For example: in case of 'Winding up by the Tribunal' when the affairs of the company have been completely wound up and the Official Liquidator has made a report to the Tribunal in that behalf, the company is dissolved from the date of the Tribunal's order (Sec. 365).

It is to be noted that although in most of the cases 'winding up' is resorted to by companies having financial difficulties, yet there have been cases when perfectly solvent companies have been wound up voluntarily by the shareholders, for instance, where the object for which the company was formed has been accomplished or where the company is in danger of its takeover by the Government or where the company is to be amalgamated with another company.

12.2.2 MODE OF WINDING UP (Sec. 270, as amended by the Insolvency and Bankruptcy Code, 2016)

Section 270 provides for one mode of winding up, namely, Winding up by the Tribunal. Before the amendment, Section 270 provided for two modes of winding up, namely, (a) Winding up by the Tribunal, or (b) Voluntary winding up.

The Insolvency and Bankruptcy Code, 2016 has shifted the provisions regarding "Voluntary Winding Up" of companies from the Companies Act to the Code with some modifications. The I & B Code has deleted Sections 304–323 relating to Voluntary Winding Up from the Companies Act, 2013. As such, if now a company wants to be wound up voluntarily, it will have to initiate the "Voluntary Liquidation" proceedings under Section 59 of the Insolvency and Bankruptcy Code, 2016.

We shall now discuss the mode of Winding up by the Tribunal.

12.2.3 WINDING UP BY THE TRIBUNAL

Grounds for Winding up by the Tribunal [Sec. 271(l), as amended by the Insolvency and Bankruptcy Code, 2016]

A company may be wound up by the Tribunal under the following circumstances:

(1) Special Resolution. If the company has, by special resolution, resolved that the company be wound up by the Tribunal. The power of the Tribunal is, however, discretionary and may not be exercised by the Tribunal if it finds that winding up would be opposed to public interest or company's interest.

(2) Acting against the national interest. If the company has acted against the interests of: (i) the sovereignty and integrity of India, (ii) the security of the State, (iii) friendly relations with foreign States, (iv) public order, (v) decency, or (vi) morality, it may be ordered to be wound up.

(3) Company's affairs are being conducted in a fraudulent manner. The Tribunal may make a winding up order if on an application made by the Registrar or any other person authorized by the Central Government, the Tribunal is of the opinion that:

(i) the affairs of the company have been conducted in a fraudulent manner; or

(ii) the company was formed for fraudulent and unlawful purpose; or

(iii) the persons concerned in the f6nnation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

(4) Default in filing financial statements. A company may be wound up by the Tribunal if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.

(5) Just and equitable. A company may also be ordered to be wound up, if the Tribunal is of opinion that it is just and equitable that the company should be wound up. The Tribunal enjoys very wide discretionary power under this clause. What is a 'Just and Equitable' cause depends upon the facts of each particular case. On the basis of judicial decisions, the following examples may be given where the Tribunal may order winding up under the head 'Just and Equitable':

(i) Loss of substratum. When the main object of the company has failed or its substratum is gone e.g., where the 'patent' under which the company proposed to manufacture could not be granted to it, or where the company proposed to acquire some running business but the vendor refused to sell the business to the company, or where the whole of substantially the whole of the paid-up capital of the company has been lost, or where there is no reasonable hope of trading at a profit in the business for which the company was formed. It is to be noted that where a company's main object fails its substratum is gone and it may be wound up even though it is carrying on its business in pursuit of a subsidiary object. However, a temporary difficulty, e.g., on account of litigation the business of the company has come to a standstill, shall not be permitted to become a ground for liquidation because in such a case the company could always restart the business with the assets it possessed.

(ii) Deadlock in management. When there is a complete deadlock in the management of the company owing to the directors not being on speaking terms or being bitterly hostile to each other or for any other reason. This ground is generally applicable to the case of closely held companies in which the directors also happen to be the only shareholders or majority shareholders and therefore reconstitution of the Board of Directors is not feasible. However, mere groupism among the directors does not make a case for winding up the company.

(iii) Oppression of minority. When the majority of shareholders have adopted an oppressive policy towards the minority, e.g., they forced an unjust scheme on minority against its wishes, or the management is carried on in such a way that the minority is disregarded.

(iv) Fraudulent object. When the company was conceived to carry out an illegal or fraudulent business or when the business of the company becomes illegal, e.g., if the main object of the company is to conducting a lottery.

(v) Losses. When the business of the company cannot be carried on except at losses. However, where the majority of shareholders are against it, the Court will not order a company to be wound up merely because it is making a loss.

(vi) Event prescribed by articles. When an event prescribed by the Articles as an event on the happening of which the company is to be wound up has happened.

(vii) Bubble company. When it is a mere 'bubble' company and it does not carry on any business or does not have any property.

NOTE. The Insolvency and Bankruptcy Code, 2016 has omitted clause (a) of Section 271(1) of the Companies Act, 2013. The omitted clause (a) prescribed "inability to pay debts" as one of the grounds on which a company may be wound up by the Tribunal. As a result, "inability to pay debts" is no longer a ground on which a company may be wound up by the Tribunal. It has been tagged with first compulsory resorting to Corporate Insolvency Resolution Process before going for liquidation process on this ground under the I & B Code.

Who May Petition to the Tribunal for Winding Up [Sec. 272, as amended by the Insolvency and Bankruptcy Code, 2016]

The following persons can make a petition to the Tribunal to get an order for winding up of a company:

(1) Petition by the company. A petition to the Tribunal by a company for its winding up may be made by its directors when it has passed resolution to this effect.

Note that a petition presented by the company for winding up shall be admitted only if accompanied by a 'statement of affairs' in the prescribed form.

(2) Contributory's petition. The members and the past members (who ceased to be the members within one year preceding the commencement of winding up), who are liable to contribute to the assets of the company in winding up, are referred to as contributories. Of course they will be liable only if they had partly paid shares. Moreover, a contributory is not essentially to contribute towards deficit but he is also to share surplus, if any. Any contributory or contributories may present a petition for winding up notwithstanding that he or they may be the holder of fully paid-up shares or that the company may have no assets at all or may have no surplus assets left for distribution amongst them after the satisfaction of its liabilities [Sec. 272(2)]. Any provision in the articles which deprives members of their right to petition for winding up is void.

A contributory may present a petition for winding up on any ground except No. 1, namely, when the company has passed a special resolution, provided: (a) he is an original allottee, or (b) he became the holder of shares through transmission, or (c) he has been the registered holder for at least six months during the 18 months preceding the petition.

(3) Petition by all or any of the aforesaid parties together. The company and/or any contributory may also present a petition for winding up of the company jointly.

(4) Registrar's petition. With the previous sanction of the Central Government the Registrar of Companies is also entitled to present a petition for winding up a company, only on the following grounds:

(i) when default it is made in filing the financial statements or annual returns;

(ii) when the company is working against the national interests;

(iii) when company's affairs are being conducted in a fraudulent manner [Sec. 272(3).

It is to be noted that the Central Government before according its sanction, must 'afford an opportunity to the company for making its representation, if any.

(5) Petition by any person authorised by the Central Government to present a petition for winding up of the company.

(6) Petition at the instance of Central Government or a State Government. If the company has acted against the sovereignty, integrity or security of India or the State, or against public order, decency or morality, the Central Government or the State Government can petition to the Tribunal for the winding up of the company.

Section 272(5) provides that a copy of petition made under this Section shall also be filed with the Registrar who shall submit his views to the Tribunal within 60 days of receipt of such petition.

Commencement of the Winding Up

Winding up commences not from the date of the winding up order of the Tribunal but it shall be deemed to commence at the time of the presentation of the petition [Sec. 357, as amended by the Insolvency and Bankruptcy Code, 2016].

The date of commencement of winding up is important for various matters such as avoidance of objectionable voluntary transfers and fraudulent preferences, and for ascertaining the liability of present and past members.

Powers of the Tribunal on Presentation of the Petition

Hearing petition. After receiving the petition for winding up of the company from any person other than the company, the Tribunal shall, if satisfied that a *prima facie* case for winding up of the company is made out, by order direct the company to file a 'statement of affairs' in the prescribed form within 30 days of the order [Sec. 274(1)]. The Tribunal will fix a date of hearing of petition and will issue notice to the company to appear before it on the date so fixed and state its case for winding up. It shall also cause the issue of public notice of the winding up petition in order to notify all the creditors and contributories of the company about the winding up petition, so that they may put their objections, if any, on the date of hearing.

On the specified date, upon hearing all the connected parties and on keeping in mind all the circumstances of the case, the Tribunal may, within 90 days from the date of presentation of the petition, pass any of the following orders:

(a) dismiss the petition, with or without costs; or

(b) make any interim order that it thinks fit; or

(c) appoint a provisional liquidator of the company till the making of a winding up order; or

(d) make an order for winding up of the company, with or without costs, or

(e) make any other order as it thinks fit (Sec. 273).

In case the Tribunal decides to make an order of winding up, it shall appoint an Official Liquidator or a liquidator as the Company Liquidator and will specify his powers, duties and remuneration [Sec. 275(l)(4)].

Company Liquidator

The liquidator is a person who helps the Tribunal to complete the liquidation proceedings, i.e., in realising the assets of the company and distributing them amongst the creditors and contributories most fairly. The shareholders or members are termed as contributories on the commencement of winding up.

For the purposes of winding up of a company by the Tribunal, the Tribunal at the time of passing of the order of winding up, shall appoint an Official Liquidator or a liquidator as the Company Liquidator. The Company Liquidator or the provisional liquidator appointed before passing the winding up order, as the case may be, shall be appointed by the Tribunal from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016. The terms and conditions of appointment as well as remuneration of the Provisional Liquidator or Company Liquidator shall be specified by the Tribunal, on the basis of task to be performed, qualifications, size of the company, etc. [Sec. 275(l) (2) (4), as amended by the Insolvency and Bankruptcy Code, 2016].

Consequences of the Winding Up Order

The consequences of the winding up order by the Tribunal are as follows:

(1) The Tribunal shall, within 7 days from the date of order of winding up, send the intimation of the fact to the Company Liquidator and the Registrar. The Registrar will then notify in the Official Gazette that such an order has been made [Sec. 277(1)(2)].

(2) In the case of a listed company, the Registrar shall intimate about such order to the Stock Exchanges, where securities of the company are listed [Sec. 277(2)].

(3) The order for winding up shall be deemed to be notice of discharge to the officers and employees of the company, except when the business of the company is continued for the purpose of beneficial realisation of assets [Sec. 277(3)].

(4) The powers of the Board of Directors are terminated and the same will now be exercised by the Company Liquidator.

(5) The winding up order shall operate in favour of all the creditors and all the contributories of the company, as if such an order has been made on their joint petition (Sec. 278).

(6) Any debts payable at a future date, become immediately payable on the winding up order.

(7) Within 3 weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a ‘winding up committee’ which shall assist and monitor the progress of liquidation proceedings by the Company Liquidator [Sec. 277(4)].

(8) The Company Liquidator shall place before the Tribunal a report along with the minutes of the meetings of the Committee on monthly basis till the final report for dissolution of the company is submitted before the Tribunal [Sec. 277(6)].

(9) The final report, after approval of the winding up committee, shall be submitted by the Company Liquidator before the Tribunal for passing of a dissolution or1er in respect of the company [Sec. 277(8)].

(10) No suit or legal proceeding can be commenced against the company without the leave of the Tribunal. Similarly, if a suit is pending at the date of the winding up order, it shall not be proceeded with, by or against the company, except with the permission of the Tribunal (Sec. 279).

(11) The Tribunal shall have full powers to entertain or dispose of any new or pending suit or proceeding by or against the company. Any suit or proceeding pending in any other court shall also be transferred to the Tribunal (Sec. 280).

12.2.4 MISCELLANEOUS PROVISIONS RELATING TO WINDING UP

Contributory

Meaning. The members of a company are termed as contributories on the commencement of winding up. As per Section 2(26), the term contributory means every person liable to contribute to the assets of a company in the event of its being wound up and includes even the holder of fully paid shares. A holder of fully paid shares is called a contributory not because he has to contribute anything further to the assets in case of deficit, but because he is entitled to share in the surplus, if any. It is only the holder of partly paid shares who is called upon to contribute towards deficit to the extent of unpaid amount on his shares at the time of winding up of a company.

The liquidator has to prepare the list of contributories in two parts, i.e., ‘List A’ and ‘List B’. ‘List A ‘includes the ‘present members’ of the company whose names appear in the register of members on the commencement of winding up. ‘List B’ contains the names of ‘past members’, i.e., the members who ceased to be the members within one year preceding the commencement of the winding up of the company for any reason whatever, e.g., because they have transferred or surrendered their shares or because their shares have been forfeited.

When does the liability of a contributory arise? A contributory shall be liable to contribute towards the assets of the company only when the assets fall short for the payment of:

(i) its debts and liabilities;

(ii) costs, charges and expenses of the winding up; and

(iii) for the adjustment of the rights of the contributories among themselves, e.g., to bring those shareholders who have paid in full, at par with those, who have paid the amount partly for their shareholding [Secs. 285(3) & 297].

Extent of liability of different types of contributories. The extent to which different categories of persons may be held liable as contributories is as follows:

(1) Present Members. They are primarily liable to pay the unpaid amount on their shares on the demand made by the Tribunal or the liquidator as the case may be. Their liability is absolute and any person whose name appears on the Register of Members cannot escape his liability on the plea that the allotment of shares to him was void. In the case of a company limited by guarantee having a share capital every member shall be liable (in addition to the amount guaranteed by him) to contribute to the extent of any sums unpaid on the shares held by him, as if the company were a company limited by shares [Sec. 285(3)].

(2) Past Members. Their liability is secondary and they will be liable to pay only when it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them. Further, a past member is not liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member. The extent of liability is same as that of present members, i.e., up to the unpaid amount or up to the amount of guarantee in case of a guarantee limited company, on the shares held by them [Sec. 285(3)].

(3) Directors, Managing Director or Manager with unlimited liability. If according to the provisions of law, the liability of any of the above persons , whether past or present, is unlimited, he shall be liable, in addition to his liability as an ordinary member, to make further contributions as if he were a member of an unlimited company, at the commencement of the winding up. But a past officer (director, managing director or manager) is not liable:

(a) if he has ceased to hold office for a year or more before the commencement of winding up; or

(b) if the debt or liability was incurred after he ceased to hold office; or

(c) where the Tribunal does not deem it necessary to require further contribution in order to satisfy' the debts and liabilities of the company and the costs and expenses of the winding up (Sec. 286).

(4) Any other person to whom the Tribunal may so direct. The Tribunal may, by its order, impose liability on any person to contribute towards the payment of the liabilities of the company, to an unlimited extent, on the ground that such a person was a party to fraudulent trading carried on by the company or was guilty of misfeasance or breach of trust in connection with the company's affairs (Sec 339).

If a contributory dies, his legal representatives shall be liable as contributory [Sec. 285(2)]. If a contributory is adjudged insolvent, his official assignee in insolvency shall take his place. If a body corporate which is a contributory is ordered to be wound up, its liquidator shall be the contributory [Sec. 285(2)]. Their liability as a contributory shall extend to the extent of the value of the estate of the deceased, insolvent or company in liquidation, which has come in their control.

Nature of a Contributory's liability. The liability of a contributory is not *ex- contractu*, i.e., it does not arise by virtue of his contract to take shares but is ex- ledge, i.e., it arises by reason of the fact that his name appears on the register of members. It is no answer for the contributory to say that although his name appears on the register of members he is not liable because he had sold his shares to a purchaser who has not got his name registered in the register. When a person knowingly continues to have his name in the 'Register of Members' up to the commencement of winding up, he will be estopped from going against the 'Register' and disowning liability.

The following points about the nature of a contributory's liability should be noted:

(1) A contributory cannot avoid his liability arising on the winding up of the company on the ground that he had subscribed to the shares on the faith of a false and misleading prospectus, unless he has started proceedings for rescission of the contract before the company goes into liquidation.

(2) Where a contributory upon whom a call has been made, also happens to be a creditor of the company in some other respects, he cannot demand any set off– balancing unpaid call against credit for, as a rule a statutory liability (e.g. for an unpaid call) cannot be set off against a credit. Of course the right of set off is available to a limited extent in case of a contractual debt.

(3) Where shares have been forfeited more than a year before the commencement of the winding up, the names of the persons concerned cannot be placed on the list of contributories as past members, but such persons shall remain liable as a debtor to the company for the amount of unpaid calls for a period of three years from the date of forfeiture, if the articles so provide.

Order of payment of Liabilities

A secured creditor need not prove his debts against the company in winding up as he has the right to realise his security in satisfaction of his debt. He can, however, put his claim for the deficiency, if any, before the liquidator as an unsecured creditor, and where there is a surplus left on the realisation of pledged assets he is required to hand over the same to the liquidator. The secured creditor has also the option of relinquishing his security and to prove his debt as if he were an unsecured creditor.

On the realisation of assets and after finalising the list of claimants, the liquidator starts making payments to various claimants, subject to the rights of secured creditors, in the following order:

(1) Costs and expenses of winding up proceedings including the remuneration of the liquidator,

(2) Preferential creditors,

(3) Creditors secured by floating charge, and

(4) Unsecured creditors.

If still some surplus is left, it is distributed among contributories as follows:

Preference shareholders must be paid their capital as well as dividend which has been declared but not paid, in priority of any return of capital to equity shareholders. The arrears of undeclared dividends, in the case of cumulative preference shares, shall also be paid in priority of any return of equity share capital if the Articles or the terms of issue contain an express provision to this effect. Any amount left after paying to preference shareholders will be applied towards the return of equity share capital. If still, any surplus is left, it will be applied to the payment of arrears of undeclared dividends on the cumulative preference shares, where such dividends have not been paid earlier in the absence of an express provision to this effect in the Articles or the terms of issue. Any surplus still left will be distributed among equity shareholders only, unless as per the terms of issue, the preference shares are participating shares.

Overriding Preferential Payments

After retaining the amount necessary for cost and expenses of winding up proceedings (including the remuneration of the liquidator), certain unsecured creditors known as preferential creditors have to be paid in priority to all other unsecured creditors; including those who are secured by a floating charge. Preferential creditors will rank equally among themselves and have to be paid in full, unless the assets are inadequate in which case they shall abate in equal proportions [Sec. 327(3)(4)].

According to Section 326, as amended by the insolvency and Bankruptcy Code, 2016, certain debts shall enjoy over-riding priority over all other debts as regards payment. These debts have been termed as "over-riding preferential payments" which must be paid in full in priority to all other debts including the preferential payments (as contained in Section 327), unless the assets are insufficient to meet them, in which case they shall abate in equal proportions. These over-riding preferential payments are as follows:

(a) Workmen's dues; and

(b) Where a secured creditor has realised a secured asset, so much of the debts due to such secured creditor as could not be realised by him or the amount of the workmen's portion in his security (if payable under the law) whichever is less, *pari passu* with the workmen's dues.

However, the sums towards wages or salary, etc., referred to in sub-clauses (i) and (ii) of clause (b) of the Explanation, which are payable for a period of two years preceding the winding up order or such other period as may be prescribed, shall be paid in full in priority to all other debts (including debts due to secured creditors), within a period of 30 days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed.

Explanation. For the purposes of this Section, and Section 327:

(a) 'workmen', in relation to a company, means the employees of the company, being workmen within the meaning of the Industrial Disputes Act, 1947;

(b) 'workmen's dues', in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely:

(i) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company, and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;

(ii) all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of the winding up order or resolution;

(iii) unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in Section 14 of the Workmen’s Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;

(iv) all sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company;

(c) ‘workmen’s portion’, in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen’s dues bears to the aggregate of:

(i) the amount of workmen’s dues; and

(ii) the amount of the debts due to the secured creditors.

Preferential Payments

According to Section 327, some payments must be treated as “preferential payments” which must be paid in priority to all other debts but after the “overriding preferential payments”. These preferential payments are as follows:

(1) All revenues, taxes, cesses and rates due to the Central or a State Government or to a local authority, which have become due and payable within twelve months preceding the date of appointment of a provisional liquidator, or otherwise the date of winding up order in case of winding up by the Tribunal and the date of the passing of the resolution for winding up in the case of voluntary winding up.

(2) All wages or salaries (including commission earned) of any employee due for a period not exceeding four months within the said twelve months, provided the amount payable to any one claimant will not exceed such sum as may be notified by the Central Government in the Official Gazette.

(3) All accrued holiday remuneration which has become payable to any employee r in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up.

(4) All amounts due in respect of contributions payable during the said twelve months under the Employees' State Insurance Act, 1948, or any other law for the time being in force, except in a case where the company is being wound up voluntarily merely for the purpose of reconstruction or amalgamation with another company.

(5) All amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act, 1923, in respect of the death or disablement of any employee of the company, except in a case where the company has taken out a workmen compensation insurance policy.

(6) All sums due to an employee from the provident fund, the pension fund, the gratuity fund, or any other welfare fund maintained by the company.

(7) The expenses of any investigation held in pursuance of Sections 213 and 216, insofar as they are payable by the company.

It is important to note that for the purposes of 'preferential payments' listed above the expression 'employee' does not include a 'workman'. According to Section 325(3) "workmen", in relation to a company, means the employees of company, being workmen within the meaning of the Industrial Disputes Act, 1947.

After paying the preferential creditors enumerated above, the liquidator has to pay creditors secured by a floating charge, and then the unsecured creditors. If still any surplus is left, it will be distributed among contributories.

Disposal of unclaimed dividends and undistributed assets. If the liquidator has in his hands or under his control any money payable to a creditor or a contributory, which had remained unpaid or undistributed for six months after the date on which it became payable, he shall, forthwith deposit the said money into a separate special account to be known as the 'Company Liquidation Dividend and

Undistributed Assets Accounts' in a scheduled bank. He shall similarly deposit into that account any money representing unpaid dividends or undistributed assets in his hands at the date of dissolution of the company. While making any payment referred above, the liquidator shall furnish to the Registrar, a statement in the prescribed form, setting forth, in respect of all sums included in such payment, the names and addresses of the persons entitled to participate therein and the amount to which each is entitled. The liquidator shall be entitled to a receipt from the scheduled bank for any money so paid to it, and such receipt shall be an effectual discharge of the liquidator in respect thereof.

Any person claiming to be entitled to any money paid into the aforesaid account may apply to the Registrar for payment thereof, and the Registrar may make the payment to that person within 60 days.

Any money remaining unclaimed in the 'Company Liquidation Dividend and Undistributed Assets Accounts' for a period of fifteen years, shall be transferred to the General Revenue Account of the Central Government but still refund to the claimants shall be allowed as if such transfer had not been made (Sec. 352).

12.3 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. Winding up of a company precedes its dissolution.
2. A company may be wound up by the Tribunal if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding three consecutive financial years.
3. A petition to the Tribunal by a company for its winding up may be made by its directors when it has passed resolution to this effect.
4. Winding up commences not from the date of the winding up order of the Tribunal but it shall be deemed to commence at the time of the presentation of the petition.
5. It is only the holder of partly paid shares who is called upon to contribute towards deficit to the extent of unpaid amount plus interest thereon on his shares at the time of winding up of a company.

12.4 SUMMARY

Winding up of a company is a process, by which the life of a company is brought to an end. Its assets are realized, liabilities are discharged and surplus, if any, remaining thereafter distributed amongst the members in accordance with their rights. After the winding up is over, the Registrar removes the name of the company from the Register of Companies and this fact is published in the Official Gazette. A Tribunal can order winding up for grounds, on which the Tribunal can order winding up.

12.5 KEYWORDS

Winding up: It is a process by which a company is dissolved and its properties are administered for the benefits of its creditors and members.

Contributory: Every person liable to contribute to the assets of the company in the event of its being wound up.

Liquidator: he is a person who helps the Tribunal to complete the liquidation proceedings.

12.6 SELF ASSESSMENT TEST

1. What is winding up? Distinguish between winding up and dissolution. What are the powers of the Tribunal on presentation of the petition for winding up of a company? Discuss.
2. Discuss the grounds for winding up by the Tribunal.
3. Who may petition to the Tribunal for winding up? What are the powers of the Tribunal on presentation of the petition? What are the consequences of the winding up order by the Tribunal? Discuss.
4. "The Tribunal can wind up the company on just and equitable grounds." Explain.
5. Define the term contributory. Who are liable as contributories in the event of winding up of a company and to what extent? Explain.

12.7 ANSWERS TO CHECK YOUR PROGRESS

1. True
2. False
3. True
4. True
5. False

12.8 REFERENCES/SUGGESTED READINGS

1. A K Majumdar, G K Kapoor, Sanjay Dhamija, Company law and Practice, Taxman, New Delhi.
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3. Avtar Singh, Company Law, Eastern Book Company, Lucknow.
4. R Suryanarayanan, Company Law Ready Reckoner, Commercial law Publishers, Delhi.

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