स्वाध्याय स्वमन्थन स्वावलम्बन

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BBA-1.4 E2
Company Law

FIRST BLOCK	:	Company and Its Formation
SECOND BLOCK	:	Principal Documents
THIRD BLOCK	:	Capital & Management
FOURTH BLOCK	:	Meetings & Winding Up

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BBA-1.4(E2)

Company Law

Block

1

COMPANY AND ITS FORMATION

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BLOCK 1 COMPANY AND ITS FORMATION

You know that the requirements of large amount of funds for, and the growing complexities of modern business the company form of business organisation has become very popular. In a company, money is invested by a large number of persons called 'shareholders' who are scattered over different parts of the country. In order to protect their interests, it becomes necessary to regulate the conduct of the affairs of the company. For this purpose, the Government of India enacted the Companies Act. The first company legislation in India was passed in 1850 which was followed by the Companies Act of 1857, 1866, 1913 and 1956. The Companies Act, 1956 is based on the recommendations of Bhabha Committee which had recommended some far reaching changes in the Companies Act of 1913. Even the 1956 Act has been amended from time to time to meet the growing needs of protecting the investors and ensuring efficient and honest management of the affairs of the company. The latest amendments were made in 1988 based on the recommendations of the Sachar Committee and further amendments are expected in 1991 for which the process has already been initiated.

The company law provides for the procedure of forming a company, its objects and scope, the rules for its internal management, the capital structure, the powers and duties of directors, the company meetings, the maintenance and audit of company accounts, powers of inspection and investigation of the affairs of a company, and the modes of its winding up.

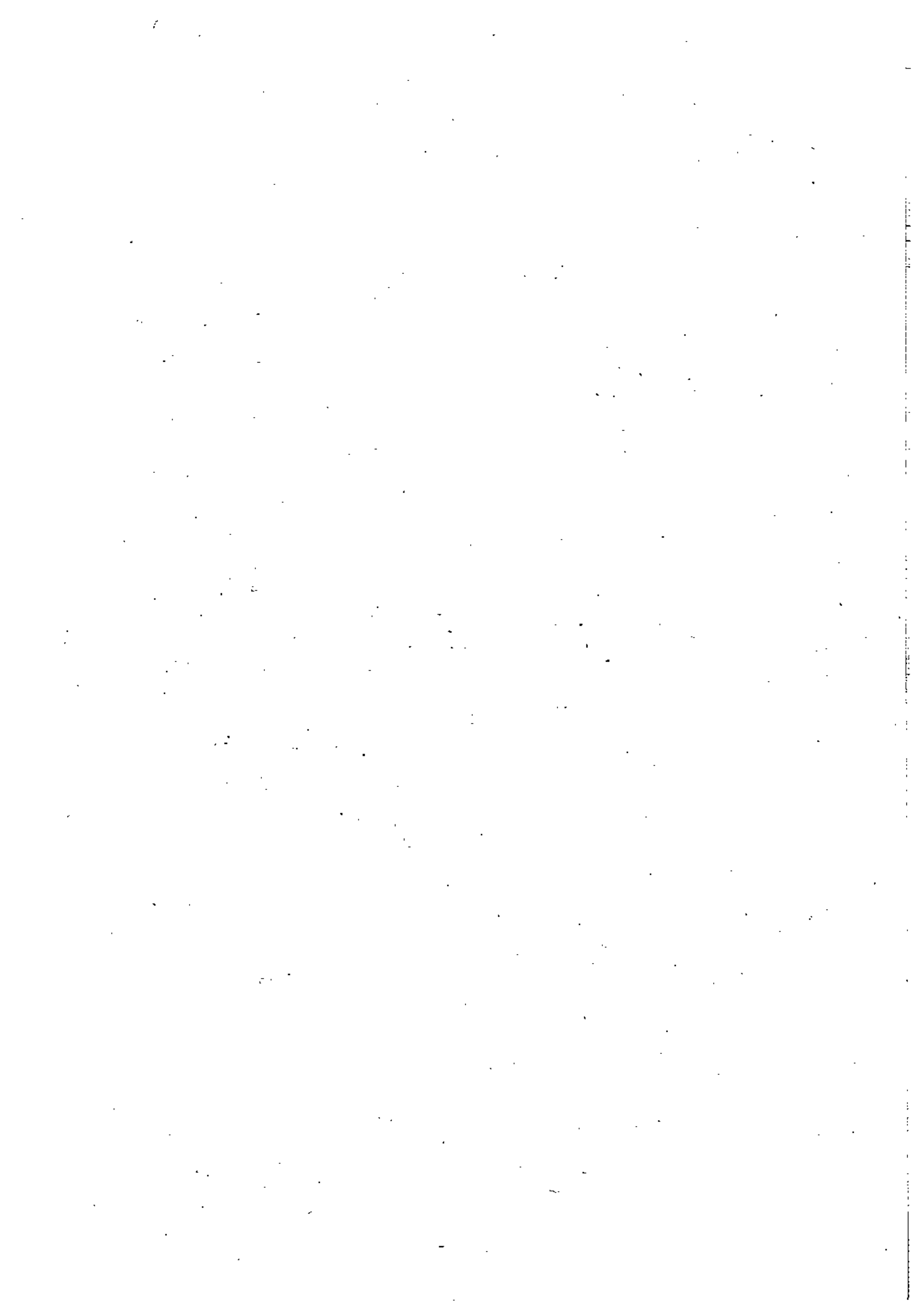
In this introductory block, we have discussed the nature and types of companies, the position of a private limited company, the role of promoters, and the procedure for the formation of a company. It consists of four units.

Unit 1 explains the nature of company, the distinction between company and partnership and the various types of companies that can be formed.

Unit 2 describes the meaning of a private limited company, its distinction from a public limited company, its privileges, and its conversion into a public limited company.

Unit 3 deals with the legal position of a promoter. It discusses his functions, liabilities, remuneration and also the position of preliminary contracts entered into by him on behalf of the company.

Unit 4 describes the procedure for the formation of a company divided into four stages (i) Promotion (ii) filing of necessary documents, (iii) incorporation (registration), and (iv) commencement of business.



UNIT 1 NATURE AND TYPES OF COMPANIES

Structure

1.0 Objectives
1.1 Introduction
1.2 Definition of a Company
1.3 Main Features of a Company
1.4 One-man Company
1.5 Lifting the Corporate Veil
- 1.5.1 Under Express Statutory Provisions
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1.6 Distinction Between a Company and a Partnership
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- 1.7.3 On the Basis of Control

1.8 Association Not for Profit
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- 1.9.1 Meaning
- 1.9.2 Exceptions
- 1.9.3 Consequences

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1.12 Answers to Check Your Progress
1.13 Terminal Questions

1.0 OBJECTIVES

After studying this unit, you should be able to:

- define a company,
- describe the characteristics of a company,
- explain the concept of corporate veil,
- distinguish between a company and a partnership
- describe the various types of companies, and
- describe an illegal association.

1.1 INTRODUCTION

The Companies Act, 1956 came into force on April 1, 1956. Despite its thoroughness, it has been revised from time to time in order to meet the growing needs of protecting the investors and ensuring efficient and honest management of the affairs of the companies. The latest in the series is the Companies (Amendment) Act 1988. This Act provides detailed rules regarding the formation and administration of companies in India. In this introductory unit you will study the definition of a company, the main feature a company form of business organisation, its distinction from partnership and the various types of companies that can be formed in India.

1.2 DEFINITION OF A COMPANY

The term 'company' implies an association of a number of persons for some common object or objects. In fact, the purposes for which people may wish to associate are multifarious but the term 'company' is normally reserved for those associated for economic purpose i.e., to carry on a business for gain. Partnerships often describe themselves as 'A, B, C and Company'. However, this does not make the firm a company in the legal sense of the word, they are only indicating that there are other persons in the association.

In legal terminology, a company means a company incorporated or registered under the Companies Act, 1956 or under any of the earlier Companies Acts. Section 3(1)(i)

of the Companies Act, 1956 states that a Company means *a company formed and registered under the Act or an existing Company.* An existing Company means a Company formed and registered under any of the previous Companies Acts. This definition, however, is not exhaustive because it does not reveal the characteristics of a Company.

A company is called a 'body corporate' because, as a consequence of incorporation, the large number of members who constitute the company are legally merged into one body which has a distinct identity of its own. In its legal form, a company is an artificial person created by law. It has a separate identity independent of its members. This artificial legal person is entitled to many rights and incurs many liabilities like any other ordinary human being.

A company has been defined by *Lord Justice Lindley* as follows: "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are called members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."

Another good definition has been given by *Chief Justice Marshall.* According to him, "a company is a person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

According to Lord Haney, "A company is an incorporated association which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal."

From the above definitions, it is clear that a company has a corporate and legal personality. It is an artificial person and exists only in the eyes of law. It has an independent legal entity, a common seal and perpetual succession.

1.3 MAIN FEATURES OF A COMPANY

On analysing the various legal and juristic definitions of the term 'company' you will observe that a company formed and registered under the Companies Act has certain special features which distinguish it from the other forms of organisations. The main characteristics of a company are as follows.

1 **Creation of law:** A company is an association of persons who have agreed to form the company and become its members or shareholders with the object of carrying on a lawful business for profit. It comes into existence when it is registered under the Companies Act.

2 **Separate legal entity:** In the eyes of law, a company formed and registered under the Companies Act has a distinct legal entity. After registration, the company is treated as an artificial person because in reality no such natural person exists. It is invisible, intangible and without any physical or natural existence. Although a company is a legal person having a nationality and domicile, it is not a citizen.

   The legal status of a company has been aptly described by the Supreme Court of India in **Tata Engineering & Locomotive Co. Ltd v. State of Bihar** as follows:

   "The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose".

   Even though the company lacks a physical existence, for purposes of law it is regarded as an independent legal person which has a personality of its own and is different from the members constituting the company. Therefore, a company can enter into a contract with any member of the company. A

person can own its shares and also be its creditor. A shareholder cannot be held liable for the acts and debts of the company even though he virtually holds the entire share capital. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or on its winding up. Similarly, creditors of the company are creditors of the company alone and they cannot take action against the members of the company.

Even where a single shareholder owns virtually the whole of its shares, the company is to be treated as a separate legal entity and is to be differentiated from such a shareholders. This can be understood better by referring to the case of **Salomon vs Salomon and Company Ltd.** Mr. Salomon was running a shoe business in England. He formed a company known as 'Soloman and Co. Ltd.' It consisted of Saloman himself, his wife, his four sons and a daughter. The shoes business of Mr. Saloman was sold to the company for £30,000. Mr. Saloman received from the company purchase price in the form of £20,000 fully paid shares of £1 each and £10,000 in debentures which carried a floating charge over the assets of the company. One share of £1 each was subscribed for in cash by each member of Saloman's family. Saloman was the managing director of the company. During the course of business, the company became liable for some unsecured loan. The company ran into financial difficulties after some time and went into liquidation within a year. On winding up, the assets realised £6,000. The company owed £10,000 to Mr. Saloman and £7,000 to unsecured creditors. Thus, after paying off the debentureholder. (Mr. Saloman), nothing was left for unsecured creditors. The creditors claimed priority over the debentures contending that Mr. Saloman and Saloman and Co. Ltd. were one and the same person, the company was only a facade to defraud the innocent creditors. Mr. Saloman should not therefore, be treated as a secured creditor. The House of Lords held that the company had been validly constituted and it had an independent existence distinct from its members. Therefore, Mr. Saloman was entitled to be paid his dues first as a secured creditor. It was observed that the business belonged to the company and not to Mr. Saloman. The company and Mr. Saloman enjoyed separate legal entities. The fact that the members were from one single family had no bearing upon the validity of the company.

In **T.R. Pratt (Bombay) Ltd. Vs E.D. Sasoon and Co. Ltd.**, it was observed that under the law, an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is a distinct entity. Similarly in **Abdul Haq v Das Mal**, an employee sued a director of the company for the recovery of the amount of salary due to him. It was held that he could not succeed because the remedy lied against the company and not against the directors or members of the company.

As a consequence of separate legal entity, the company may enter into contracts with its members and vice-versa. Thus, a shareholder can be the creditor of the company.

3 **Limited Liability:** A major advantage enjoyed by a company is that the liability of its members is limited. You will later on study that on the basis of liability, companies may be classified as (i) Companies limited by shares; and (ii) Companies limited by guarantee. In the case of former the liability of every member of the company is limited to the amount of shares subscribed by him. If the member has paid full amount of the face value of the shares subscribed by him, his liability shall be nil and he cannot be asked to contribute anything more. Similarly, in the case of a company limited by guarantee, the liability of the members is limited upto the amount guaranteed by a member.

4 **Perpetual Succession:** The term perpetual succession means the continued existence. The existence of the company is not affected by reasons such as the insolvency, death, unsoundness of mind of its members. The company has a perpetual succession. Members may come and members may go but the company goes on. Even if all the members of a company die, the legal existence of the company will not come to an end. **Gower** puts it very interestingly when he says that even a hydrogen bomb cannot destroy a company. But this does not mean that a

company can never come to an end. You learnt that a company is the creation of law. It can also be brought to an end by the process of law.

5 **Transferability of shares:** The shares of a public limited company are freely transferable. A shareholder can transfer his shares to any person without the consent of other members. Under the articles of association, even a public limited company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of a public limited company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the manner provided for in the articles of association of the company. However, a private limited company is required to put certain restrictions on transferability of its shares.

6 **Common seal:** In view of the fact that a company is an artificial person and cannot sign its name on a contract, every company is required to have its own seal. The common seal of the company is of great importance. It acts as the official signature of the company. A metallic seal should be used. Every company must have a common seal with its name engraved on the same. The seal acts as a substitute for the signature of the company. Any document which does not bear the common seal of the company is not binding on the company.

7 **May sue or be sued:** As juristic person, company can sue and be sued in its own name. This is so because a company has a separate legal existence. A company may enter into contracts and can enforce the contractual rights against others and it can be sued by others if it commits a breach of contract.

1.4 ONE-MAN COMPANY

A company in which a single individual holds the whole, or virtually the whole, of the share capital is termed as 'one-man company'. Though there may be other members also, but these members are usually his relatives, friends or nominees. This dominating person is usually the managing director of the company and has full control over the company. This is a means to enjoy the benefits of the corporate status and limited liability of the company. Although only one person runs the entire show in such a company, yet such type of companies are legal. The formation of one-man companies has certainly been to the disadvantage of creditors because they cannot proceed against the actual proprietor, Saloman's case propounded the concept of 'one-man company' as you have learnt in Section 1.3 of this unit.

Check Your Progress A

1 Define a company.

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2 Enumerate the main features of a company.

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3 Define 'one-man company'.

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4 State whether the following statements are true or false.

i) A company is the creation of law.

ii) A company is an artificial person.

iii) Since the company is an artificial person it can commit no wrong nor can it be sued in its own name.

iv) Like a partnership a company comes to an end when any shareholder of the company dies.

v) A company although is a corporate person yet it is not a citizen.

vi) A one-man company is one in which a single individual holds virtually the whole of the shares of the company.

vii) The liability of a member is limited to the face value of the shares held by him.

viii) All contracts entered into by a company must be under its seal.

1.5 LIFTING THE CORPORATE VEIL

You learnt that a company has a separate legal entity independent and different from its members. The principle of separate legal entity was well established in the famous case of **Saloman v. Saloman and Co. Ltd.** On incorporation a line of demarcation or a veil is drawn between the company and its members. In fact, a company is an association of persons and such persons are the real beneficial owners of all the corporate property. Real persons behind the company are disregarded once they have formed a company and given to their association the status of a legal entity.

As a consequence of this separate legal entity, the company enjoys several advantages which you have studied in foregoing paras. But when the company starts using the corporate veil for improper conduct, or to protect fraud or to justify wrongs, the law disregards the corporate veil and looks at the persons behind and treat the company and its members as same persons. The corporate veil is said to be lifted when the court ignores the company and concerns itself directly with the members of the company. Prof. Gower has observed, "when the law disregards the corporate entity and pays regard instead to the individual members behind the legal facade, it is known as lifting the veil of corporate personality."

You should, however, note that the powers of the court to lift the corporate veil is purely discretionary. The court will lift the corporate veil when it is in the public interest to do so. The circumstances and cases in which the corporate veil will be lifted may broadly be classified under the following two heads:

1. Under express statutory provisions, and
2. Under judicial interpretations.

Let us now discuss them in detail.

1.5.1 Under Express Statutory Provisions

The Companies Act, 1956 itself provides for certain cases in which the directors or members of the company may be held personally liable. In such cases, while the separate entity of the company is maintained, the directors or members are held personally liable along with the company. These cases are as follows:

i) **When the number of members falls below statutory minimum:** According to Section 45 of the Act if at any time the number of members of a company is reduced below the statutory requirement and the company carries on business for more than six months while the number is so reduced, every person who was member of the company during the time when it carried on business after those six months and who was aware of this fact, shall be severally liable for all debts of the company contracted during that time. It should be noted that the personal liability of the members commences only after six months of carrying on business with reduced members and this liability is only for the debts contracted after those six months.

From this you will see that although the company continues to enjoy its distinct personality but loses the important feature of limited liability of the members of a company. Such a situation entitled the creditors to disregard the separate entity of the company, and the creditors can take action against the members directly.

ii) **Non disclosure of representative capacity:** As a rule when an officer of a company or any person on its behalf signs or authorises to be signed, on behalf of the company, any bill of exchange, hundi, promissory note, endorsement, cheque or order for money or goods, it is incumbent on such person that he should clearly disclose the name of the company on whose behalf he is acting. If the officer or the authorised person fails to disclose his representative capacity, such officer or person shall be personally liable for the amount due if the company refuses to pay it. For example, a bill of exchange drawn upon a company is accepted by a director in his personal capacity i.e., without disclosing that he is accepting the bill on behalf of the company, such a director shall be personally liable for the bill.

iii) **Holding and subsidiary company:** When one company controls the composition of the board of directors of another company or holds majority of its shares, the former is called the holding company and the latter as subsidiary company. In general, a subsidiary company is altogether treated as a separate entity and the holding company is not liable for its acts. But, under Section 212 of the Act, every holding company is required to disclose to its shareholders the accounts of its subsidiaries. It requires that the copies of balance sheet, profit and loss account, directors report and auditor's report of each subsidiary company be attached to the balance sheet of the holding company. Thus, companies under the same group are treated as one entity disregarding the rule that each subsidiary company has a separate legal entity.

iv) **For investigation into affairs of related companies:** Section 239 of the Act provides that if an inspector is appointed by the Central Government of investigate the affairs of a company, he shall also have the power to investigate into the affairs of related (subsidiary) companies in the same management. The power to do so may thus lift the veil of incorporation.

v) **For investigation of ownership of a company:** When the Central Government feels it necessary to know about the membership of any company and also some other matters relating to the company with the object of determining true persons who are (or have been) financially interested in the success or failure of the company or who are (or have been) able to control the policy of the company, may appoint one or more inspectors to investigate and report on these matters (Section 247). This will be done by lifting the corporate veil so as to find out the true persons controlling it.

vi) **Fraudulent conduct of business:** Under Section 542 of the Act if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly parties to such acts may be held personally liable for any debts and other liabilities of the company. In such a situation, the court may disregard the legal entity of a company and make the fraudulent persons personally liable for the debts of the company.

1.5.2 Under Judicial Interpretations

Besides the above mentioned circumstances, the courts have allowed the lifting of corporate veil for proper administration of taxation laws, estate duty laws, wealth tax laws etc. and also in some other circumstances. Let us now study some of the cases where the corporate veil was lifted.

i) **For determination of the character of the company:** Sometimes, particularly during war between countries it becomes necessary to ascertain the character of certain companies. At such times the courts are justified in lifting the corporate veil of a company which is controlled by alien enemy. In this way a company registered in India may be declared alien enemy if it is found that the persons controlling such a company are citizens of an enemy country. For example in **Daimler Co. Ltd. v. Continental Tyre and Rubber Co. Ltd**'s case, a company with the name Continental Tyre and Rubber Co. Ltd. was registered in England. The

object of this company was to sell tyres in United Kingdom, which were manufactured in Germany by a German company. Majority of the shares of this company were held by Germans. Besides this, all the directors of the company were German residents. When the First World War broke out, the company filed a suit to recover a trade debt. The court came to the conclusion that the company was an enemy company because the effective control of the company was in the hands of Germans who were alien enemy. Hence, the claim of the company was disallowed on the ground that it was against public policy to allow alien enemies to trade by using the corporate veil.

ii) **For prevention of fraud or improper conduct:** The courts will allow lifting of the corporate veil if the purpose of the company is to avoid legal obligations or to defraud the creditors. In the case of **Gilford Motor Co. Ltd. v Horne,** Horne was appointed as a managing director of Gilford Motor Co. with the condition that he would not solicit or entice away the customers of the company, so long as he was in the employment of the company and afterwards. After leaving the company, Horne formed another company which was to carry on the same business. This new company of Horne solicited the customers of Gilford Motor Co. Ltd. In a suit filed by Gilford Motor Co. Ltd. against Horne to restrain him from soliciting the business, the court came to the conclusion that Horne had created the company for his own benefit and to solicit the customers of his employer's company. The court issued an injunction against Horne and his new company and held that the new company was a mere cloak for the purpose of enabling the defendant to commit a breach of his contract that he would not solicit the business of his employer's company. Similarly, where a dummy company was formed to avoid a legal obligation, the court lift the corporate veil. **(Jones v Lipman)** Thus, where a company is formed to defraud, the court will lift the corporate veil and look into the true ownership of the company.

iii) **For protecting the revenue:** The court will allow piercing of corporate veil if it is of the opinion that the company has been formed for evading the tax or to circumvent tax obligations. If such is the case, the court will disregard the corporate entity and would instead hold individual members liable to fulfil the revenue obligations. In **Re Sir Dinshaw Maneckjee Petit's** case the assessee, Sir Dinshaw who was a very rich man, was earning huge dividend and interest income. He formed four private companies and entered into an agreement with each company to hold a block of investment as this agent. Under the arrangement the income received was credited in company's account and the company handed the amount back to him as a loan (which was never repaid). In this way he divided his income in four parts in order to reduce his tax liability. The court ignored the corporate facade of these companies and held that the company was nothing more than the assessee himself. Sir Dinshaw was held the owner of total income and liable to pay tax.

iv) **Where company is formed to act as an agent of its members:** As a general rule, a company is not an agent of its shareholders or of another company. But, under certain circumstances, a company may be regarded as an agent or trustee of its members or of another company. In such a situation, for the acts done by the company, it will be the members who would be responsible and not the company. In **Re F.G. Films Ltd.'s** case, an American company financed and produced a film 'Monsoon' in India. But, technically, the film was made in the name of a company incorporated in England. This British company had only a capital of £100 divided into £100 shares of £1 each, of this, 90 shares were held by the President of the American company. The Board of Trade declined to register the film as a British film. The view of the Board of Trade was upheld by the court. The court held that the British company acted only as an agent of the American Company which was the true maker of the film.

v) **Avoidance of Welfare Laws:** The courts have disregarded of the separate legal personality of the company when the company's independent status was being used as a device to reduce the amount payable by the company to defeat the provisions of welfare laws, such as payment of bonus to its workmen. In the case of **Workmen Employed in Associated Rubber Industries Ltd. Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and Another,** a new company was formed with no assets of its own except those transferred to it by the principal

company. The new company had no business of its own, it received dividend on shares transferred to it by the principal company. Thus, the principal company was able to reduce its gross profits and consequently the amount of bonus payable to workman was also reduced. The Supreme Court rejected the independent status of the new company and directed that the amounts paid to the new company as dividend shall also be taken into account while determining the gross profits of the principal company. The court held that "in every case where ingenuity is expected to avoid taking and welfare legislations, the court will go behind the smoke-screen and discover the true state of affairs.

1.6 DISTINCTION BETWEEN A COMPANY AND A PARTNERSHIP

You learnt that a company is an artificial person created by law, with limited liability and perpetual succession as its main features. Let us now study the distinction between a company and partnership, the main points of difference between the two are as follows:

1 **Formation:** A company comes into existence when the Registrar of Companies issues the certificate of incorporation. This certificate is issued when the Registrar is satisfied that all the formalities with respect to registration of company have been complied with in accordance with the provisions of the Companies Act, 1956. A partnership, as you have already read can be formed by an agreement between the partners. Registration of a partnership firm, is not compulsory under the Indian Partnership Act, 1932.

2 **Membership:** Minimum number of members required in case of private and public company is two and seven, respectively. Maximum number of members in case of private company is fifty (excluding its past and present employees) and in case of a public company there is no statutory limit. But in the case of partnership, minimum number of person required is two and maximum number of partners is restricted to ten in the case of partnership engaged in banking business and twenty in the case of a non-banking business.

3 **Legal status:** After incorporation, in the eyes of law, a company is recognised as a distinct legal personality different from the members who constitute it, whereas the partnership does not acquire any juristic status and contiuues to be only an association of persons even after registration. In simple words, the partners and the firm are one and the same.

4 **Liability:** As you have already read in this unit that in the case of a company, the liability of its members is limited to the value of shares held by them or upto the amount of guarantee given by them. A creditor of a company cannot proceed against the private properties of a member. However, in case of a partnership, the liability of partner is unlimited as well as joint and several. The creditors of a firm may proceed against the individual property of any partner for the recovery of their debts which had been incurred in the ordinary course of business.

5 **Transfer of Shares:** In the case of a public company, the shares are freely transferable. But, in the case of partnership, a partner cannot transfer his share in the firm without the consent of other partners.

6 **Perpetual succession:** A company enjoys perpetual succession. The life of a company does not come to an end if one or more of its members die or become of unsound mind or are declared 'insolvent'. But in the case of a partnership, unless otherwise agreed, on the happening of any of these contingencies, the partnership firm comes to an end.

7 **Management:** The affairs of the company are managed by a Board of Directors. Members of the company have no role in managing the affairs of the company. While in partnership, every partner has a right to participate in the management of the partnership business.

8 **Agency of members:** Shareholders are not agents of the company whereas every partner is an agent of the firm and has the implied authority to bind other partners by their acts done in the ordinary course of business.

9 **Property:** In the case of a company, the property of the company is in the name of the company and is owned by it. It does not belong to the individual shareholders of

the company. During the life time of the company, no shareholder has any legal or equitable interest in any property of the company. But in the case of partnership, the partners are the joint owners of the property of the firm.

10 **Statutory requirements:** A company is required to comply with various statutory formalities, such as convening the statutory meeting and delivery of statutory report to the Registrar of Companies, whereas a partnership is not required to perform any such statutory obligations.

11 **Dissolution:** The corporate existence of a company can be brought to an end only in accordance with the provisions of the Companies Act, 1956. A partnership, being a creation of an agreement, can be dissolved at any time by an agreement.

12 **Governing legislation:** A company is governed by the Companies Act, 1956, while a partnership is governed by the Indian Partnership Act, 1932.

Check Your Progress B

1 What is meant by corporate veil?

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2 List four circumstances when the corporate veil can be pierced?

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3 Enumerate three main points of difference between a company and a partnership?

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4 Fill in the blanks.

a) The effect of incorporation is that the company is regarded as a .... person.

b) The corporate veil can be lifted when the number of company's members fails below.. in the case of a private limited company and below........................... in case of a public limited company.

c) If an officer of a company, while entering into contract on behalf of the company, fails to disclose his........................... capacity, he becomes personally liable on such contract.

d) When two nations are at war, the corporate veil of the company can be lifted to ascertain the .... of the company

e) The corporate veil can be lifted due to Court's intervention and under..........................

f) The liability of each partner is...........................

5 State whether the following statements are True or False.

i) A company comes into existence when the company is registered.

ii) Registration of a company, though desirable, but is not compulsory.

iii) After registration, a partnership ceases to be an association of persons and acquires a juristic status.

iv) For the recovery of his debts, a creditor of the company can proceed against private properties of a member.

v) In case of a company, except a private company, any member may freely transfer his shares to any person.

vi) A shareholder is not an agent of the company.

vii) A person can be a member and a creditor of a company at the same time.

1.7 KINDS OF COMPANIES

Companies can be classified according to various bases. These are:

1 On the basis of incorporation
2 On the basis of liability
3 On the basis of control

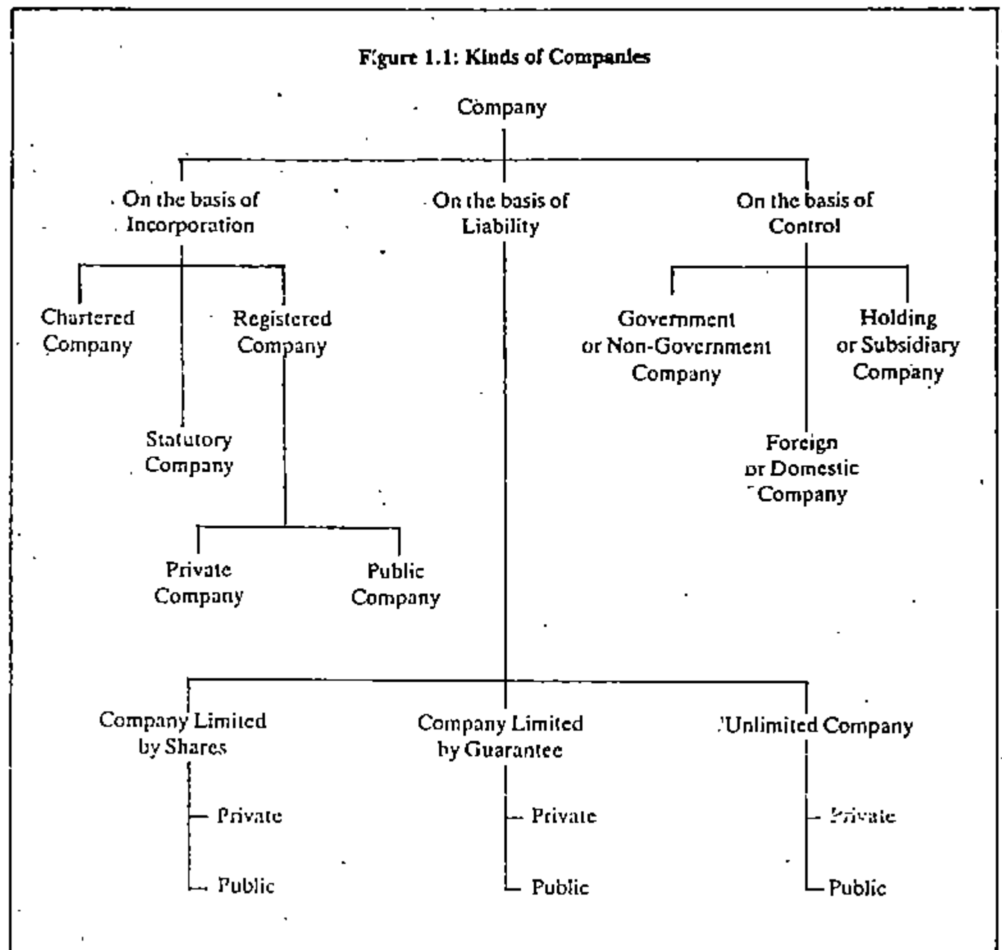
Look at Figure 1.1 carefully to have an overall view of the different types of companies.

1.7.1 On the Basis of Incorporation

Depending upon the mode of incorporation, joint stock companies may be divided into the following three categories:

i) **Chartered company:** A company incorporated under a special charter granted by the King or Queen of England is called 'chartered company'. A chartered company is regulated by its charter and the Companies Act does not apply to it. The charter also prescribes the nature of business and the powers of the company. The familiar examples of chartered company are the East India Company and the Bank of England. *This type of company cannot now be formed in India.*

Figure 1.1: Kinds of Companies



ii) **Statutory company:** A statutory company is one which is created by a special Act of Parliament or a State Legislature. Such companies are usually formed for achieving a purpose related with public utilities. The nature and powers of such companies are laid down in the special Act under which they are created. However, the provisions of the Companies Act are also applicable to them in so far as they are consistent with the provisions of the special Act. Such companies

need not have a memorandum of association. A statutory company has also a separate legal entity and it is not required to use the word 'limited' after its name. The audit of such companies is conducted under the control and supervision of the Auditor General of India and the annual report of working is required to be placed before the Parliament or State legislature, as the case may be. Familiar example of such companies are Reserve Bank of India, Unit Trust of India, The Life Insurance Corporation of India, State Trading Corporation, The Food Corporation of India, State Bank of India etc.

iii) **Registered or incorporated company:** A registered company is one which is registered in accordance with the provisions of the Companies Act of 1956 and also includes the existing companies. By existing company we mean a company formed and registered under any of the previous Acts. A registered company comes into existence only when it receives the certificate of incorporation. Registered companies are governed by the provisions of the Companies Act.

A registered company may either be a private limited company or a public limited company. A private limited company is one which by its articles of association (a) restricts the right of transfer of shares (b) limits the number of its members to fifty (not including the present or past employees) (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company. On the other hand, a public limited company is one which is not a private company. The minimum number of members to form a private company is two, while for the public company the minimum number is seven. **You will study more about them in Unit 2.**

1.7.2 On the Basis of Liability

On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee, or (iii) an unlimited company.

i) **Company limited by shares:** A company in which the liability of its members is determined on the basis of the amount, if any, remaining unpaid on the shares held by them is termed as a 'company limited by shares'. Such companies are popularly known as limited liability companies. The liability of the members is limited to the extent of nominal value of shares held by them. If a member has paid the full amount of shares, then his liability shall be nil. Let us make this clear by taking an example. Suppose you buy 100 shares of a company of the face value of Rs. 10/- each. In this company your liability is fixed to the tune of Rs. 1000 only. If you pay (when called by the company) Rs. 600 to the company, you are now liable to pay the company only Rs. 400, this being the amount unpaid on your shares. When you have paid the entire amount of Rs. 1,000 (which means when your share have been fully paid up) your liability shall be nil. The liability can be enforced against the members of the company during the existence of the company or during the winding up of the company.

ii) **Company limited by guarantee:** Section 12(12) (b) of the Act provides that a company having the liability of its members limited by its 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 is termed as a 'company limited by guarantee'. Such companies are generally formed for the promotion of art, science, culture, sports, etc. It is interesting to note that in a company limited by guarantee, a member is required to pay the amount guaranteed by him only if the company is wound up while he is a member or within one year after he ceases to be a member. Thus, the members cannot be asked to pay the guaranteed amount during the life time of the company. The memorandum of association of a company limited by guarantee, should state that each member of the company undertakes to contribute to the assets of the company in the event of its being wound up. You should, however, remember that a member cannot be asked to pay an amount in excess of the amount for which he has given the guarantee.

Such a company may or may not have share capital. If a company limited by a guarantee is formed without any share capital, then the members would be liable to pay only the guaranteed amount and that too when the company goes into liquidation. But if the company limited by guarantee is formed with share capital, then the members are also liable to pay the unpaid amount on their shares. But the guaranteed amount can be called up only at the time of winding up of the company.

iii) **Unlimited company:** A company where the liability of members is unlimited i.e., there is no limit on the liability of members is termed as an unlimited company. The members of such companies may be required to pay company's losses from their personal property. Because such companies have separate legal entity, its creditors cannot file a suit against the members directly. The creditors will have to apply to the court for the winding up of the company and then the liquidator will direct the members to contribute to the assets of the company to pay off its liabilities.

As in the case of a company limited by guarantee, here also an unlimited company may or may not have a share capital. If the company has share capital, the articles of association of the company must specify the amount of share capital with which the company is to be registered. Such a company must have its memorandum and articles of association. The articles of association must specify the number of members with which the company is to be registered.

1.7.3 On the Basis of Control

Let us now study the classification of companies on the basis of control i.e., who effectively control the affairs of the company. On this basis the companies may be grouped as following:

i) Government Company and Non-Government Company
ii) Foreign Company and Domestic Company
iii) Holding Company and Subsidiary Company

i) **Government company:** According to Section 617 of the Act a government company means "any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a government company as thus defined". Indian Telephone Industry, Hindustan Aeronautics Ltd. are examples of government companies. Even a subsidiary company of a government company is regarded as a Government Company. A government company registered under this Act is a non-statutory company and is not an agent of the government. Further, like any other company, it is governed by the provisions of the Companies Act. Section 620 of the Act, however, provides that the Central Government may by notification in the official Gazette direct that any of the provisions of this Act specified in the notification

a) shall not apply to any government company, or
b) shall apply to any Government company, only with such exceptions, modifications and adaptations, as may be specified in the notification. A copy of such notification shall be laid before the Parliament.

Sections 618, 619 and 619(A) of the Act cannot be exempted as these Sections specially deal with Government companies.

A company which may not be termed as a government company as defined in Section 617 is regarded as a **non-government company.**

ii) **Foreign company:** A foreign company means a company which is incorporated in a country outside India under the law of that country but has established a place of business in India. A company incorporated outside India may carry on business in India even without establishing a business e.g., through agents.

After the establishment of business in India, the following document must be filed with the Registrar of companies within thirty days from the date of establishment:

ii) A certified copy of the charter or statutes under which the company is incorporated, or the memorandum and articles of the company translated into English,

ii) The full address of the registered office of the company,

iii) A list of directors and secretary of the company,

iv) The names and address of any person resident in India who is authorised to accept, on behalf of the company, service of legal process and any notice served on the company, and

v) The full address of the company's principal place of business in India

A foreign company is obliged to state the name of the country in which the company is incorporated in every prospectus inviting subscription in India for its shares or debentures. The company will also conspicuously exhibit on the outside of every office or place, where it carries on business in India, the name of the company, and the country in which it is incorporated in legible English and secondly in a language in general use in the locality in which the office or place is situated. The name of the company and of the country where the company has been incorporated should also be stated in legible English on all business letters, bill heads, letter paper, all notices and other official publications of the company.

A company which cannot be termed as foreign company under the provisions of the Companies Act should be regarded as a **domestic company.**

A foreign company is required to keep at their principal place of business in India the books of accounts with respect to money received and expended, sales and purchases made and assets and liabilities of their business in India.

Provisions of Section 159 of the Act relating to the filing of the annual return with the Registrar of companies are also applicable to a foreign company.

iii) **Holding and Subsidiary company:** Generally speaking, if one company controls another company, the controlling company may be termed as the 'Holding company' and the company so controlled may be termed as a 'subsidiary company'.

Section 4(4) of the Act defines a holding company as "a company shall be deemed to be the holding company of another, if that other is its subsidiary".

A company (let us call it Company S) is deemed to be a subsidiary of another company (let us call it Company H) only in the following cases:

i) When the company (Company H) controls the composition of Board of Directors of other Company (Company S).

ii) When the Company H holds more than half of the equity share capital of Company S in terms of nominal value. You must understand that a majority shareholding of this sort would mean that the Company H controls more than half of the total voting power in Company S.

iii) When Company S is a subsidiary of a Company T, which in turn is the subsidiary of Company H.
In any of the above cases and only in these cases, would the Company S be deemed a subsidiary of Company H.

As you have just learnt from the above discussion, a holding company is usually a very major shareholder of its subsidiary and both continue to enjoy separate legal entities in the eyes of law. Unless there is a specific contract between the two companies, one cannot be said to be the agent of another. A subsidiary company also cannot be said to be a part of the holding company.

1.8 ASSOCIATION NOT FOR PROFIT

You learnt that limited companies are required to use the word 'limited' as the last word of their name. There is however, one exception which is provided by Section 25. This section provides that the Central Government may by licence grant that an association may be registered as a company with limited liability, without using the words 'limited' or 'private limited' as part of its name. The licence will be granted only in the case of 'association not for profit'. In other words the Central Government will grant the licence only if it is satisfied that:

a) the association about to be formed as a limited company aims at the promotion of commerce, art, science, religion, charity or any other useful object;

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

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

Such companies may be public or private companies and may or may not have share capital.

The Central Government may impose any terms and conditions that it deems fit for the grant of the licence which shall be binding on the association. The Government

can at any time, after giving notice of its intention, revoke the licence given to the association. It would, however, allow the association to present its case against revocation of the licence.

1.9 ILLEGAL ASSOCIATIONS

1.9.1 Meaning

The law desires to prevent the mischief arising from large trading undertakings being carried on as unregistered bodies because if business is carried on by such bodies, the persons dealing with such trading undertakings would not know with whom they are contracting. Due to this ignorance they might be put to great hardship. Section 11 of the Companies Act aims at repressing this public mischief. It provides that *no company, association or partnership consisting of more than ten persons for the purpose of carrying on the business of banking and more than twenty persons for the purpose of carrying on any other business shall be formed unless it is registered as a company under this Act, or is formed in pursuance of some other Indian law.*

It is, thus, clear from the above description that if an association is formed for carrying on banking business, the maximum number of its members should not exceed ten. If the number of individual forming such association exceeds ten, the association must be registered under the Companies Act or should be formed in pursuance of some other Indian laws. Similarly, any association formed for the purpose of carrying on any other business for profit and consisting of more than twenty persons in order to be a legal association, should be registered as above. If it is not registered as above, the association will be regarded as an 'illegal association' even if none of the objects for which the association has been formed is illegal.

Now imagine the situation where an unregistered association is formed for carrying on the business of banking with nine members. Subsequently, two more persons join the association as members. What will be the effect of their joining the association? Your answer would be that the association would become an illegal association from the moment the number of members exceed ten. For the purpose of computing the number of persons, each individual forming the association or partnership shall be counted as one. *When we say person, we mean an individual and not bodies of individuals.* Now suppose an association is formed between three partnership firms A, B and C. Firms A and B have four partners each and firm C has three partners. Will the association fall within the purview of Section 11 and require registration? Yes, the association would require registration because the total number of members has exceeded ten.

From the above description you may conclude that the limit on maximum number of members is applicable only if the association is to carry on business for profit. This restriction is not applicable if the association is formed for non-commercial purposes such as associations formed for promoting religion, science, art or charity etc.

1.9.2 Exceptions

Section 11 does not apply in the following cases:

i) **Joint Hindu Family:** A joint Hindu family may carry on any business, even for earning profits and with any number of members without being registered in pursuance of any Indian Law as required by Sec. 11 of the Companies Act, 1956 and yet it will not be an illegal association. But, where two joint Hindu families join hands to carry on business, the provisions of Section 11 became applicable. However, for computing the number of members of such an association, the minor members of such families shall not be included.

ii) **Stock exchange:** A stock exchange is not covered by Section 11 as it is not formed for the purpose of carrying on any business.

iii) **Non-profit earning associations:** All religious, charitable, literary, social, sports and other associations whose object is not to make profit are also not covered by Section 11.

1.9.3 Consequences

The consequences of an illegal association are as follows:

1 Every member shall be personally liable for all liabilities incurred in such business.

2 An illegal association cannot sue to recover any of its debts or any other property. Likewise, no suit can be filed against an illegal association to recover money lent to it. However, a suit can be filed against every member of an illegal association. A suit cannot be filed even if the association is subsequently registered as a company.

3 Every person who is a member of such an association shall be punishable with fine which may extend to one thousand rupees.

4 An illegal association cannot be wound up under the Companies Act.

5 No suit can be filed by any member for partition, dissolution or for taking account of an illegal association.

6 Since an illegal association has no legal existence, it cannot enter into a contract.

7 The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members.

Check Your Progress C

1 What is a statutory company?

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2 What is meant by a registered company?

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3 What is meant by a company limited by guarantee?

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4 What is a Government Company?

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5 What do you mean by 'Illegal Association'?

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6 Fill in the blanks.

a) An incorporated company can come into existence as a chartered company, as a statutory company and as .... company.

b) In a company limited by guarantee, a member is required to pay the guaranteed sum only if the company is wound up while he is member or within........................... year after he ceases to be a member.

c) A Government company is one in which not less than........................... per cent of the paid up share capital is held by the Central Government.

d) An auditor for a government company is appointed by the Central Government on the advice of the ....

e) A foreign company which establishes a place of business in India after the commencement of the Companies Act, 1956, shall deliver to the Registrar of Companies, necessary documents for registration within........................... days of establishing the place of business in India.

f) Under Section.............................. of the Act, any association created not for profit may be exempted by the Central Government and be registered with limited liability without using the word 'limited' as its last word.

g) An association of persons formed for carrying on 'any other business' for gain should not consist of more than.. persons as its members.

7 State whether the following statements are True or False.

a) Once a company has been registered as an unlimited company it cannot be converted into a limited company without dissolving the company.

b) A government company is not governed by the provisions of the Companies Act, 1956.

c) In a government company, company's paid up share capital can be held partly by the Central Government and partly by one or more State Governments.

d) A Foreign company may carry on business in India even without establishing a place of business in India.

e) A foreign company is a company registered in India and carries on its business in a foreign country.

f) In case of a holding company and a subsidiary company both companies continue to enjoy separate legal status.

g) A private company which is a subsidiary of a public company is, for all practical purposes, treated like a public company.

h) An association of persons formed for carrying on banking business can be formed with a maximum of twenty persons as its members.

i) A partnership firm can be a member of an illegal association.

j) An illegal association has no independent personality.

1.10 LET US SUM UP

The term 'company' means an association of persons for some common object, which may be for carrying on some business for profit or for some charitable purposes. The Companies Act, 1956 defines a company as "a company formed and registered under the Act or an existing company". An 'existing company' means a company formed and registered under earlier Companies Act.

The essential features of a company are as follows:-

i) It is an artificial person created by law.

ii) It has an independent legal entity.

iii) The liability of members of a company is limited to the unpaid value of shares held by them or the amount guarantee by them.

iv) A company has a perpetual succession i.e., the existence of a company is not affected by the death or insanity of a shareholder.

v) Its shares are freely transferable.

vi) The company, being a juristic person, must have a common seal.

vii) A company can own and dispose off property in its own name. Although the shareholders are the owners of the company, the money and property belong to the company and not to the shareholders.

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

Thus, a company differs from a partnership firm in various ways.

A one-man company or a family company is one where almost the whole share capital is held by a single person who takes a few dummy members simply to meet the provisions of the Act regarding the minimum number of members. The company is a legal person distinct from its members. There is a veil, known as corporate veil, between the company and its members. Sometimes, it may become necessary to pierce this veil and look at the persons behind the company. This is known as "lifting or piercing the corporate veil". The circumstances and cases in which the corporate veil may be lifted can be classified under the following two heads:

(A) under express statutory provisions; and

(B) under Judicial interpretation.

(A) **Under express statutory provisions**

i) When the number of members falls below the statutory minimum.

ii) When the person acting for the company fails to disclose his representative capacity.

iii) When the relationship of a holding and a subsidiary company is to be established.

iv) For investigation into affairs of related companies.

v) For investigation of the ownership of a company.

vi) For knowing whether there is any fraudulent conduct of business.

(B) **Under judicial interpretation**

i) For determination of the character of the company.

ii) For prevention of fraud and improper conduct.

iii) For protection of revenue.

iv) Where company is formed to act as an agent of its members.

v) For avoidance of welfare laws.

Kinds of Companies: Companies may be classified into the following categories: (i) Chartered companies, (ii) Statutory companies, and (iii) Registered companies. A registered company may be either a company limited by shares or a company limited by guarantee or an unlimited company. Such company may, either be a private company or a public company. Foreign companies are those which are incorporated outside India, but have a place of business in India.

A company is deemed to be the holding company of another, if that other is its subsidiary. A company is deemed to be a subsidiary of another company only if:

i) the other company controls the composition of its board of directors;

ii) the other company holds more than half of the nominal value of its equity share capital; or

iii) it is a subsidiary of any other company which, in turn, is the subsidiary of holding company.

Illegal Associations: An association which is formed with more than ten persons in case of banking or more than twenty persons in case of any other business not registered under the Companies Act, 1956, must be regarded as an illegal association. However, a joint Hindu family carrying on a business, a stock exchange, non-profit carrying associations are not illegal associations. Every member of an illegal association shall be personally liable for all liabilities incurred in such business.

1.11 KEY WORDS

Company: An association of persons registered under the companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

Chartered company: A company which is incorporated under a special Royal Charter granted by the King or Queen of England.

Statutory company: A company which is created by a special Act of Parliament or State Legislature.

Company limited by shares: A company having the liability of its members limited to the value of shares held by them.

Company limited by guarantee: A company having the liability of its members limited to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

Government company: A company in which not less than 51 per cent of the paid up capital is held by the Government.

Private limited company: A company which by its articles (a) restricts the right to transfer its shares, (b) limits the maximum number of its members to fifty excluding its employees, and (c) prohibits the invitation to the public to subscribe to its shares or debentures.

Public limited company: A company which is not a private limited company.

Unlimited company: A company in which the liability of the members is unlimited.

Perpetual succession: Continued existence irrespective of the life or sanity of its members.

Foreign company: A company incorporated outside India but having a place of business in India.

Corporate veil: A line of demarcation or a veil is drawn between the company and its members.

1.12 ANSWERS TO CHECK YOUR PROGRESS

A 4 i) True, ii) True iii) False, iv) False v) True vi) True vii) True viii) True

B 4 a) Independent, legal

b) two, seven

c) representative

d) enemy character

e) express statutory provisions

f) unlimited

5 i) True ii) False iii) False iv) False v) True vi) True vii) True

C 6 a) registered
b) one
c) fifty one
d) Auditor General of India
e) thirty
f) 25
g) 20

7 a) False b) False c) True d) True e) False f) True g) True h) False i) True. j) True.

1.13 TERMINAL QUESTIONS

1. "Company is an artificial person created by law with a perpetual succession and is different from the personality of the member constituting it'. Comment.
2. Discuss the concept of corporate veil. Under what circumstances can this veil be lifted?
3. Distinguish between a company and a partnership.
4. Describe the characteristics of a company.
5. Discuss the circumstances in which lifting of corporate veil is justified
6. What are the different types of companies which may be incorporated under the Companies Act.

7 Write a comprehensive note on government company.

8 Describe special provisions relating to a foreign company.

9 Distinguish between a holding company and a subsidiary company. When can a company be called a subsidiary of another company? Illustrate.

10 Discuss the salient characteristics of an illegal association. What are the consequences of forming such an association?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 2 PUBLIC AND PRIVATE COMPANIES

Structure

2.0 Objectives
2.1 Introduction
2.2 Meaning of a Private Limited Company
2.3 Meaning of a Public Limited Company
2.4 Distinction Between a Private Company and a Public Company
2.5 Privileges of a Private Limited Company
2.6 Exemptions Available to an Independent Private Company
2.7 Restrictions on a Private Company
2.8 Conversion of a Private Company into a Public Company
2.9 Conversion of a Public Company into a Private Company
2.10 Let Us Sum Up
2.11 Key Words
2.12 Answers to Check Your Progress
2.13 Terminal Questions

2.0 OBJECTIVES

After studying this unit you should be able to:

- define a private and a public limited company,
- distinguish between private and public companies,
- describe the privileges enjoyed by a private limited company,
- explain the restrictions imposed on a private company,
- describe how a private company is converted into a public company and vice versa, and
- explain the conditions under which a private company is deemed to be a public company.

2.1 INTRODUCTION

In Unit 1 you learnt about the definition of a company, its main features, and the various types of companies that can be formed. A registered company, whether limited by shares or by guarantee, can either be a private limited company or a public limited company. In this unit, you will learn the meaning of a private limited company, its distinction from a public limited company, the privileges enjoyed by private companies and the restrictions imposed on them. You will also study the ways in which a private company is converted into a public company and the steps to be followed for converting a public company into a private company.

2.2 MEANING OF A PRIVATE LIMITED COMPANY

Under Section 3(1) (iii) of the Companies Act of 1956, a private limited company has been defined as a company which, by its Articles of Association (a) restricts the right to transfer its share if any, (b) limits the number of its members to fifty, and (c) prohibits any invitations to the public to subscribe for any shares in, or debentures of, the company.

Let us now discuss the implications of each of these restrictions.

a) **Restriction on the right of members to transfer their shares.** The articles of association of a private company must specifically have a provision restricting the right of the members to transfer their shares, if any. It means that the shares of a private company are not as freely transferable as those of the public companies. But it does not mean that the shares of a private company cannot be transferred at all. The articles generally provide that whenever a member of a private company desires to transfer his shares, he must offer them to the existing members at a price

to be determined by the directors. This restriction is placed so as to preserve the family nature of the company's members. That is why a private company is sometimes called a 'closed corporation. The Act, however, does not specify the manner in which this restriction is to be imposed. You should note that a private company having no share capital need not contain this restriction in its articles.

b) **Restriction on maximum number of members:** A private limited company is also required to limit the maximum number of its members to fifty. It means that the number of members in a private company can be between two and fifty, two being the statutory minimum required for the formation of a private company. While counting the members the following are not to be included:

   i) persons who are in the employment of the company and by virtue of their employment happen to be members of the company, and

   ii) persons, who, having been in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased. It is also provided that where two or more persons hold one or more shares of the company jointly, they shall be treated as a single member for the purpose of counting the number.

c) **Prohibition on invitation to public:** This restriction implies that a private limited company must not issue a prospectus or any other public invitation, directly or indirectly to the general public so as to invite them to invest in its shares or debentures. The question arises as to how would one ascertain whether an invitation made by the company is in the nature of public invitation or not. The public may include any section of the public whether selected as members or the debenture holders of the company or as customers of the person issuing the prospectus, or in any other manner. The invitation cannot be treated as one made to the public when it can, under all circumstances, be properly regarded as a domestic or private concern of the persons making the invitation and those receiving it.

In simple words, it means that a private company cannot issue any invitation to the public. It has to make its own private arrangement to raise its capital or loan.

You should note that since the above mentioned three restrictions must be contained in the articles of a private limited company, it is necessary for a private company to frame its own articles. In case a private company is a limited company, then it must add the words 'Private Limited' at the end of its name. A private company may be (a) a company limited by shares or (b) a company limited by guarantee, or (c) an unlimited company. If a private company does not comply with any of the restrictions contained in the articles, it ceases to enjoy some of the privileges granted to a private company.

2.3 MEANING OF PUBLIC LIMITED COMPANY

According to Section 3(1) (iv) of the Companies Act, a public limited company means a company which is not a private company. In Section 2.2 of this unit you learnt about the restrictions imposed on a private company. Thus, it can be said that a public company is one, the articles of which do not contain these restrictions. In other words, a public company is one which does not impose any restrictions on the right of the members to transfer their shares, does not restrict the maximum number of members, and which can invite general public to subscribe for its shares. Thus, any member of the public can acquire shares or debentures of a public company. The shares of a public company can be traded on a stock exchange. It should be noted that the minimum number of members in a public company must be seven.

A public company, like a private company, can also be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.

2.4 DISTINCTION BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

Having learnt the meaning of a private company and a public company, you should

now be able to distinguish between the two. The following are the main points of difference between a private company and a public company:

1 **Minimum number:** For the formation of a public company you require atleast seven members, while the minimum number of members required for forming a private company is only two.

2 **Maximum number:** In the case of a public company there is no restriction on the maximum number of members, but in the case of a private company the maximum number must not exceed fifty.

3 **Name:** The name of a public company limited by shares or guarantee must end with the word 'Limited' whereas the name of a private company limited by shares or guarantee must end with the words 'Private limited'.

4 **Transferability of shares:** The shares of a public company are freely transferable, whereas in a private company the right to transfer the shares is restricted by the articles of association.

5 **Invitation to the public:** A public company, after issuing a prospectus or a statement in lieu of prospectus, invites the general public to subscribe for its shares or debentures. But a private company cannot invite public to subscribe for its shares or debentures, as its articles prohibit any such invitation to the public.

6 **Commencement of business:** A private company can commence its business soon after obtaining the certificate of incorporation, but a public company can commence business only after obtaining the certificate of incorporation as well as the certificate to commence business.

7 **Documents:** The memorandum of association and articles of association of a public company should be signed by seven members, while in case of a private company, they are required to be signed by two members. If a public company chooses not to prepare its own articles of association and instead chooses to adopt 'Table A' of the Companies Act as its articles of association, it can do so, but, a private company has to compulsorily frame its own articles of association because it is by this document alone that the company places some statutory restrictions.

8 **Allotment of Shares:** No public company can allot shares until the amount of minimum subscription has been received by the company. No such restriction is applicable in case of a private company. A private company can allot shares immediately after incorporation.

9 **Share Warrant:** A public company can issue bearer share warrants. But a private company cannot issue share warrants.

10 **Statutory meeting:** A public company must hold a statutory meeting and file a statutory report with the Registrar of companies. A private company is neither required to hold the statutory meeting nor file a statutory report with the Registrar.

11 **Directors:** A public company must have at least three directors whereas a private company must have at least two directors. The director of a public company must file with the Registrar a written consent to act as a director. He is also required to sign the memorandum and enter into a contract for their qualification shares, while the directors of a private company need not do any such thing.

Two thirds of the total number of directors of a public company must retire by rotation, while the directors of a private company are not liable to retire by rotation, they may be appointed as permanent life directors. In case of a public company, no loan can be given to its directors without the approval of the Central Government, but directors of a private company can borrow from their company without the approval of the Central Government.

Any director of a public company, if he has any interest in the subject matter which is being discussed in a meeting, cannot participate in the Board's proceedings nor can be vote on that issue. But in case of a private company, the interested director can participate in the meeting. He is also entitled to cast his vote.

12 **Special privileges:** A private company enjoys some special privileges, but a public company enjoys no such privileges.

13 **Quorum:** In the case of a public company, there must be at least five members personally present for holding the company meeting, but in a private company, this number is two.

14 **Managerial remuneration:** In case of a public company total managerial remuneration cannot exceed eleven per cent of the net profits. This restriction is not applicable to a private company.

Check Your Progress A

1 Define a private limited company.

....

....

....

....

2 What is a public limited company?

....

....

....

....

3 Give four important distinctions between a public and a private company.

....

....

....

....

4 Fill in the blanks.

a) A private company must have atleast .... members and at the most .... members.

b) A private company cannot issue a .... to its members.

c) A public limited company must hold a .... meeting within the first six months of its incorporation.

d) A.............................. company can commence its business only after obtaining a certificate of commencement of business.

e) At least .... directors of a public company must retire by rotation.

5 State whether the following statements are true or false.

i) The minimum number of members in a public company is seven.

ii) A public company need not issue a prospectus or a statement in lieu of prospectus before issue of its shares.

iii A public company can be registered without the Articles of Association.

iv) A private company must obtain the certificate to commence business before alloting its shares.

v) The memorandum of association of a private company needs to be signed by only two members.

vi) A company is called a private company because it restricts the transfer of shares.

vii) A public company must have at least five directors.

viii) A private company need not hold statutory meeting.

2.5 PRIVILEGES OF A PRIVATE LIMITED COMPANY

You know that in a public company a large amount of public money is invested.

Therefore, there is greater need to protect their interests by framing strict rules. But in a private company, the membership is usually restricted to the promoters, their friends and relatives. It raises its capital privately from a limited number of members. The members of the public are not substantially interested in such companies. Therefore, many of the provisions of the Companies Act are not applicable to a private company. Thus, a private company is granted a number of exemptions or privileges. These are as follows:

1 **Number of members:** A private company can be formed with only two members.

2 **Commencement of business:** A private company can start its business immediately after its incorporation.

3 **Minimum subscription:** A private company can allot shares without waiting for the minimum subscription to be received.

4 **Prospectus:** A private company need not issue a prospectus or file with the Registrar of companies a statement in lieu of prospectus before allotment of its shares.

5 **Assistance for purchase of shares:** A private company can help its prospective member or members financially for the purchase of its own shares.

6 **Subsequent issue of shares:** A private company is not required to offer further shares first to the existing shareholders i.e., it can issue further shares even to the outsiders.

7 **Statutory meeting and report:** A private company need not hold a statutory meeting or file a statutory report with the Registrar of companies.

8 **Provisions regarding directors:** A private company may have a minimum of two directors. They need not file their consent to act as such with the registrar. They need not hold qualifying shares.

9 **Quorum:** Only two members who are personally present at the general meeting of shareholders shall form the quorum, unless otherwise provided in the articles.

10 **Demand for Poll:** If a resolution is being discussed in a meeting and the number of members is seven or less than seven a poll may be demanded by only one member. If more than seven members are present, such a poll may be demanded by only two members.

11 **Managerial remuneration:** The restriction on the managerial remuneration i.e. 11 per cent of net profit is not applicable to a private company.

2.6 EXEMPTIONS AVAILABLE TO AN INDEPENDENT PRIVATE COMPANY

The various privileges discussed in Section 2.5 above are available to every private company whether it is a subsidiary of a public company or a private company 'deemed to be a public company' (discussed in Section 2.9 of this unit). But such companies do not enjoy many of the privileges which are enjoyed by an independent private company. An independent private company has the following additional privileges.

1 **Kind of Shares:** An independent private company can issue any class of shares in such forms and with such voting rights as it deems appropriate. Even shares with disproportionate voting rights can be issued.

2 **General meetings:** A private company, if it so desires, can exclude the provisions of Companies Act in respect of general meetings. Through its articles, it can formulate its own provisions to regulate its general meetings. These provisions may relate to the notice of the meetings, quorum, chairman, proxy, voting and demand for poll.

3 **Exemption regarding managerial remuneration:** The restrictions imposed by the Companies Act regarding the remuneration of directors are not applicable to an independent private company. It is also not necessary for such companies to obtain sanction of the Central Government to increase the remuneration of directors.

4 **Appointment of a firm or body corporate to any office of profit:** The restrictions regarding the appointment of a firm or body corporate to a place of profit under the company do not apply to an independent private company.

5 **Increase in the number of directors:** A public company and a private company which is subsidiary of a public company is required to obtain the approval of the Central Government before increasing the number of its directors beyond the maximum number mentioned in the articles. No such approval is required in case of an independent private company.

6 **Filling of casual vacancies:** The regulations in respect of filling the casual vacancies in the Board of Directors do not apply to an independent private company.

7 **Disqualification of directors:** The independent private company may, by its articles, provide special grounds for disqualifications for appointment of directors.

8 **Qualification shares:** Directors of public companies and private companies which are subsidiaries of a public company are required to obtain their qualification shares within six months of their appointment to the office of the director. This provision as well as the one relating to the maximum amount (Rs. 5,000) of qualification shares do not apply in case of an independent private company.

9 **Number of companies:** A person can be the director of any number of independent private companies. The provisions of the Act limiting the number of companies to be managed by a director to twenty, do not apply to it.

10 **Restrictions on loans:** The provisions of the Act laying down restrictions on loans or guaranteeing the loans or providing security for loan to any of its director, do not apply to an independent private company.

11 **Inter company loans:** An independent private company can lend money to other companies under the same management.

12 **Intercorporate purchase of shares:** The provisions prohibiting the purchases of shares and debentures of other companies in the same group do not apply to such a company.

13 **Power of Central Government in respect of Board of Directors:** Under the Company Law, the Central Government has been given the power to prevent any changes in the Board of directors, which may prejudicially effect the interests of the company. Independent private companies are exempt from such provisions.

You should however, note that the above privileges and exemptions can be enjoyed by an independent private company so long as it remains as such. The moment a private company fails to comply with any of the three restrictions contained in its articles or it becomes a subsidiary to a public company, it shall lose these special privileges.

Check Your Progress B

1 State whether the following statements are True or False.

i) A private company must have at least three directors.

ii) The prospectus of a private company must be filed with the Registrar of Companies five weeks before the allotment of shares.

iii) A private company can start business immediately after incorporation.

iv) An independent private company places no restrictions on the amount of managerial remuneration payable to its directors.

v) An independent private company can issue only equity and preference shares.

2 Choose the most appropriate shares

a) A private company may allot shares

i) within five weeks of filing of the prospectus.

ii) within three days of filing statement in lieu of prospectus.

iii) without issuing a prospectus or a statement in lieu of prospectus.

b) Provision relating to the powers of Central Government to prevent changes in the Board of Directors do not apply to

i) a public company.

ii) a private company which is a subsidiary of a public company.

iii) an independent private company.

2.7 RESTRICTIONS ON A PRIVATE COMPANY

Alongwith the privileges available to a private company, some restrictions have also been placed. You have learnt about the three restrictions placed on a private company by its articles viz., (a) restriction on the right to transfer shares, (b) restriction on the maximum number of the members exceeding fifty, and (c) prohibition on invitation to the public for investment in its shares or debentures. Besides these, a private company is also subject to the following restrictions:

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

ii) Under Section 159 private companies are required to send an annual list of their members and a summary of certain particulars to the Registrar of companies. A private company, is also required to send with this return, a certificate, certifying that the company has not, since the last return, made any public invitation inviting the public to subscribe for its shares or debentures. It is also required to certify that where the annual return shows the number of members of the company exceeds fifty, the excess consists of those persons who are not to be included in counting the number of fifty.

iii) A private company is also annually required to certify to the Registrar that since the last annual general meeting, (a) no body corporate has held twenty-five per cent or more of its paid up share capital, (b) the company itself did not hold twenty-five per cent or more of paid up capital of one or more public companies, (c) its average annual turnover during the preceding three years did not exceed ten crore rupees, and (d) the company did not accept or renew deposits from the public.

iv) The member of a private company is not allowed to appoint more than one proxy to attend and vote at a meeting of the company.

2.8 CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

A registered company may choose to be a public or a private company depending upon the restrictions it wants to place upon itself or the privileges it wants to enjoy. A private company, after incorporation, may get itself converted into a public company either by its own choice or by a default in meeting the provisions of Section 3 (i) (iii). In addition, there are certain circumstances under which a private company, inspite of following all the restrictions mentioned in Section 3(1) (iii) is deemed to be a public company by operation of law. Let us now discuss the ways in which a private company, by choice or by default, gets converted into a public company.

Conversion by Choice: A private company may itself choose to become a public company. The procedure for conversion is laid down in Section 44 of the Indian Companies Act. It is as follows:

i) The company must call a meeting of its Board of Directors to consider and approve the proposal to convert the company into a public company.

ii) In accordance with the decision of the Board, the company must convene a general meeting at which the company must pass a special resolution altering its articles of association. The articles must be altered in such a way that they no longer contain the restrictions of Section 3(1) (iii); as well as all the provisions which may be inconsistent with the requirements of a public company. The name of the company would also be altered by deleting the word 'private' from the name of the company.

iii) Within thirty days of the general meeting at which the special resolution is passed, the company must file the following documents with the Registrar of companies.

   a) a copy of the special resolution regarding alteration of the articles,

   b) a copy of the altered articles, and

   c) a copy of the prospectus containing the information required in accordance with Part I and II of Schedule II of the Companies Act or a statement in lieu of prospectus in the prescribed form.

iv) If the number of members in the private company is less than seven, the company must increase the number of members to seven. Similarly the number of directors must be increased to at least three.

v) After filing the copy of resolution and the prospectus or statement in lieu of prospectus, the company must apply to the Registrar for a fresh certificate of incorporation. The company generally enters into fresh agreements with its managerial personnel just before conversion.

The company becomes a public company from the date on which the special resolution is passed. However, the change in its name becomes effective only on the issue of fresh certificate of incorporation. Your must note that on such conversion no new company comes into existence. This conversion does not affect the legal personality of the company which continues to remain the same. Such conversion does not, in any way, extinguishes the liability of the company i.e., its liability remains the same as it was before conversion.

Conversion by default: You have learnt that a private company is one which places certain restrictions on itself by its articles of association. If it makes a default in complying with the provisions of Sec. 3(1) (iii), then it ceases to be a private company and is treated as a public company. Then the special privileges are not available to the company. All the provisions of a public company shall become applicable to it as if it was a public company. It must however, be remembered that the court has been given the power to grant relief in cases where it is satisfied that the default in respect of the provisions of Section 3(1) (iii) was purely accidental and not intentional.

Deemed to be public company

Under the Indian Companies Act 1956, the private companies enjoy certain privileges primarily on the ground that they are closely held corporate bodies where funds of a limited number of persons are involved. Since public money is not involved, the law does not provide for as stringent a scrutiny of the affairs of a private company as it does in the case of a public company where public money is directly involved.

It may, however, happen that, over a period of time, private companies may, through their enterprise and investments, engage in extensive business and may actually be in a position to control many public companies. At times, other private and public companies may invest their funds in such a private company. In an indirect way, therefore, public money gets invested in the private companies. There is no reason why such companies should still be allowed the privileges given to private companies. The Companies Act has provided for such contingencies by making specific provisions. These provisions are mainly contained in *Section 43-A of the Act. Section 43-A provides that if a private company operates on a large scale or in some way takes advantage of or utilises public money, it will be deemed to be a public company.* All the provisions of the Act applicable to a public company shall then become applicable to such a private company. However, if such a company wants, it may continue with the three restriction of Section 3(1) (iii) in its articles and the number of its members may continue to be less than seven.

The circumstances described in Section 43-A under which a private company is deemed to be a public company are:

i) When twenty-five per cent or more of its paid up share capital is held by one or more bodies corporate, a private company shall automatically become a public company on and from the date on which the percentage mentioned above is so held. While calculating the percentage of paid up share capital, the shares held by a bank in the capacity of a trustee or executor of a deceased member will not be counted. According to the explanation given under Section 43-A the term "bodies corporate" means public companies, or private companies which have become public companies by virtue of this section.

ii) Where the average annual turnover of a private company is rupees ten crore or more during the period of three consecutive financial years, the company will be deemed to be a public company on the expiry of a period of three months from the last day of the third financial year during which the company had attained the average annual turnover of the said amount. The term turnover here has been defined as "the aggregate value of realisation made from the supply of distribution of goods or on account of services rendered, or both, by the company during a financial year".

iii) Where a private company holds twenty-five per cent or more of the paid up share capital of a public company, it will become a public company on, and from the date, on which the above mentioned percentage was first held by the private company.

iv) Where a private company invites, accepts or renews deposits from the public, other than from its members, directors or relatives, it shall become a public company. By the inclusion of a new sub-section (1-C) from 1988, Section 43-A provides that if a private company, after an invitation is made by an advertisement, accepts or renews deposits from the public, such private company shall become a public company from the date on which such an acceptance or renewal is first made. After that date all the provisions of Section 43-A shall apply to such a deemed public company.

A private company which becomes a public company under any of the above circumstances by virtue of Section 43-A is termed as a 'deemed public company'. Again such a company may carry on with just two directors and less than seven members. A deemed public company shall continue to be a public company, till it has, with the approval of the Central Government and in accordance with the provisions of the Act, again become a private company. Section 43-A further provides that every private company which becomes a deemed public company under this section will inform the Registrar within three months of such conversion that it has become a public company. On being so informed, the Registrar will delete the word 'private' from the name of the company in the register of companies. He will also make necessary alterations in the certificate of incorporation and the memorandum of association of the company. If a company fails to comply with this provision, the company and every officer of the company who is guilty of default shall be punishable with a fine extending upto rupees five hundred for every day of default.

To sum up, we may say that Section 43-A creates a special type of public company (a deemed public company). The special features of such a public company are that the number of its members may be below seven and its articles may continue to have the restrictions of Section 3(1) (iii) which pertains to a private company. The Central Government if it so directs, may exempt the profit and loss account of such company filed with the Registrar from being open to public inspection. Like any other private company, the deemed public company may have only two directors. Further, unless a deemed company raises subscription from the public, the requirement of filing a statement in lieu of prospectus with the Registrar, does not apply. In all other respects a deemed public company is treated as a public company.

2.9 CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

You have learnt that under certain circumstances a private company gets converted into a public company. Similarly, a public company may also be converted into a private company. While the law does not lay down a specific procedure for the conversion of a public company into a private company, it does not prohibit such a conversion. A public company by altering its articles in such a manner that the three restrictions mentioned in Section 3(1) (iii) are incorporated, may get itself converted into a private company. Such an alteration may be effected by passing a special resolution in the general meaning of the company. Such a resolution would also be needed to alter the name of the company. Similarly, some alterations would also be necessary in the articles of association to make them relevant to a private company.

Section 31 of the Act specifically provides that any alteration made in the articles which has the effect of converting a public company into a private company, shall be effective only when it is approved by the Central Government. When the special resolution in respect of the alteration has been approved by the Central Government, a printed copy of the articles, as altered should be filed with the Registrar within one month of the receipt of the order of approval.

After such a conversion of a public company into a private company, it will have to reduce the number of its members and add the word 'Private' at the end of its name. After it is duly converted into a private company, it shall enjoy all the privileges of a private company.

Check Your Progress C

1 Tick the most appropriate answer to the following questions.

a) A deemed public company is

i) a private company which does not follow restrictions prescribed in Section 3(1) (iii) of the Company's Act.

ii) a private company which chooses to get converted into a public company.

iii) a private company which become a public company by virtue of Section 43-A.

iv) None of the above

b) The members of a private company

i) cannot send a proxy to attend and vote at the company's meeting.

ii) can send as many proxies as he wants to attend and vote at the company's meeting.

iii) can send only one proxy to attend and vote at the company's meeting.

c) In case of conversion of a private company into a public company by choice, the company

i) can continue with two directors and less than seven members.

ii) must increase the number of members to at least seven but can continue with two directors.

iii) must increase the number of directors to three but can continue with less than seven members.

2 State whether the following statements are True or False.

i) For conversion of a public company into a private company no specific procedure has been laid down in the Act.

ii) The special resolution altering the articles so that a private company is converted into a public company, can be passed only at a general meeting.

iii) A copy of the special resolution altering the articles must be filed with the Registrar within three months of passing the resolution.

iv) In case of conversion by choice, a private company becomes a public company on the date of issue of new certificate of incorporation.

v) If 30 per cent of the paid up share capital of a private company is held by a public company, it becomes a deemed public company.

vi) As soon as a private company becomes a deemed public company, it will have to raise the number of its members to at least seven.

vii) Within three months of becoming a deemed public company, the private company so converted will have to notify the Registrar of this fact.

viii) A deemed public company may continue to follow the restrictions imposed by Section 3(1) (iii) of the Act.

ix) A deemed public company need not change its name after conversion.

x) Conversion of a private company to public and vice-versa, does not effect the legal identity of the company.

2.10 LET US SUM UP

From the point of view of the general public and on the basis of number of members, a company may either be a public company or a private company. A private company is one which, by its articles of association, restricts the right of its members to transfer shares, restricts the number of members to fifty and prohibits invitation to the public to subscribe for its shares or debentures. The Act has granted certain privileges to private companies and they are not subject to legal scrutiny as the public companies are. Some additional privileges have been given to independent private companies. These are not available to a private company which is a subsidiary company of a public company or which is deemed to be a public company.

A company which is registered initially as a private company, may be converted into a public company. Such a conversion may be by choice, or by default or by operation of law. When a private company gets converted into a public company by operation of law under Sec. 43-A, it is called as 'deemed public company'. When a private company becomes a public company, it loses the special privileges.

Just as a private company may become a public company, a public company by altering its articles and obtaining the approval of the Central Government, can also become a private company. However, conversion of a company from private to public and from public to private does not affect the legal identity of the company.

2.11 KEY WORDS

Private company: a company which by its articles (a) restricts the right of the members to transfer shares, (b) restricts the maximum number to fifty, and (c) prohibits invitation to the public to subscribe to its shares or debentures.

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

Proxy: a right by which another person can attend and vote at the meetings of the company.

Share: units in which the total capital of the company is divided.

Share warrant: a document the bearer of which is the owner of the number of shares mentioned therein.

Quorum: Minimum number of persons who should be personally present to conduct the meeting.

2.12 ANSWERS TO CHECK YOUR PROGRESS

A 4 (a) two, fifty (b) share warrant (c) statutory (d) public (e) two thirds
5 (i) True (ii) False (iii) True (iv) False (v) True (vi) True (vii) False (viii) True

B 1 (i) False (ii) False (iii) True (iv) True (v) False
2 (a) iii (b) iii

C 1 (a) iii (b) iii (c) i
2 (i) True (ii) True (iii) False (iv) False (v) True (vi) False (vii) True (viii) True (ix) false (x) True

2.13 TERMINAL QUESTIONS

1. Define a private company. Distinguish between a private company and a public company.
2. Discuss various privileges enjoyed by a private company. Why does law grant these privileges to a private company?
3. Enumerate the various restrictions imposed by law on a private company.
4. Describe the procedure for converting a private company into a public company.
5. Define a public company. Describe the procedure for converting a public company into a private company.
6. Section 43-A of the Companies Act creates a new class of company, a deemed public company. Describe the circumstances under which a private company shall become a deemed public company.
7. A private company need not issue a prospectus? Why?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 3 PROMOTERS

Structure

3.0 Objectives
3.1 Introduction
3.2 Promoter : Meaning and Importance
3.3 Functions of a Promoter
3.4 Legal Position of Promoters
3.5 Duties of Promoters
3.6 Liabilities of Promoters
3.7 Remuneration of Promoters
3.8 Position of Preliminary Contracts
3.9 Let Us Sum Up
3.10 Key Words
3.11 Answers to Check Your Progress
3.12 Terminal Questions/Exercises

3.0 OBJECTIVES

After studying this unit you should be able to:

- explain the meaning and importance of promoters,
- describe the functions of a promoter,
- enumerate duties and liabilities of a promoter,
- describe remuneration payable to promoters, and
- explain the position of preliminary contracts.

3.1 INTRODUCTION

In Unit 1 you learnt about the various types of companies that can be formed. The formation of a company is a lengthy process, involving different stages. The first stage in the process of formation of a company is the 'promotion'. At this stage the idea of carrying on a business is conceived by a person or by a group of persons called promoters. For incorporating a company various formalities are required to be carried out. The promoters perform these functions and bring the company into existence. In this unit you will learn about the meaning and functions of promoters, their legal position and their duties. You will also learn about the position of pre-incorporation contracts.

3.2 PROMOTER : MEANING AND IMPORTANCE

You learnt that a company is an artificial person created by law. A company is born only when it is duly incorporated. For incorporating a company various documents are to be prepared and other formalities are to be complied with. All this work is done by promoters. Gerstenberg has defined promotion 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.* After the idea is conceived, the promoters make detailed investigations to find out the weaknesses and strong points of the idea, determine the amount of capital required and estimate the operating expenses and probable income. On being satisfied about the economic viability of the idea, the promoters take all the necessary steps for incorporating the company.

The Companies Act does not define the term promoters anywhere, it only refers to the liabilities of the promoters. A number of judicial decisions have defined the term promoter. According to *L.J. Bowen, the term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial word by which a company is generally brought into existence.*

Another definition given by Lord Blackburn states that "the term promoter is a short

and convenient way of designating those who set in motion the machinery by which the Act enables them to create an incorporated company".

Justice C. Cockburn described a promoter as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose."

A company may have more than one promoter. The promoter may be an individual, firm, an association of persons or a body corporate. Even if a person has taken a very minor part in the promotion activities, he may still be a promoter. But a person cannot be held as promoter merely because he has signed at the foot of the memorandum or that he has provided money for the payment of formation expenses.

It is, however, important for you to remember that everyone who is associated with the process of the formation of a company cannot be called a promoter. For example, a solicitor who draws up the documents of the proposed company in his professional capacity is not a promoter in the eyes of law. Similarly, an engineer who advises on the selection of site or a valuer who helps with drawing the estimates would not be regarded a promoter. Section 62 (6) makes it clear that persons assisting the promoters by acting in a professional capacity e.g., solicitors, accountants and other experts are not promoters.

From the above it should be clear to you that *a promoter is one who performs the preliminary duties necessary to bring a company into existence.* Thus, the true test to describe a person as a promoter lies in finding out whether he is keen to form a company and take steps to give it a concrete shape.

The promoters, in fact, render very useful services in the formation of a company. They render a very useful service to society and they play an important role in the industrial development of countries. A promoter has been described as 'a creator of wealth' and 'an economic prophet'. The promoters carry considerable risk because if the idea sometimes goes wrong then the time and money spent by them will be a waste.

3.3 FUNCTIONS OF A PROMOTER

You learnt that a promoter plays a very important role in the formation of a company. You have also noted that a promoter may be an individual, an association or a company. In their capacity of promoters, they perform the following functions in order to incorporate a company and to set it going.

i) **To originate the scheme for formation of the company** : Promoters are generally the first persons who conceive the idea of business. They carry out the necessary investigation to find out whether the formation of a company is possible and profitable. Thereafter, they organise the resources to convert the idea into a reality by forming a company. In this sense, the promoters are the originators of the plan for the formation of a company.

ii) **To secure the cooperation of the required number of persons willing to associate themselves with the project** : The promoters, in accordance with whether they want to incorporate a private or a public company, try to secure the co-operation of persons needed to form the company. You learnt that the minimum number of members required to form a public company is seven and that for a private company the minimum number is two. Depending upon the form chosen, the promoters may decide upon the number of primary members.

iii) **To seek and obtain the consent of the persons willing to act as first directors of the company**: In Unit 1 you learnt that the company has a system of representative management and is managed by individuals appointed as directors. The first directors of the company are, however, generally appointed by the promoters. The promoters seek the consent of some individual whom they deem appropriate so that they agree to be the first directors of the proposed company.

iv) **To settle about the name of the company** : The promoters have to seek the permission of the Registrar of companies for selecting the name of the company. The promoters usually give three names in order of preference. The promoters should ensure that the name of the company should not be identical with or should not too closely resemble the name of another existing company.

v) **To get the documents of the proposed company prepared:** You will study in the next unit that certain documents like the Memorandum of Association and the Articles of Association are required to be filed with the Registrar of Companies before the company is registered and brought into existence. As the company itself does not exist before incorporation, this work of preparation of these documents has to be undertaken by the promoters. The promoters, on the advice of legal experts get the Memorandum and Articles of Association prepared and arrange for their printing. In case the proposed company is a public limited company, intending to issue shares on incorporation, the promoters must also arrange to get the prospectus prepared and printed.

vi) **To appoint bankers, brokers and legal advisers for the company:** The incorporation of a company involves a lot of legal formalities. The promoters may need to consult the legal experts on several of these matters. They, therefore, appoint solicitors to assist them in the process of formation of the company.

The company is formed for the purposes of carrying on business and as such deals with funds and their management. The promoters must, therefore, also appoint bankers for the company who will receive share application moneys. If the proposed company is a public limited company, the promoters must also ensure the success of the first capital issue made by the company by appointing underwriters and brokers.

vii) **To settle preliminary agreements for acquisition of assets:** The promoters may be required to acquire a suitable site for the factory, make arrangements for plant and machinery, and may even make tentative arrangements for key personnel. Sometimes in order to run the business the company may be required to take over property of a running business. Promoters fulfil the function of seeing that such property and business is acquired by the proposed company on justifiable terms.

viii) **To enter into preliminary contracts with the vendors:** In respect of all the properties and assets mentioned above, the promoters would need to settle the terms of contracts with the third parties from whom these properties are to be bought. These contracts are called preliminary contracts. We shall study more about them later in this unit.

ix) **To arrange for filing of the necessary documents with the Registrar:** The promoters are required to pay the stamp duty, filing fee and other charges for registration of the company. The promoters are to see that the various legal formalities for incorporating the company are complied with.

3.4 LEGAL POSITION OF PROMOTERS

You learnt that promoters are responsible for the formation of a company. As such, they occupy important position, and have very wide powers relating to the formation of the company. It will, however, be interesting to note that there are no specific statutory provisions in this regard.

The legal position of a promoter is somewhat peculiar. The promoters legal position is that he is neither an agent nor a trustee of the company he promotes. He is not an agent because there is no principal in existence. You will recall from your exposure to the contract of agency that in order to be a valid contract of agency both the principal and the agent must be in existence. For the same reason, he also cannot be called the trustee of the company.

However, it does not mean that the promoters do not have any legal relationship with the proposed company. The legal position of a promoter can be correctly described by saying that *he stands in a fiduciary position (relationship of trust and confidence) in relation to the company he promotes.*

Lord Cairns has rightly stated the position of promoter in **Erlanger V. New Sambrero Phosphate Co.** "The promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape, and under whose supervision, it shall come into existence and begin to act as a trading corporation." In fact, the promoters occupy a fiduciary position in regard to the company they

promote, and also the original allottees whom they induces to buy shares of the company.

You would recall from what you have studied in the contract of agency and partnership that a fiduciary relationship means a relationship of utmost trust and confidence and implies disclosure of all material facts. Being in a fiduciary position, the promoter must not make, either directly or indirectly, any profits at the expense of the company that he promotes, without the knowledge and consent of the company.

Check Your Progress A

1 Who is a promoter?

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2 List the four most important functions of a promoter.

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3 What is meant by 'fiduciary relation'?

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4 State in three lines the legal position of promoters.

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5 State whether the following statements are true or false:

i) A promoter can be an individual, a group of persons or a company.

ii) The term 'Promoter' is defined in the Companies Act.

iii) Promotion is the first step for the formation of the company.

iv) All the persons associated with the formation of the company are promoters of the company.

v) The promoter is a person who brings the company into existence.

vi) A promoter cannot be allowed to make any secret profits.

vii) A promoter stands in a fiduciary relationship towards the company he promotes.

viii) The promoters in fact act as agent of the company which is being promoted.

3.5 DUTIES OF PROMOTERS

In the above section you have just learnt that the promoter occupies a position of total confidence and trust in relation to the company promoted by him. The promoter in this fiduciary capacity has the following important duties.

1 **Not to make any secret profit:** A promoter cannot make any direct or indirect profits out of the promotion of the company. Since he occupies a position of a trust, it is his duty to be honest and uphold the trust of his position. You must clearly understand that the law does not forbid the promoter from making a profit. The law prohibits only the making of secret profits i.e. the profits which the promoter has not disclosed to the company. The promoters of a company are perfectly free to

make a profit provided they disclose fact to an independent Board of directors. If there is no independent Board of Directors, then he must disclose the profits to the intended shareholders. When a promoter makes a secret profit, the company has the following remedies against him:

a) Recision of the contract — The Company may on learning of the secret profit, rescind the contract entered into by the promoter to make the said profit.

b) Order for refund — The company may require the promoter to refund the amount of secret profit.

c) Suit for breach of duty — The company may sue the promoter for misfeasance, as the promoter, by making the secret profit, has defaulted in his duty towards the company.

2 **To make full disclosure to the company of all relevant facts:** In keeping with his fiduciary capacity, a promoter is bound to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with the company. You should bear in mind that while making a disclosure the promoter must make the full and complete disclosure. If he contracts to sell his own property to the company without making a full disclosure, the company may either repudiate the contract or affirm the contract and recover the profits made by the promoter. Let us explain these fiduciary duties of the promoter with the help of an example.

'A' was the owner of some arid land. He and some of his friends, decided to form a company to manufacture microchips. They appointed the first directors of the company and 'A' sold his own land to the company at a price higher than the actual valuation of the land. When the company was formed, the purchase agreement of land was approved at the meeting of the shareholders but the fact of A's ownership and the profit made by him were not disclosed at the meeting. Subsequently when the company went into liquidation, the liquidator filed a suit against 'A' to recover the profits made by him in the sale of land. You would observe that in this case 'A' had defaulted in his duty to make full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure by the promoters of the profits they were making,the company is entitled to rescind the contract. 'A' could have retained the profits made by him if he had made a full disclosure to the directors of the company or to the shareholders of the company, all the relevant facts of the transaction including his personal interest and the profits made.

3 **To give the benefit of negotiations to the company:** The promoter must pass on to the company, the benefit of any negotiation or agreement that he has carried on in his capacity of a promoter. For example, when he has negotiated a certain price for some land for the company, he must sell the property to the company at the negotiated price. If he charges a price higher than the negotiated price, the company may rescind the contract on discovering the truth of the matter. If, due to some reason, the contract could not be rescinded, the company is entitled to claim damages from the promoters and the amount of damages shall be equal to the amount of profits made by promoters. However, it should be remembered that secret profits on the sale of property can be recovered from the promoter only when the property was bought and sold to the company while he was acting as a promoter. The promoter must act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.

4 **Duty of promoters towards future allottees:** The promoters stand in a fiduciary position towards the company. It does not mean that they stand in such relation only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at his instance contains all material facts and particulars and does not contain any mis-statements.

3.6 LIABILITIES OF PROMOTERS

You have just gone through the duties of a promoter in his fiduciary capacity and learnt that in the event of any breach the promoter can be made liable to hand over to the company, any secret profit made by him. The company can also file a suit for

recission of the contract of sale made by the promoter if the promoter has not made a disclosure of his interest to the company.

The liability of the promoter, under the Companies Act, is discussed below :

i) Section 56 explains *the matters that should be stated and the reports that should be set out in the prospectus*. If this provision is not compiled with, the promoter may be held liable by the shareholders.

ii) Section 62 discusses the *civil liabilities for any mis-statements made in the prospectus*. Under this section the promoter can be held liable for any false statements in the prospectus, by a person who has subscribed for the shares and debentures of the company acting on the faith of the prospectus. The promoter may be held liable to pay compensation to every person who subscribes for shares or debentures for any loss or damage sustained by him on account of the untrue statements made in the prospectus. Under Section 62 specific provisions have also been made of the grounds on which the promoter can avoid his liability. These remedies are common to all persons who can be held liable for mis-statement in the prospectus. You will study more about these remedies in Unit 7 of this course.

iii) Section 63 discusses the *criminal liabilities for issuing a prospectus which contains untrue statements*. It is clearly provided that in addition to the civil liability mentioned in the above two cases, the promoters can be held criminally liable if the prospectus issued by them contained mis-statements. The punishment prescribed is imprisonment extending upto two years or a fine upto 5000 rupees or both. The promoter may have to bear this criminal liability for mis-statements unless he can prove that the untrue statement was immaterial or that he was justified in believing, because of reasonable grounds, that the statement was true at the time of issue of prospectus.

iv) Section 478 states the *power of the court to order public examination of all the promoters held guilty of fraud in promotion or formation of a company*. If in the event of winding up of the company the liquidators report alleges a fraud in the promotion or formation of the company, the promoter can also be held liable for public examination by the Court, like any other director or officer of the company.

v) Section 543 of the Act provides for the *liability for misfeasance or breach of trust by misapplication of funds* during the formation of the company. Like any other director or officer of the company, a promoter can also be held liable if he had misapplied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

vi) Section 203 provides that the *court may suspend a promoter from taking part in the management of the company* for a period of five years if he is convicted of any offence in connection with the promotion, formation or management of a company.

vii) The promoters are *personally liable for pre-incorporation contracts*. Even the death of the promoter does not relieve him from this liability. You shall learn about pre-incorporation contracts in 3.8 of this Unit.

Check Your Progress B

1 List three important duties of promoters.

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2 Fill in the blanks

a) A promoter plays a very important role in the .... of a company.

b) Besides an individual even an.... .... may be a promoter.

c) Promoter .... the idea of setting up a business and then organise .... to convert this idea.

d) .... directors of the company are generally appointed by the promoters.

e) The promoters enter into .... for acquisition of assets for the company.

f) A promoter can be made liable to hand over to the company any .... made by him.

g) A promoter stands in a .... relationship towards the company.

3.7 REMUNERATION OF PROMOTERS

You have noted through the above paragraphs that the prometer occupies a unique position in relation to the company. Before the company is brought into existence he has to complete all the formalities, spend considerable skill and effort and organise necessary resources so that the company can be formed. He has to incur preliminary expenses as well. For all these important activities and his considerable effort he should be suitably remunerated. However, he is also in a peculiar position for doing all these activities for a company that is not yet in existence. The promoters cannot claim as a matter of right any remuneration from the company. He, therefore, is not entitled to recover any remuneration for his services unless the company after getting formed enters into a specific contract with the promoter for this purpose. You must note that even if the promoter has entered into a contract with the prospective directors before the incorporation, he has no valid claim against the company for remuneration. This is so because the directors cannot enter into any contract on behalf of a company that is not yet in existence. There are also cases where the articles of a company may specifically provide that a specified sum may be paid to the promoters as remuneration for their services. While this provision gives the director an authority to make such payment, it does not give the promoters a right to claim remuneration or to sue the company, for the same. In actual practice, therefore, the company, once it is registered, usually agrees to pay some remuneration for the valuable services rendered by the promoters. This remuneration may be paid to the promoters in any of the following ways:

i) He may be allowed to sell his own property to the company for cash at a price higher than the valuation, after he has made a full disclosure about the valuation and the profit earned to an independent Board of directors.

ii) If the promoter has purchased some business or some other property to be sold to the company, he may sell the same to the company at a higher price after making a full disclosure of the price paid and the profit earned.

iii) The company may allot to the promoters fully paid up shares of the company.

iv) He may be paid a certain lump-sum by the company as a remuneration for services rendered.

v) He may be given a commission at a fixed rate on the shares sold.

vi) The company may give him an option to subscribe for a certain number of the company's unissued shares at par. This option is generally limited to a certain period which means that the promoter must subscribe to the shares within a certain time.

The remuneration to the promoter may be paid in any of the ways mentioned above. Whatever is the manner in which the company chooses to compensate for the services of the promoter, the amount of remuneration and the manner of payment must be disclosed in the prospectus, if the remuneration is paid within two years preceding the date of the prospectus.

3.8 POSITION OF PRELIMINARY CONTRACTS

In order to fulfil the necessary formalities and organise the required resources for the formation of the company, the promoters of a company enter into contracts for a company which is yet to be incorporated. These contracts are generally entered into by the promoters in order to acquire some property or some rights for the company that they are interested in pr... ..ing. *All such contracts entered into by the promoters with the third parties for the proposed company (before incorporation) are called 'preliminary contracts'.*

You must note that such preliminary or pre-incorporation contracts are not legally binding on the company even after its incorporation. The reason for this is that before incorporation the company cannot enter into contract as it has no legal entity. Not only this, the company cannot ratify such contracts after incorporation because, for valid ratification, the principal must have been in existence at the time when the promoters entered into such contracts. A company can neither sue nor be sued on such contracts since a company before incorporation is a non- entity. The position of these contracts can be explained as follows.

i) On registration, the company is not bound by the preliminary contracts — A company is not bound by the preliminary contracts even if the company has taken the benefit of the work on its behalf under the contract. For example, a solicitor was appointed by the promoters of the company and was instructed by them to prepare the articles and the memorandum of the company. The solicitor a so paid the necessary registration fee of the company. These promoters later became the directors of the company. The solicitor sued for his expenses and the fees paid by him. It was held that since the company was not in existence when these expenses were incurred, the company is not bound to pay.

ii) The company cannot enforce preliminary contracts — You must note that just as the company cannot be held liable for the preliminary contracts, it also cannot enforce such contracts made before incorporation, by the promoters. This means that on account of a preliminary contract the company does not get a right to sue the third party for fulfilment of the contract. For example, 'X' the owner of a piece of land in Assam agreed to lease it to a company to be formed by promoters A, B and C. The promoters later on formed a company called M.Pvt. Ltd. On some prospecting of the land, it was discovered that there was a definite possibility of striking oil in that land. Subsequently 'X' refused to grant the lease to the company M.Pvt.Ltd. It was held that the company cannot sue 'X' and cannot claim specific performance as it was not even in existence when the lease was signed.

In relation to the above two principles, important provisions have been made in our country in the Specific Relief Act, 1963. These provisions provide an important exception to the above principles. According to Section 15 and 19 of the Specific Relief Act "where the promoters of the Company have, before its incorporation, entered into contracts for the purpose of the company and such contracts are warranted by terms of incorporation, specific performance may be obtained by or against the company, if the company has accepted the contract after the incorporation and has communicated such acceptance to the other party".

In the above paragraph the term "contracts for the purposes of the company" means contracts which are necessary for the incorporation and working of the company. For example, contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the production work in the company are contracts for the purposes of the company. It should be clear to you now that in order to be enforceable, it is necessary that the company after its incorporation accepts the contract and communicates its acceptance to the other contracting party.

iii) The company cannot ratify the preliminary contracts — After incorporation the Company cannot ratify the contracts formed before its existence. You will recall from your study of the Unit on agency that for valid ratification of a contract, it is essential that the principal must exist of the date when the contract is originally entered into. And as the company does not exist on the date of contract, it cannot ratify a preliminary contract on being incorporated. In the case of Kelner

v.Baxter, it was held as the company was not in existence when the preliminary contracts were made, it could not be bound by any purported ratification. What the company can do is to enter into a new contract with the vendors after incorporation to give effect to the terms of the contract made before incorporation.

iv) Liability of the promoter for preliminary contracts — The promoters are personally liable for contracts made for a company which is not yet in existence. You have already learnt that the company is neither bound nor entitled on account of a preliminary contract. Therefore, it is the promoters alone who remain personally liable for the preliminary contracts. The reason for this is that the preliminary contract is made for a company which, as known to both the contracting parties, is as yet non-existent. The contract, therefore, is deemed to be personally entered into by the promoters and they will be held personally liable for the performance of these contracts.

The preliminary contracts made by the promoters generally contain a provision that if the company adopts the agreements on incorporation, the liability of the promoters shall come to an end and if the company does not adopt the preliminary contract within a specified period either party may rescind the contract. In such a case liability of the promoter will cease on the expiry of the specified period.

Check Your Progress C

1 Enumerate three ways in which the promoter can be remunerated.

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2 What is a pre-incorporation contract?

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3 State whether the following statements are true or false.

i) A promoter is entitled to be suitably remunerated for the services rendered during formation of the company.

ii) In the absence of a contract with the company, the promoter cannot recover the payments he has made in connection with the formation of the company.

iii) If the promoter has made the necessary disclosures, he can sell his own property to the company at a higher price.

iv) If a prospectus is issued within fifteen months of the remuneration being paid to the promoters, the fact of the remuneration need not be mentioned in the prospectus.

v) In the remuneration to the promoter is paid in cash and the prospectus is issued within two years of the date of remuneration being paid, it need not be mentioned in the prospectus.

vi) The liability of the promoter for the preliminary contracts ceases as soon as the company is formed.

vii) Upon registration the company is not bound by the preliminary contracts.

viii) If all the members of the company agree, the company can ratify the preliminary contracts.

ix) A preliminary contr[illegible] cannot be enforced by the company against the third parties.

x) Promoters are personally liable for preliminary contracts.

3.9 LET US SUM UP

Promotion is the first step in the formation of a company. A promoter occupies a unique position in relation to the company as he is neither an agent nor a trustee of the company and yet has fiduciary relationship with the company. A promoter cannot be allowed to make any secret profits. If it is found that a secret profit has been made by promoters, then the promoters are bound to refund the money to the company. Further, the promoters are not allowed to derive a profit from the sale of his own property to the company unless all mater· · facts are disclosed. Thus, a promoter who wishes to sell his own property to the company must make a full disclosure of his interest.

Contracts entered into before the incorporation of a company are termed as pre-incorporation or preliminary contracts. Such contracts are no legally binding on the company because at the time of making of the contract, the company was not in existence. Even if the company has received the benefit of work done, the company shall not be bound by it. On incorporation, the company cannot ratify preliminary contracts.

3.10 KEY WORDS

Promoter: The person who performs various functions in relation to the formation of a company.

Fiduciary relation: The relationship based on mutual trust and confidence.

Preliminary contracts: Contracts made before the incorporation of the company.

Ratification: To approve of an act already done.

Secret Profits: Profits made without making a full disclosure of all relevant facts.

Prospectus: A document issued by the company inviting public to subscribe for its shares or debentures.

3.11 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) True ii) False iii) True iv) False v) True vii) True viii) False.

B 2 a) formation b) association or a company c) conceives, resources d) first e) preliminary contracts f) secret profits g) fiduciary.

C 3 i) False ii) True iii) True iv) False v) False vi) False vii) True viii) False ix) True x) True

3.12 TERMINAL QUESTIONS/EXERCISE

1 Define the term 'promoter' and explain the functions performed by him.

2 Discuss the legal position of a promoter.

3 What are the fiduciary duties of a promoter towards a company promoted by him.

4 Discuss the liabilities of a promoter.

5 Is a promoter entitled to remuneration for the services rendered by him during the formation of the company? List the ways in which a promoter might be given remuneration.

6 What do you understand by preliminary contracts? Discuss (a) the position of the company in relation to the preliminary contracts, and (b) the liability of the promoter for a preliminary contract.

7 Explain the statement that "Promoter is not a trustee or an agent of the company but he stands in a fiduciary position towards it."

8 Why pre-incorporation contracts are not binding on the company?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answer to the University. These are for your practice only.

UNIT 4 FORMATION OF COMPANY

Structure

4.0 Objectives
4.1 Introduction
4.2 Stages in the Formation of a Company
4.3 Promotion
4.4 Documents to be Filed with the Registrar
4.5 Incorporation
  4.5.1 Conclusiveness of Certificate of Incorporation
  4.5.2 Effects of Registration
4.6 Commencement of Business
  4.6.1 Certificate of Commencement of Business
  4.6.2 Procedure for Obtaining the Certificate of Commencement of Business
4.7 Let Us Sum Up
4.8 Key Words
4.9 Answers to Check Your Progress
4.10 Terminal Questions

4.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the stages in the formation of a company,
- enumerate the documents to be filed with the registrar,
- explain the effects of registration,
- explain the meaning of the certificate of incorporation, and
- describe the procedure for obtaining the certificate of commencement of business.

4.1 INTRODUCTION

In Unit 1 you learnt that a company is an artificial person created by law and has a distinct separate legal entity of its own. You have also learnt in Unit 3 that before a company is actually formed, certain persons known as 'promoters', make a detailed investigation and, after satisfying themselves about the viability of the business, take certain steps to form the company. In this unit, you will learn about the various stages involved in the formation of a company and the documents which are required to be filed with the Registrar of Companies. You know that a private limited company can commence business immediately after obtaining the certificate of incorporation, but a public limited company is required to wait till another certificate known as 'certificate of commencement of business is obtained. The procedure for obtaining the certificate of commencement of business has also been discussed.

4.2 STAGES IN THE FORMATION OF A COMPANY

The formation of a company is a lengthy process. It involves the following three stages:

1 Promotion
2 Registration or incorporation, and
3 Commencement of business

Each of the above stages comprises specific activities to be undertaken. Figure 4.1 gives you an overview of the activities involved in the various stages of formation of a company.

Figure 4.1

Stages in the Formation of a Company.

Stage 1		Stage 2	Stage 3
Promotion		Incorporation	Commencement of Business
Discovery of business idea and subsequent organisation	Filing of documents with the Registrar of Companies		
• Discovery of business idea • Organisation of resources like capital, plant and machinery, experts, etc. • Obtaining consent of first directors • Preparation of documents • Payment of reg'stration fee • Application for s itable name • Pre iminary contracts	• Memorandum of Association • Articles of Association • Copy of proposed agreements • Statement of nominal capital • Address of registered office • List of director's and their written consent • Directors undertaking to buy qualification shares • Statutory declaration	– Registrar, on scrutiny of company's documents, if satisfied a) enters the name of the company in the Register of Companies, and b) issues a certificate of incorporation.	– Private company can immediately begin exercise its borrowing powers and transacting the business. – Public company shall apply for and obtain certificate of commencement of business. It can then begin to exercise its borrowing powers and transacting the business.

4.3 PROMOTION

You have already learn. in Unit 3 about the activities carried out by promoters to bring a company into existence. After discovery of the business idea and judging its soundness, the promoters organise the necessary resources for giving shape to their business idea. They negotiate for, and obtain, the required property, the necessary plant and machinary and arrange for the capital necessary for the company. The promoters will also talk to persons who are willing to take the responsibility of becoming the first directors of the company.

It should be noted that a company can be formed only for a lawful purpose. The purpose of the company may be unlawful if it is (a) against any provisions of the company law, or (b) against the provisions of any other law applicable in India.

You would recall from Unit 2 that promoters may form the company with limited liability or with unlimited liability. In case of a company with limited liability, the liability of members may be limited either by shares or by guarantee.

The promoters then obtain the approval of the proposed name from the Registrar of Companies. For this purpose, the promoters shall select a few suitable names in order of preference and would then apply on prescribed form to the Registrar for registration.

Section 20 of the Act provides that no company shall be registered by a name, which in the opinion of the Central Government, is undesirable i.e., the name should not be identical with, or too nearly resemble, a name by which a company is already in existence. You will study in detail about this aspect in Unit 5 dealing with memorandum of association.

Before an application for registration is filed with the Registrar of Companies, the promoters shall take the necessary steps for preparing the important documents such as 'memorandum of association' and 'articles of association'. For this, the promoters may seek the half of a legal expert, a solicitor or a company secretary. These documents should be duly printed. However, a public company limited by shares need not prepare its own articles. It can adopt 'Table A' as given in Schedule I of the Act. The memorandum and articles have to be stamped and the value of the stamp differs from state to state as per the respective state stamp laws.

Section 15 requires that every memorandum should be signed by each subscriber who should give his address, description and occupation, if any, in the presence of at least

one witness who shall attest the signature, and the witness is also required to give his address and description of his occupation, if any. The articles of association should also be signed separately by subscribers. However, it is not necessary that the promoters themselves should sign the memorandum and articles. These documents may be signed by an agent provided he is authorised by a Power of Attorney in this behalf.

The written consent of directors to act as such is also to be filed. But, in the case of a private company, it is not needed. The directors are required to give a written undertaking to take up and pay for their qualification shares. You will study about this in detail in Unit 5.

The fee prescribed for registration of a company is required to be paid to the Registrar. A statutory declaration is also to be filed that all the requirements of the Act and the rules thereunder have been complied with.

Besides these steps depending upon the peculiar nature of the company and its objects, the promoters may be asked to comply with certain other requirements of the Companies Act with respect to registration. They may include (i) obtaining the license under the Industries (Development and Regulation) Act, 1951, (ii) entering into preliminary contracts, (iii) obtain in consent of the Controller of Capital Issues, if the company wishes to raise capital by issue of shares or debentures, and (iv) preparing prospectus or a statement in lieu of prospectus, as the case may be.

Check Your Progress A

1 What is meant by promotion of a Company?

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....

....

2 Fill in the blanks

a) For formation of a company, the promoters have to pass through .... stages.

b) The three stages for the formation of a Company are promotion, ... and the commencement of the business.

c) Promotion of a company begins with the ....

d) A private company can commence business after it is ....

e) A company may be formed only for a .... purpose.

f) A company not having any limit on the liability of its members is known as a company.

g) In accordance with Section 20 of the Act, no company shall be registered by a name which is .... in the opinion of the ....

h) The rules framed for the internal management of the affairs of the company are termed as ....

i) Before delivering the memorandum and articles to the Registrar for registration of the company, these documents will be .... by the .... of the proposed company.

j) The subscriber to the memorandum of association shall sign in the presence of atleast one ....

3 State whether the following statements are True or False.

i) A company cannot come into existence if it does not elect directors.

ii) The minimum number of members required to form a public company is ten.

iii) The liability of members of a public company is limited to the face value of shares held by them.

iv) A company may or may not be registered.

v) No company can be registered with an unlimited liability.

vi) A private company has to register its articles of association.

4.4 DOCUMENTS TO BE FILED WITH THE REGISTRAR

After the promoters have got the necessary documents prepared, these are required to be filed with the Registrar of companies. The documents that are necessary for the purpose of registration are as follows:

1 **Memorandum of Association:** The Memorandum of Association, is the charter of the company. It needs to be originally prepared for every company. It defines the objectives for which the company is being formed. The memorandum by its clauses, describes the whole character of the company. This includes its objectives, its name, the nature of its liability, the address of its registered office, the capital which the company is authorised to have as well as the names, addresses and agreement of people who agree to form the company. The memorandum defines the powers of a company and its relations with third parties. For purposes of registration, the promoters have to file with the Registrar of companies, a duly signed and properly stamped printed memorandum of association.

2 **Articles of Association:** The articles of association contain the rules and regulations for managing the internal affairs of the company and, therefore, govern the relationship between the company and its members. A private company must prepare its own articles because the articles impose restrictions on the right to transfer shares, prohibit invitation to the public to subscribe to its share capital and restrict the maximum number of members to fifty. You have learnt these restrictions in Unit 2.

   It is not necessary for a public company limited by shares to file the articles of association. If a public company does not file its articles and chooses to remain silent about the same, it is deemed to have adopted 'Table A' of Schedule I of the Act. This table is a model set of articles given in the Act 7. The articles of association should also be signed separately by subscribers and they should also be attested by a witness.

3 **Copy of the proposed agreement:** According to the Companies Amendment Act, 1988 a clause has been inserted in the Act which provides that if a company proposes to enter into an agreement with any individual for appointment as its managing director, or a whole time director or manager, a copy of such an agreement should also be filed with the Registrar along with the other documents.

4 **Statement of nominal Capital:** In case of a company limited by shares or by guarantee, and having a share capital, the promoters must also file a statement declaring the amount of nominal capital with which the company is proposed to be registered. Normal capital is also called the 'authorised capital '. It means the amount of capital which a company is authorised to issue. The nominal capital is divided into shares of a uniform fixed value. The authorised capital must be clearly defined in the memorandum of association in its capital clause. The amount of nominal capital for a company depends upon its projected capital requirement. In accordance with the provisions of Capital Issues (Control) Act, 1947, if the company proposes to raise more than one crore of rupees within twelve months of its incorporation through the issue of shares or debentures, the promoters should also obtain and file the consent of the Controller of Capital Issues.

5 **Address of the registered office of the company:** Though not required for the purposes of registration, the address of registered office of the company is usually filed with the Registrar, by both private and public companies. In case it is not given at the time of filing of other documents, it should be filed within thirty days of incorporation.

6 **A list of persons who have agreed to become the first directors of the company should also be filed.** This is not necessary in case of private companies. The directors of a public company have also to give a written undertaking to take up and pay for their qualification shares.

7 **Statutory declaration:** Lastly, the promoters must file a statutory declaration in the prescribed form stating that all requirements of the Companies Act and its rules relating to registration have been complied with. This declaration may be signed by any of the following:

a) an advocate of the Supreme Court or of a High Court; or
b) an attorney or a pleader entitled to appear before a High Court; or
c) a secretary, or a chartered accountant practising in India and who has been engaged in the formation of the company; or
d) by a person named in the articles as a director, manager or secretary of the company.

Check Your Progress B

1 List any three documents which are required to be filed with the Registrar, for the purpose of incorporation of the company.

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2 State whether the following statements are True or False.

i) The memorandum of association of a company defines the objectives for which a company is formed.
ii) The articles of association govern the relationship between the company and third parties.
iii) The relations between the company and its members are regulated by its articles of associations.
iv) For the registration of a public company it is necessary that the articles of association are filed with the Registrar.
v) The first directors of a company are appointed by the promoters.
vi) Nominal capital of a company is also called 'authorised capital'.
vii) Every company is bound to inform the Registrar of Companies, the address of the registered office of the company within thirty days of registration.
viii) The list of directors of a private company alongwith their written consent to act as such must be filed with the Registrar.

4.5 INCORPORATION

When the necessary documents have been delivered to the Registrar and the requisite fees paid, the Registrar shall scrutinise these documents and if he is satisfied that (a) all the documents are in order, (b) all the requirements of the Companies Act in respect of registration have been complied with, and (c) the objects for which the company is to be formed are lawful; he shall enter the name of the company in the Register of Companies maintained by his office. He would then issue a certificate, under his signature, certifying that the Company is incorporated. This certificate is called the 'Certificate of Incorporation'. This certificate contains the name of the company, the date of its issue, and the signature of the Registrar with his seal. Certificate of Incorporation constitutes the company's birth certificate and the company becomes a body corporate, with perpetual succession and a common seal. The company comes into existence on the date given in the Certificate of Incorporation.

If the Registrar is of the view that there are some minor defects in any document, he may require that the defects be rectified. But, if there are some material and substantial defects, the Registrar may refuse to register the company.

The procedure for incorporation of a private company is similar to that for a public limited company. However, in case of a private company, the necessary documents viz., the memorandum of association and the articles of association should be signed by at least two persons in contrast to seven in case of a public company. The written consent of the directors of a private company need not be filed. However, the articles of a private company must be registered with the Registrar and it must incorporate the restrictions imposed by Section 3(1)(iii) of the Companies Act.

4.5.1 Conclusiveness of Certificate of Incorporation

A certificate of incorporation given by the Registrar of Companies in respect of any association shall be conclusive evidence that all the requirements of Companies Act have been complied with in respect of its registration as well as matters precedent and incidental thereto. This is also known as rule in Peel's case.

In this case, the memorandum was found materially altered after the signatories had signed but before registration. It was held that the corporate status remained unaffected and the certificate of incorporation was valid. Highlighting the necessity of this rule, Lord Cairns observed as follows:

"When once the memorandum is registered and the company holds out to the world as a company undertaking business, willing to receive shareholders and ready to contract engagements, then, it would be of the most disastrous consequence if after all that has been done, any person was allowed to go back and enter into an examination of the circumstances attending the original registration and the regularity of the execution of the documents."

As is clear from the above statement once the Registrar has issued the certificate of incorporation, nothing further is to be inquired into and the validity of this certificate cannot be disputed on any gound whatsoever. **In Moosa Goolam Arif v Ebrahim Goolam Arif,** the memorandum of association of a public limited company was signed by two adult persons. Other five members of the company were minors. Their guardian made separate signatures for each of the minors. The Registrar registered the company and issued the certificate of incorporation. The incorporation of the company was challenged and the plaintiff prayed that the certificate of incorporation should be declared void. The Privy Council rejected the plea of the plaintiff and held that the certificate of incorporation was valid.

The certificate of incorporation is also a conclusive proof of the fact that the company came into existence on the date mentioned in the certificate. In the case of **Jubilee Cotton Mills Ltd. v Lewis,** the company delivered to the Registrar of Companies documents required for the registration of the company on 6th January. On 8th January, the Registrar registered the company and issued the certificate of incorporation but dated it January 6.The company allotted few shares to Mr. Lewis on 6th January. The allotment was challenged and the court was requested to declare the allotment as void. The court held that the certificate of incorporation is conclusive evidence of all that it contains. Hence, the company shall be deemed to have been formed on 6th January and allotment of shares was valid.

It should, however, be noted that the certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company, mentioned in the objects clause of the memorandum of association. As such, if a company has been registered whose objects are illegal, the incorporation does not validate the illegal objects. In such a case the only remedy available is to wind up the company.

4.5.2 Effects of Registration

You have just learnt that the certificate issued by the Registrar of Companies is called the 'certificate of incorporation'. This certificate is a very important document for the company because the company begins its corporate life from the date of the certificate.

On filing of documents like memorandum of association, articles of association, the proposed agreement etc., the Registrar shall issue a Certificate of Incorporation to the company. In this certificate he shall certify that the company has been incorporated. If the company is a limited company, the Registrar shall further certify that the company is a limited company.

From the date of incorporation i.e., the date mentioned in the certificate of incorporation, the company becomes a legal person distinct from its members. Section 34 clause 2 describes the effects of registration which are as follows:

i) From the date of incorporation, the original subscribers to the memorandum as well as the other persons who may, from time to time, become members of the company, shall constitute a body corporate by the name contained in the memorandum of association. You would recall from Unit 1 that a company after incorporation becomes a body corporate distinct from its members. It

becomes a legal person. The company's life starts from the date of its incorporation.

ii) The company acquires a perpetual succession. The consequence of it may be understood better by an example. If a company had ten shareholders and all of them die at the same time in a train accident, the company's existence will not be effected. In other words we may say that the members may come and members may go, but the company goes on till it is wound up.

iii) The company will have a common seal.

iv) The company can sue and be sued in its own name.

v) A private company is entitled to commence business immediately after obtaining the certificate of incorporation.

vi) Liability and debts of the company are not the liability of the shareholders/members. They are, however, liable to contribute to the assets of the company, in the event of its being wound up, to the extent of their contract or guarantee, as the case may be.

vii) The company will hold its property in its own name. The property of the company is not the property of the shareholders.

viii) The memorandum and articles of association become binding on the members and the company. This articles are deemed to be a contract between the company and its members and would, after incorporation, govern the rights (a) of members against the company (b) of company against the members, and (c) between members *inter se*.

4.6 COMMENCEMENT OF BUSINESS

You know that a company comes into existence when it receives the certificate of incorporation. A private company can commence its business immediately after receiving the certificate of incorporation. But, a public limited company will have to obtain another certificate known as the 'certificate to commence business' before it can start its business. However, a public company having no share capital can also commence business immediately on receiving the certificate of incorporation. It, therefore, follows that a public company having share capital, is required to fulfil some more formalities before it obtains the certificate to commence business.

4.6.1 Certificate of Commencement of Business

As stated earliler, a private company can commence business immediately upon incorporation, but a public company having share capital cannot do so. A public company having share capital, whether it issues a prospectus inviting the public to subscribe for its shares or not, is required to comply with some more formalities before it can commence business. A public company having share capital is required to file with the Registrar either a prospectus or a statement in lieu of prospectus and the declaration by one of the directors or the secretary (or, where the company has not appointed a secretary, a practising secretary) that the company has complied with the requirements of Section 149 of the Act. On being satisfied that all the formalities have been complied with, the Registrar shall certify that the company is entitled to commence business.

4.6.2 Procedure for Obtaining the Certificate of Commencement of Business

If a public company, having share capital, has issued a prospectus, inviting the public to subscribe for its shares or debentures, it cannot commence any business until

i) The company has received in cash, the amount mentioned in the prospectus as minimum subscription and the shares upto the amount of minimum subscription have been allotted.

ii) every director has paid to the company, in cash, the application and allotment money on the shares taken or contracted to be taken by him:

iii) no money is liable to be repaid to the applicants for failure to apply for or to obtain permission for the shares or debentures to be listed on any recognised stock exchange:

iv) where the shares of the company are to be quoted on the stock exchange, requisite application must have been submitted to the stock exchange and approval obtained within the stipulated time;

v) the prescribed stamp duty as prescribed by the Indian Stamp Act and as prevalent in that State in which the company is registered is paid;

vi) a treasury challan showing payment of prescribed fee is attached; and

vii) a statutory declaration on duly verified in the prescribed form has been filed with the Registrar. The declaration should specify that clause (i), (ii), and (iii), as above have been complied with. The declaration should be verified by one of the directors or the Secretary of the Company. Where the Company has not appointed a Secretary, the declaration may be verified by a practising Secretary.

If the company has a share capital but does not issue a prospectus inviting the public to subscribe for its shares, the company cannot commence any business unless

a) the company files with the Registrar, a statement in lieu of prospectus, along with the report specified in Part II of Schedule III. The statement should be filed with the Registrar at least three days before the first allotment.

b) a declaration that every director of the company has paid to the company, in cash, the application and allotment money on the shares taken or contracted to be taken by him.

c) a duly verified declaration in the prescribed form has been filed with the Registrar at least three days before the first allotment is made. The declaration should specify that the above conditions have been complied with and should be verified by one of the directors or the Secretary of the Company. In case the company has not appointed a Secretary, the declaration may be verified by a Secretary in whole time practice (Section 149).

When the above requirements are duly fulfilled, the Registrar shall issue a certificate known as 'certificate of commencement of business'. This document certifies that the company is entitled to commence business and is also a conclusive evidence of the fact that the company is so entitled. If any company commences business in contravention of these provisions, every person who is responsible for the default shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues [Sec. 149(6)]. It should be noted that the company must commence business within one year of its incorporation or otherwise it is liable to be wound up by the Court [Sec.433(c)].

You should, however, note that a public company having share capital cannot commence any business unless this certificate is obtained. Any contract made before obtaining the certificate to commence business but after incorporation shall be provisional and shall not be binding on the company until this certificate is obtained.

An interesting question arises as to the position of contracts entered into by the public company after incorporation but before the receipt of certificate of commencement of business. According to Section 149(4) such contracts are purely provisional in nature and shall not be binding on the company until the date on which it becomes entitled to commence business. Therefore, if a company enters into contract after its incorporation but never gets the certificate to commence business, contracts so entered shall not be binding upon the company. However, on the issue of the commencement certificate, such contracts become automatically binding on the company and need no ratification. Let us explain this point by taking an example. A, a furniture dealer entered into a contract with the company for supplying some furniture to the company. The company went into liquidation before it could obtain the certificate of commencement of business. A will not succeed in recovering the amount from the company because the company never became entitled to commence business.

Check Your Progress C

1 What is meant by certificate of incorporation?

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2 What are the effects of incorporation?

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3 When can a company, which has issued a prospectus, commence business?

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4 What is the legal position of provisional contracts?

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5 State whether the following statements are True or False.

i) A company comes into existence from the date of incorporation, mentioned on the certificate of incorporation.

ii) The Registrar issues the certificate of incorporation under his signature.

iii) Procedure for incorporation is same for incorporating a public company or a private company.

iv) A certificate of incorporation issued by a Registrar is conclusive evidence of the fact that all the requirements of Companies Act have been complied with in respect of registration.

v) A certificate of incorporation is not conclusive evidence of the fact that the company came into existence on the date mentioned on the certificate.

vi) Only a public company acquires perpetual succession, after incorporation.

vii) A private company is entitled to commence business immediately after obtaining the certificate of incorporation.

viii) The provisions of articles of association after incorporation govern the rights of company with third parties.

ix) A public company in order to commence business would have to obtain the certificate of commencement of business.

x) Any contract entered into by a public company after obtaining certificate of incorporation but before the issue of certificate of commencement of business is provisional.

xi) A necessary condition for obtaining certificate to commence business, in case of a public company with share capital, is that the shares payable in cash upto the amount of minimum subscription, have been allotted.

xii) A public company having a share capital but which has not issued a prospectus inviting the public to subscribe for its shares, can commence its business, without filing with the Registrar, a statement in lieu of prospectus.

4.7 LET US SUM UP

The information of a company consists of three stages, promotion, incorporation and commencement of business. In the promotion stages, the promoters of the company conceive the business idea and organise all the resources needed for forming the

company. They also get the necessary documents prepared, printed and file them in the office of the Registrar of companies, along with the prescribed fees for registration. On scrutiny of these documents, if the Registrar is satisfied that all the formalities prescribed by the Companies Act have been complied with, he issues to the company, under his signatures, a certificate of incorporation. From this date the company begins its corporate existence.

A private company and a company without share capital can commence business immediately on incorporation. A public company with a share capital, on the other hand, has to follow the prescribed procedure to obtain a certificate of commencement of business. It can only start its business after such a certificate has been issued. The certificate of commencement of business entitled a public company with share capital to exercise all its powers, conferred upon it by memorandum of association.

4.8 KEY WORDS

Conclusive: Final, which does not require any other evidence.

Debenture: A document or certificate signed by the officer of a company acknowledging indebtedness for money lent and a guaranteeing repayment with interest.

Incorporated: Constituted as a body corporate legally authorised to act as a person.

Inter-se: In between or amongst themselves.

Promoter: Those who promote the formation of a company.

Pros...us: On invitation to the public to subscribe to the shares or debentures of a compan..

Rectification: ..e action or process of correcting.

Statement: Some..ing that is stated or a document setting forth information on any point.

Statutory declaration: A declaration made in compliance of a written law.

Undertaking: A promise, engagement or stipulation.

4.9 ANSWERS TO CHECK YOUR PROGRESS

A 1 For answer to this question please refer to 4.2 of this Unit.

2 (a) Three
(b) incorporation
(c) discovery of the business idea
(d) incorporated
(e) lawful
(f) Unlimited
(g) Undesirable, Central Government
(h) Articles of association
(i) signed, subscribers or promoters
(j) Witness.

3 i) False ii) False iii) True iv) False v) False vi) True.

B 1 Please refer to 4.3. of this Unit

2 i) True ii) False iii) True iv) False v) True vi) True vii) True viii) False.

C 5 i) True ii)True iii) False iv) True v) False vi) False, vii) True viii) False ix) True x) True.xi) True xii) False.

4.10 TERMINAL QUESTIONS

1 What are the different stages in the formation of a company? Discuss.

2 List the documents that are required to be filed with the Registrar of companies for the purposes of registration.

3 What do you mean by 'incorporation' of a Company? What are the effects of registration of a company?

4 "The certificate of incorporation is a conclusive proof that all the requirements of the Act in respect of formation of the company, have been complied with"? Explain.

5 What is meant by commencement of business? Describe the steps that need to be taken before a company can commence its business.

6 What would happen if a public company having share capital enters into contracts before the issue of certificate of commencement of business?

7 You know that when the promoters of a proposed company apply for incorporation of the company they are required to submit to the Registrar, printed copy of memorandum of association of the proposed company. Instead of the printed copy of the memorandum, the promoters submitted a computer print out of the memorandum of association for the purposes of registration of the company. Can the Registrar refuse to accept the same.
(**Hint:** In view of the advancement of printing technology, computer printing fulfils the requirements that the memorandum should be printed. Hence the Registrar cannot refuse.)

8 The promoters of a company, entered into an agreement with Z to appoint him as the solicitor of the company, on behalf of the company. After incorporation, the company did not appoint Z the solicitor of the company. Advise Z.
(**Hint:** Z has no remedy against the company. However, he may hold the promoters personally liable on the contract.)

9 A private company was incorporated with the object of running lotteries in the State of Tamilnadu. The activities of the company were challenged on the ground that it is illegal to run lotteries. The company stated that once the company has been incorporated, the nature of the business of the company is not open to examination and the certificate of incorporation is conclusive.
(**Hint:** You have learnt in 4.5 above that the certificate of incorporation is not conclusive evidence of with respect to the legality of the objects of the company, mentioned in its object clause and that the incorporation does not validate the illegal objects. Hence the company may be restrained from operating lotteries.

10 Explain the procedure for obtaining the certificate to commence business, by a public company, having share capital and which has issued the prospectus, to invite the public to subscribe for the shares of the company.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answer to the University. These are for your practice only.

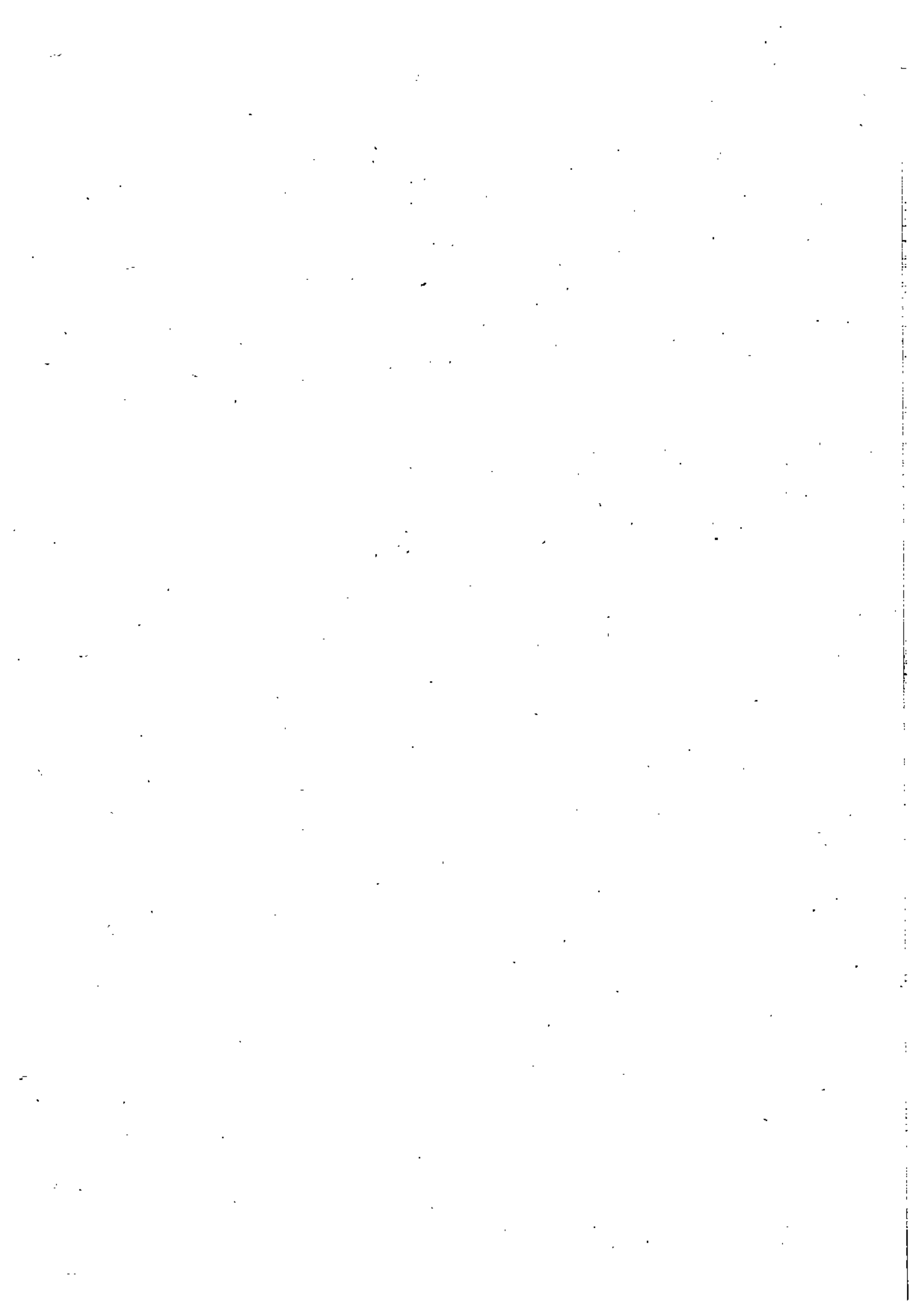
SOME USEFUL BOOKS

Bagarial, Ashok K. 1990, *Company Law*, Vikas Publishing House Pvt. Ltd., New Delhi (Chapters 1-4).

Chawla, R.C. and K.G. Garg 1990, *Mercantile Law*, Kalyani Publishers, New Delhi (Chapters 1-3 of Section on Company Law).

Kapoor, N.D. 1990, *Elements of Company Law*, Sultan Chand and Sons, New Delhi (Chapters 1,2).

Kuchhal, M.C. 1990. *Modern Indian Company Law*, Shree Mahavir Book Depot, Delhi (Chapters 1-4).



Uttar Pradesh
Rajarshi Tandon Open University

BBA-1.4(E2)

Company Law

Block

2

PRINCIPAL DOCUMENTS

UNIT 5

Memorandum of Association 5

UNIT 6

Articles of Association 10

UNIT 7

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BLOCK 2 PRINCIPAL DOCUMENTS

For the formation of a company and the commencement of its business, a company has to prepare a number of documents. Of these, the main documents are : (i) Memorandum of Association (ii) Articles of Association and (iii) Prospectus.

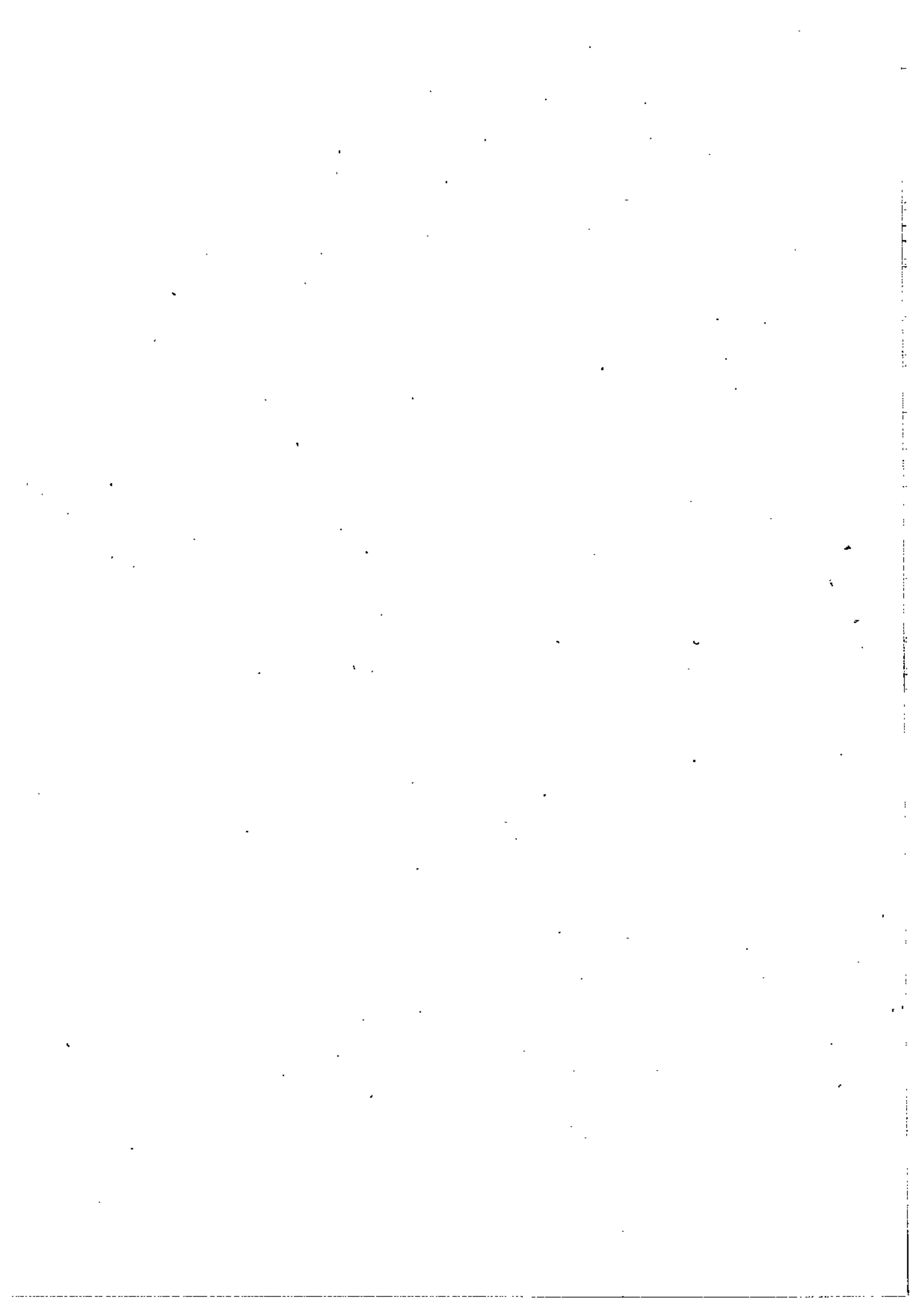
The Memorandum of Association defines the relation of the company with the outside world and the scope of its activities beyond which its actions cannot go. The Articles of Association of a company contains the rules relating to the management of its internal affairs. The purpose of a prospectus is to provide the required information about the company and induce the prospective investors to subscribe to the shares and debentures of the company.

In this block we shall study in detail about the importance, contents and legal implications of these three documents.

Unit 5 deals with Memorandum of Association and discusses the meaning, the purpose, the contents and the procedure for alteration of different clauses of Memorandum.

Unit 6 explains the meaning, purpose and contents of Articles of Association and describes the procedure for the alteration. It also discusses the effect of Memorandum and Articles and the doctrine of indoor management.

Unit 7 deals with prospectus and explain its meaning, purpose and contents. It also discusses the remedies available to an aggrieved party in case of misrepresentation in the prospectus.



UNIT 5 MEMORANDUM OF ASSOCIATION

Structure

5.0 Objectives
5.1 Introduction
5.2 Meaning and Purpose of Memorandum
5.3 Form of Memorandum
5.4 Contents of Memorandum
- 5.4.1 Name Clause
- 5.4.2 Registered Office Clause
- 5.4.3 Objects Clause
- 5.4.4 Liability Clause
- 5.4.5 Capital Clause
- 5.4.6 Association Clause or Subscription Clause

5.5 Doctrine of Ultra Vires
5.6 Alteration of Different Clauses in the Memorandum
- 5.6.1 Change of Name
- 5.6.2 Change of Registerd Office
- 5.6.3 Change in Objects Clause
- 5.6.4 Change in Liability Clause
- 5.6.5 Change in Capital Clause

5.7 Let Us Sum Up
5.8 Key Words
5.9 Some Useful Books
5.10 Answers to Check Your Progress
5.11 Terminal Questions

5.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning and purpose of Memorandum of Association
- describe the different forms of Memorandum of Association
- list the different clauses of the Memorandum of Association
- explain the doctrine of *ultra vires*
- explain the procedure for alteration of different clauses of Memorandum of Association.

5.1 INTRODUCTION

In todays' world where business has become very complex and production is done on a large scale requiring large amount of funds, the company form of organisation has become very popular. The most important feature of a company is that it is a separate legal entity different from the persons who constitute it. A company comes into existence only when it receives the certificate of incorporation from the Registrar of Companies. For incorporating a company, certain documents are to be filed with the Registrar of Companies. The first and the most important document to be filed is the memorandum of association. In this unit, you will learn the meaning and purpose of memorandum of association. You will also learn the contents of this document and how the different clauses of the memorandum can be altered.

5.2 MEANING AND PURPOSE OF MEMORANDUM

Under Section 2(28) of the Companies Act, *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.* But this definition is not an exhaustive one. Lord Cairns in the famous case of **Ashbury Railway Carriage Co. V. Riche** defined memorandum as following—*The memorandum of association of a company is its charter and defines the limitations of the powers of the company.*

The Memorandum of Association of a company is its charter. It contains the fundamental conditions upon which alone the company can be brought into existence. It tells us what the company can do as specified in its objects clause. The objects clause is an important clause in the Memorandum, as it tells us the scope of activities of the company. The company's actions cannot go beyond this clause. Thus, it defines as well as confines the sphere of activities of the company. If the company does something beyond the objects as given in the Memorandum, that will be *ultra vires* (beyond powers) of the company and is declared by law to be void.

The Memorandum of Association is a public document open for inspection by any member of the public, therefore, every person who deals with the company is presumed to have the knowledge of its contents. The main purpose of the Memorandum of Association is to enable its shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. Thus the intending shareholder can find out the field in, or the purpose for which his money is going to be used by the company and what risk he is taking in making the investment. Also anyone dealing with the company, say, a supplier of goods or a lender of money, will know whether the transaction he intends to make with the company is within the objects of the company or not. In case, he finds that the contract, which he intends to enter into with the company does not fall within the purview of objects as stated in the Memorandum, he would, for his own interest, refrain from entering into the intended contract.

5.3 FORM OF MEMORANDUM

Section 14 of the Companies Act, 1956, requires that the Memorandum of a company must be in one of the Forms given in Schedule 1 to the Companies Act, 1956 as may be applicable to the case of the company, or in a Form as near thereto as circumstances admit. The different forms are applicable to different types of companies.
The following model Forms of Memorandum are given in the aforementioned schedule:

Table B : A Company limited by shares.

Table C : A Company limited by guarantee and not having a share capital.

Table D : A Company limited by guarantee and having a share capital.

Table E : A Company having unlimited liability.

The Memorandum of Association must be printed, divided into paragraphs, numbered consecutively. It is to be signed by at least 7 persons in the case of a public company and by at least 2 in the case of a private company. The persons signing the Memorandum are known as 'subscribers to the Memorandum'. Every subscriber must give his address and occupation. Their signatures are required to be witnessed by at least one witness. The witness has also to give his address and occupation. A subscriber cannot witness the signature of another subscriber. Each of the subscribers must take at least one share and write opposite his name in the Memorandum the number of shares he is subscribing for.

5.4 CONTENTS OF MEMORANDUM

You have learnt the meaning and purpose of the Memorandum of Association. Let us now study the contents of the memorandum.
Section 13 of the Companies Act requires the Memorandum of a company limited by shares to contain:

a) the name of the company, with "Limited" as the last word of the name in the case of a public limited company, and with "Private Limited" as the last words in the case of a private limited company.
b) the name of the state, in which the Registered Office of the company is to be situated.
c) the objects of the company, stating separately as (i) "Main objects" and (ii) "Other objects" not included in (i).
d) the declaration in the case of a company limited by shares or by guarantee that the liability of the members is limited.
e) in the case of a company having a share capital,
   i) the amount of share capital with which the company is to be registered and the

division thereof into shares of a fixed amount (this provision is not applicable in the case of an unlimited company),

ii) Every subscriber of the memorandum has to take at least one share, and he shall write opposite his name the number of shares he takes.

From the above provisions of Section 13, we may list the following main clauses of the Memorandum of Association:

1) Name Clause
2) Situation Clause (Registered office clause)
3) Objects Clause
4) Liability Clause
5) Capital Clause
6) Association Clause (Subscription clause)

Check Your Progress A

1) What is a Memorandum of Association?

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2) Mention the type of company against the Table in which its model form of Memorandum is given:

Table B ....
Table C ....
Table D ....
Table E ....

3) State whether the following statements are True or False

i) Memorandum of Association is a primary document of a company.
ii) Memorandum of Association delimits the area of operations of a company.
iii) The signatures of subscribers to the memorandum need not be witnessed.
iv) Every company is not required to prepare and file its own Memorandum of Association at the time of incorporation.
v) There are six clauses in the Memorandum of Association of a company.
vi) Memorandum of Association of a company must contain a capital clause.

4) Fill in the blanks.

i) Memorandum of Association is to be signed by at least .... persons in the case of a public company and by .... persons in the case of a private company.
ii) The objects clause of the Memorandum is divided into two: (a) "Main objects" and (b) ....
iii) Every subscriber to the Memorandum has to take at least .... share.
iv) .... of a company defines the objects for which it has been formed.
v) The purpose of the Memorandum of Association is to protect the interest of .... as well as outsiders.
vi) The Memorandum of Association regulates the relationship of company with ....

5.4.1 Name Clause

The Memorandum of every company must state the name of the company with the word "Limited" as the last word of the name in the case of a public Limited company and with "Private Limited" as the last words of the name in the case of a private limited company. As you are already aware that a company is a legal person, it must have its name by which it will be known.

A company may choose any name but it must not be undesirable in the opinion of the Central Government (Section 20). The Department of Company Affairs (the Government of India) has formulated certain guidelines for deciding cases of making a name available for registration under the Companies Act, 1956.

Also the proposed name should not be identical with or too closely resemble, the names of an already existing company.

Further, the name of the proposed company should not contravene the provisions of the Emblems and Names (Prevention of Improper use) Act, 1950 which prohibits the use of certain names. This Act prohibits the use of the name and emblem of (a) U.N.O. and W.H.O., (b) Indian National Flag, (c) The Official Seal and Emblem of Central and State Govt. and (d) the name and pictorial representation of Mahatma Gandhi and the Prime Minister of India. Thus the proposed name, if it suggests Government patronage, where it is not there, then it will not be allowed to be registered with such name.

Publication of the company's name: Once the name is registered, it must be painted or affixed on the outside of every office or place of business in a conspicuous position, in letters easily legible, in the language in general use in the locality. It must also be engraved on the seal of the company and mentioned in all notices, advertisements, bills, letter heads etc. Non-compliance of these provisions renders the company and its officers in default liable to fine (Section 147).

5.4.2 Registered Office Clause

This clause states the name of the State in which the Registered Office of the company will be situated. Every company must have a registered office, which establishes its domicile. In fact, it is also the address where company's statutory books must normally be kept and to which notices, and all other communications can be sent.

In the Memorandum, only the name of the State in which Registered Office is to be situated, is to be mentioned. The exact address of the Registered Office may be communicated later to the Registrar of Companies, but not later than 30 days from the date of incorporation of the company (Section 146).

5.4.3 Objects Clause

This clause defines the objects of the company and thus indicates the sphere of its activities. A company cannot do anything beyond or outside its objects clause and any act done beyond them will be *ultra vires* and void. Such an act cannot be ratified even by the assent of the whole body of shareholders.

The company may, however, do anything which is incidental to and consequential upon the objects specified, and such act is not to be considered as *ultra vires*. Thus, a trading company has an implied power to borrow money, draw and accept Bills of Exchange.

Section 13 requires every company to divide its Objects Clause into the following two parts:

i) The main objects of the company. The objects which are incidental or ancillary to the attainment of the main objects are also covered in this part.
ii) Other Objects of the company not included in (i) above.

The objects given in (ii) include those objects of the company, which it is going to pursue after it is incorporated. In fact, section 149 requires that as and when a company wants to pursue an object given in the "Other Objects Clause", the company can do so only after the company in general meeting has passed a resolution authorising the company to do so (Section 149).

You should note that the objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Companies Act, 1956. For example, Section 77 prohibits a company from purchasing its own shares, Section 205 prohibits payment of dividend out of capital. Thus if the objects clause permits the company to purchase its own shares or to pay dividend out of capital, it will be *ultra vires* and void.

The objects clause must be carefully drafted but it must be in a clear and unambiguous language. This clause enables the shareholders and the creditors to know the purposes for which the funds of the company are going to be used.

5.4.4 Liability Clause

This clauses contains the nature of liability of the members of the company. This clause is necessary where the liability of the members is limited. Therefore, this clause shall not be included in the case of an unlimited company. As you know that a company may be limited by shares, or by guarantee. In case the company is limited by shares, the liability clause must state that the liability of the members shall be limited by shares. It means that the liability of a member is limited to the nominal value of shares held by him. In case the shares are partly paid, then no member can be called upon to pay more than the amount that remains unpaid on his shares. Thus, a member is liable to pay only the unpaid amount on his shares and no further. **For example:** A shareholder holds a Rs. 10 share and has paid Rs. 7.50 on it so far. He can be called upon to pay Rs. 2.50 and nothing more.

In the above example, if he holds a fully paid-up share, then his liability is nil.

In case of a company limited by guarantee, the liability of a member is limited to the amount which he has agreed to contribute to the assets of the company in the event of its liquidation.

If a company limited by guarantee has a share capital, then the liability of the member is two fold. He is liable to pay the amount remaining unpaid on the shares as and when he is called upon to pay and he is also liable upto the amount of guarantee, whatever it may be, but only if he is called upon to contribute to the assets of the company at the time of winding up.

5.4.5 Capital Clause

This clause must indicate the amount of capital with which the company is registered, and is known as Registered or Authorised or Nominal capital.

In the case of a public company having a share capital, a share may be either a Preference share or an Equity share. Thus a company's capital may be Preference share capital and Equity share capital. This clause shall state the number and value of shares into which the capital of the company is divided.

These shares are of a certain fixed value or amount. This fixed value is known as the "Par" or "nominal" value of a share. Thus the nominal value of an equity share may be Rs. 10, and that of a Preference share Rs. 100.

The effect of this clause is that the company cannot issue more shares than are authorised by the Memorandum.

5.4.6 Association Clause or Subscription Clause

In this clause the subscribers to the Memorandum of Association make the following declaration:.

"We the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the Memorandum of Association and we respectively agree to take the number of shares in the capital of the company set opposite our respective names".

According to Section 12 of the Act, the Memorandum shall be signed by at least seven subscribers in case of a public company and at least two subscribers in case of a private company. Each subscriber should sign the memorandum in the presence of at least one witness who must attest the signature. Each subscriber must take at least one share and write opposite his name in the memorandum the number of shares he is subscribing for.

5.5 DOCTRINE OF ULTRA VIRES

The term *'Ultra'* means *'beyond'* and the term *'vires'* means the *'powers'*. Thus, ultra vires a company means *'beyond the powers of a company'*. You have learnt that the objects clause of the Memorandum states the objects of the company, therefore, any act which is beyond the stated purposes is ultra vires the company and, therefore, null and void. The company shall not be bound by such acts which are *ultra vires* the company. The purpose of the

doctrine of ultra vires is to protect the interests of members, outsiders and creditors. They are:

i) The members of the company know the purposes for which their money can be used by the company.
ii) The third parties dealing with the company know the purposes for which the company has been brought into existence and, therefore, restrict their transactions with the company to those purposes only. Similarly, the creditors are assured that the assets of the company shall not be risked in unauthorised business.

Thus in order to protect the interests of the shareholders and the third parties which enter into contracts with the company, the company's activities are confined to the objects given in the Memorandum of Association. It cannot do anything beyond the objects clause and if it does, it will be considered *ultra vires* (beyond capacity) and void *ab-initio*.

Ultra vires acts can be divided into the following three categories:

1) *Ultra vires* the Companies Act,
2) *Ultra vires* the Memorandum of Association, and
3) *Ultra vires* the Articles of Association.

1) Ultra vires the companies Act: Any act done contrary to or in excess of the scope of Companies Act will be ultra vires the Act. Such an act shall be void and cannot be ratified even by a unanimous resolution of all the shareholders. A few examples of such acts are as follows:

a) Payment of dividend out of capital
b) Free distribution of bonus shares
c) Purchasing its own shares
d) Reducing the share capital without complying with legal formalities.

2) Ultra vires the Memorandum: The Memorandum defines and confines the powers of the company. The object of the company is determined by the Memorandum. A company cannot do anything which is beyond the purview of the objects clause. Any act done in contravention of the object clause shall be *ultra vires* the Memorandum and shall be void and it cannot be ratified even by an unanimous resolution of all the shareholders. The doctrine of ultra vires was first applied in the famous case of *Ashbury Railway carriage and Iron Co. v. Riche*. In this case the company was incorporated to make, and sell, or lend on hire, railway carriages and wagons and to carry on the business of machanical engineers and general contractors. The directors of the company entered into a contract with Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. The contract was ratified by the company by passing a special resolution at a general meeting. Later, the contract was repudiated by the company on grounds of its being ultra vires and it was sued for breach of contract. The House of Lords held that the contract was ultra vires the Memorandum and therefore void. It could not be ratified by the shareholders, as the contract was *ultra vires* the objects clause.

The doctrine of ultra vires has been recognised in India as well. The doctrine has been affirmed by the Supreme Court in *A. L. Mudaliar v. LIC of India*.

3) Ultra vires the Articles: Acts which are ultra vires the articles of associations but are within the powers of the company are termed as ultra vires the articles. For example, payment of interest on 'advance calls' at a rate higher than allowed by the articles. Such act shall also be void, but the company in General Meeting may alter the articles by a special resolution and ratify unauthorised acts.

Effects of Ultra vires transactions:

1) An act which is *ultra vires* the company shall be null and void and it cannot be enforced against the company.
2) An ultra vires the company transaction cannot be ratified even by the whole body of shareholders.
3) Not only the outsiders cannot enforce *ultra vires* transactions against the company, the company can also not enforce such transactions against third parties.
4) Whenever an ultra vires act has been or is about to be done, any member of the

company can approach the Court and get an injunction restraining the company from proceeding with the ultra vires acts.

5) The directors of the company can be held personally liable for any loss caused by an ultra vires transaction.

From the above it should be clear to you that if an act is *ultra vires* the company, then such act shall be null and void. Thus, if a company borrows money beyond its limit, it is ultra vires and the lender has no right in respect of the loan against the company.

You should note that if an act is ultra vires the directiors, but it is with in the powers of the company then such an act is not altogether void. It can be ratified by the shareholders in their general meeting and when it is so ratified, the company becomes liable for such acts. Now, if the company has power to brorrow, but it restricts the authority of the directors to borrow upto a certain sum. If the directors exceed their authority and borrow more than what they are authorised to borrow, then the company may, if it wishes, ratify the directors' act, in which case the loan binds both the lender and the company as if it had been made with the company's authority in the first place.

5.6 ALTERATION OF DIFFERENT CLAUSES IN THE MEMORANDUM

You have learnt that the Memorandum of Association is a document of prime importance, and therefore, it cannot be altered by the sweet will of the members of the company. The Companies Act, 1956 has laid down the procedure for altering the various clauses of the memorandum and the same has to be followed strictly. Let us now discuss the procedure for making alterations in the different clauses of the memorandum.

5.6.1 Change of Name

The name of a company may be changed at any time by (i) passing a special resolution at a general meeting of the company and with (ii) the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of the name involves only the addition or deletion of the word "Private" (i.e. when public company is converted into a private company and *vice versa).*

If a company is registered with a name which is considered by the Central Government as undesirable, it may change its name by passing an ordinary resolution and obtaining the approval of the Central Government.

The change of name must be communicated to the Registrar of companies within 30 days of passing of the said resolution. The Registrar shall enter the new name in the Register of companies and shall issue a fresh certificate of incorporation with necessary alterations. You should note that the change of name shall not affect any rights or obligations of the company.

5.6.2 Change of Registered Office

The registered office of the company may at any time be shifted from one place to another but within the same city the company is only required to inform the Registrar the new address within 30 days of the change. But if the Registered Office is to be shifted from one city to another, but within the same state, a special resolution should be passed by the company.

The Registered Office of a company may be shifted from one state to another by passing a special resolution at its General Meeting. Further this special resolution is required to be confirmed by the Company Law Board. The Company Law Board, before confirming the special resolution, will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interests are likely to be affected by the alteration. This notice is also required to be given to the Registrar of Companies and the Government of the State in which the Registered Office of the company is situated.

The Company Law Board will give an opportunity, to members and creditors of the company, the Registrar of companies and other persons interested in the company, to be

heard. The Company Law Board has authority to confirm the special resolution of the company subject to such terms and conditions as it thinks fit.

The company is under an obligation to send a printed or a typewritten copy of the special resolution to the Registrar of Companies within 30 days of passing thereof.

The company is also under an obligation to file a certified copy of the order of the Company Law Board, within three months of the passing of the order, wi . the Registrar of companies of each state—the old from which the Registered office is being shifted and the new to which it is to be shifted.

If the Company fails to file a certified copy of the order within the prescribed time, as mentioned above, then the alternation shall at the expiry of such period, become void and inoperative. Once the Company has shifted its Registered Office to the new state, then it must send to the Registrar of that state, the address of the Registered Office, within 30 days of shifting thereof.

It is to be noted that a company can shift its Registered office from one state to another state for certain purposes only. These are mentioned below under the heading "change of objects clause."

5.6.3 Change in Objects Clause

You know that the objects clause is the most important clause and any alteration in this clause has wide implications. Therefore, some restrictions have been placed on the right of a company to alter this clause. A company may, by passing a special resolution and getting it confirmed by the Company Law Board, alter its objects clause if the alteration is required to enable the company:

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

The company is under an obligation to file a printed or a type written copy of the special resolution with the Registrar of Companies within 30 days of the passing thereof. Further, the company has to file a petition with the Company Law Board for confirmation of the special resolution passed at the general meeting. The Company Law Board has to satisfy itself that the notice of the special resolution was given to all persons, whose interests are likely to be affected by the alteration. Also the notice must have been served on the Registrar of companies and the State Government. The Company Law Board will give an opportunity, to all those to whom notice has been given, to be heard. There upon, on being satisfied the Company Law Board may confirm the alteration either wholly or in part or subject to such conditions as it thinks fit.

The company is under an obligation to send a certified copy of the order of the Company Law Board together with a printed copy of the altered Memorandum to the Registrar of companies, within three months of the passing of the order. The Registrar of Companies, as soon as he receives the above-mentioned documents, will register them and issue, within one month, a certificate which will be conclusive evidence that everything required to be done under the law has been done. The alteration is effective from the date of registration of the alteration.

If the required documents as mentioned above are not filed with the Registrar of Companies within the prescribed time, the alteration and the order of the Company Law Board confirming the alteration shall, at the expiry of such period, become void and inoperative.

5.6.4 Change in Liability Clause

You know that one of the main features of a company is the limited liability of members.

Ordinarily, the liability clause cannot be altered so as to make the liability of the members unlimited.

A member of a company is bound to pay the nominal value of shares which he has purchased. The company may ask for some payment at the time of application, and some at the time of allotment. The balance may be payable as and when called for. But the company cannot demand, anything more than the nominal value of the shares held by a member. A member may, however, agree in writing, to any alteration made in the memorandum, which has the effect of increasing his liability to contribute to the share capital of, or otherwise to pay money to the company (Section 38).

5.6.5 Change in Capital Clause

The nominal or registered or authorised capital of a company may be increased as provided in section 94 of the Companies Act, 1956. A company limited by shares, if so authorised by its articles, may alter that condition of its Memorandum so as to increase its share capital by such amount as it thinks expedient by issuing new shares. This power to increase the authorised capital can be exercised by a company from time to time. Generally, this power is exercised when the company has issued all its authorised capital and requires more funds. Thus, the share capital may be increased from Rs. 20,000 in 2000 equity shares of Rs. 10 each, by the addition of Rs. 30,000 in 10 percent 300 preference shares of Rs. 100 each. The additional share capital may consist of equity and/or Preference Shares.

This alteration in the share capital must be made by the company in General Meeting. An ordinary resolution is sufficient to make the alteration. The notice convening the meeting should specify the proposed increase or different type of capital.

Where the capital has been increased, notice thereof must be filed with the Registrar of Companies. Also a copy of the resolution authorising the increase must be submitted to the Registrar of Companies within 30 days of the passing thereof. Thereupon the Registrar of Companies shall record the increase and also make any alterations which may be necessary in the company's Memoranudm of Association.

If default is made in filling the notice as aforesaid, the company and every officer of the company, who is in default shall be punishable with fine upto Rs. 50 per day during which the default continues.

Check Your Progress B

1) Why is it necessary for a company to have a Registered Office?

....

....

....

2) What is the purpose of Memorandum of Association?

....

....

....

3) Name the two parts into which Objects Clause of a company is required to be divided:
   1) ....
   2) ....

4) What do you understand by the doctrine of *ultra vires*?

....

....

....

5) State whether the following statements are True or False.
   i) A company cannot choose a name which in the opinion of the Central Government is an undesirable one.
   ii) The exact address of the company at which its Registered Office is situated in a

particular state must be given in the Memorandum of Association.

iii) Any act done by a company beyond its objects clause is *ultra vires*.

iv) In the case of a company limited by shares, a member is liable to pay only the unpaid amount on his shares.

v) In the case of a company limited by guarantee, a member can be called upon to pay at any time during the life time of the company

vi) The altered Memorandum must be filed with the Registrar within three months of the Company Law Board order.

6) Fill in the blanks.

i) A public company limited by shares can issue two types of shares i.e., Preference and ....

ii) .... is the authority that can confirm change in objects clause of a Memorandum of a company.

iii) A company can shift its Registered Office to another state by passing a special resolution and with the permission of the ....

iv) A company cannot pursue 'other objects' listed in its Memorandum of Association except with the consent of ....

v) The capital clause of Memorandum points out the .... capital of a company.

5.7 LET US SUM UP

A Memorandum of Association of a company is the foundation of a company as without it, it cannot be established. It defines the objects beyond which the activities of a company cannot go. Further it defines its relationship with third parties which enter into contracts with it. Also it tells the prospective shareholders of the company as to the purposes on which money subscribed by them would be spent.

A Memorandum of a company limited by share must contain the following clauses: (i) Name Clause (ii) Registered Office Clause (iii) Objects Clause (iv) Liability Clause (v) Capital Clause and (vi) Association clause

A company's activities are to be confined to its objects clause. If a company does something which is beyond its objects clause, then that act is *ultra vires* and is null and void *ab initio*.

Though Memorandum of Association is a fundamental charter of the company, it can be altered to some extent, for certain purposes and by following the procedure laid down in the Companies Act, 1956.

5.8 KEY WORDS

Limited Liability: It denotes that the liability of the members is limited by the amount remaining unpaid on their shares. In the case of a guarantee company, this phrase denotes the maximum amount upto which a member of a company can be called upon to pay at the time of winding up.

Memorandum of Association: It is a fundamental document containing conditions on the basis of which a company is incorporated.

Par Value: A company limited by shares has a share capital which is divided into shares of a certain fixed values or amount. This fixed value amount is known as "Par value".

Registered Office: The Registered Office of a company determines its domicile. Also this is the office to which notices are served and communications are sent to the company.

Ultra vires: Something which is beyond the powers of a company to do.

Unlimited Liability: The Liability of the members of a company is termed as unlimited when their personal assets can be called up to pay the liabilities of the company.

5.9 SOME USEFUL BOOKS

Chawla R.C. and K. C. Garg 1990. *Mercantile Law*. Kalyani Publishers: New Delhi. (Chapter 4, Section on Company Law)

Kapoor N.D. 1990. *Elements of Company Law*. Sultan Chand and Sons: New Delhi. (Chapter 5)

Kuchhal. M.C. 1989-90. *Modern Indian Company Law*. Shree Mahavir Book Depot : Naisarak, Delhi. (Chapter 5)

5.10 ANSWERS TO CHECK YOUR PROGRESS

A 2 Table B A company limited by shares
Table C A company limited by guarantee and not have a share capital
Table D A company limited by guarantee and having a share capital.
Table E A company having unlimited liability.

3 i) True ii) True iii) False iv) False v) True vi) True

4 i) 7;2 ii) Other objects iii) one iv) Memorandum v) members vi) Outsiders.

B 5 i) True ii) False iii) True iv) True v) False vi) True

6 i) Equity ii) Company Law Board, iii) Company Law Board iv) Company in general meeting v) Authorised/Registered/Nominal.

5.11 TERMINAL QUESTIONS

1) What do you understand by Memorandum of Association?
2) What is the purpose of Memorandum of Association?
3) Enumerate the different clauses which are included in the Memorandum of Association.
4) Illustrate the Doctrine of *ultra vires* with suitable examples.
5) Describe the procedure for alteration of the objects clause of a company.

> **Note:** These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 6 ARTICLES OF ASSOCIATION

Structure

6.0 Objectives
6.1 Introduction
6.2 Meaning and Purpose of Articles
6.3 Registration of Articles
6.4 Contents of Articles
6.5 Alteration of Articles
6.6 Relationship between Memorandum and Articles
6.7 Distinction between Memorandum and Articles
6.8 Effect of Memorandum and Articles
6.9 Constructive Notice of Memorandum and Articles
6.10 Doctrine of Indoor Management
6.11 Let Us Sum Up
6.12 Key Words
6.13 Some Useful Books
6.14 Answers To Check Your Progress
6.15 Terminal Questions/Exercises

6.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning and the purpose of articles of association
- describe the contents of articles of association
- explain the relationship of and distinction between articles and memorandum
- explain the legal effects of the memorandum and articles
- explain the doctrines of constructive notice and indoor management
- explain the procedure for alteration of articles of association.

6.1 INTRODUCTION

You have learnt in earlier units that a company is an incorporated body. Therefore, rules are to be framed for the management of its internal affairs and the conduct of its business. The relationship between the company and the members constituting it, is to be defined. The rights and duties of members *vis-a-vis* the company are to be described. All such rules and regulations are given in the Articles of Association. The Articles is the second important document which has to be filed with the Registrar of companies.

The Companies Act, 1956, in Table A of Schedule I has given model regulations for the management of a company limited by shares. A company limited by shares may adopt all or any of the regulations contained in Table A. Every company must have Articles of Association. In this unit you will learn about the significance of the Articles and its contents. You will also note the distinction between the Memorandum and the Articles. The procedure of altering the Articles has also been explained briefly. You will also study the legal effects of these documents. The doctrine of Indoor management has been explained in detail, which will help you to appreciate the purpose of these documents.

6.2 MEANING AND PURPOSE OF ARTICLES

Section 2(2) of the Companies Act defines Articles as *the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act*. This definition is not sufficient to explain its meaning.

The Articles of Association of a company are the rules and regulations relating to the management of its internal affairs. They are similar to the 'partnership deed' in a

partnership. The Memorandum defines the area beyond which the company cannot act while the articles contain the rules and regulations for carrying out the business of the company. Thus 'Articles' is subordinate to, and controlled by the 'Memorandum'.

The Articles embody the powers of directors, officers and of the shareholders as to voting etc., the mode and the form in which the business of the company is to be carried out and the mode and the form in which the changes in the internal regulations can be made. The rights, duties and powers of the company *vis-a-vis* the members are included in the Articles of Associations. The Articles bind not only the existing members, but the future members of the company also. Even the successors, legal representatives or heirs of members are bound by whatever is contained in the Articles. In fact, the Articles bind the company and the members as if they had been signed by each one of them.

Articles of Association is the basis of contract between the company and the members. Members have certain rights against the company. Also members have certain duties towards the company. These rights and duties of members are given in the Articles. For example, a member is under an obligation to pay call money on his shares as and when the directors of the company decide to make the calls in accordance with the procedure laid down in the Articles of Association. If the member fails to make the payment, his shares may be forfeited by the company in accordance with the procedure prescribed. On the other hand, a member has a number of rights. For example, he has right to attend the meeting of the Company and vote.

Further, Articles of Association of a company constitute a contract not only between members and the company; but members *inter se* also. This is explained in detail under 6.8 (Effect of Memorandum and Articles).

6.3 REGISTRATION OF ARTICLES

Section 26 of the Act requires that every private company, an unlimited company and a company limited by guarantee must have their own articles and it should be registered along with the memorandum. But a public company limited by shares need not necessarily have its own articles. A public company limited by shares may either have its own articles or it may adopt either wholly or partly Table A of Schedule I of the Companies Act. Even if it does register Articles of its own, Table A will still apply automatically unless it has been excluded or modified. In other words, there are three possible alternatives in which a public company limited by shares may adopt Articles of Association. These are:

i) It may adopt Table A in full; or
ii) It may wholly exclude Table A and set out its own Articles in full; or
iii) It may set out its own Articles and adopt part of Table A.

If such a company goes in for the first alternative, then it is not necessary to get any Articles of Association registered. It has only to endorse on the face of the Memorandum of Association, that it has adopted Table A as its Articles of Association.

You should note that the Articles of a private limited company must contain the three restrictions as given in Section 3(1) (iii). The Articles of Association of an unlimited company should state the number of members with which the company is to be registered and, if the company has a share capital, the amount of share capital with which the company is to be registered [Section 27 (1)].

In the case of a company limited by guarantee, the articles should state the number of members with which the company is to be registered [Section 27 (2)]. The Articles of Association must be printed, divided into paragraphs, numbered consecutively and signed by each subscriber of the Memorandum of Association in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any [Section 30].

6.4 CONTENTS OF ARTICLES

You have learnt that the Articles of Association of a company contains the rules and regulations for the internal management of the company.

The Articles of Association of a company should usually contain rules and regulations relating to the following matters:

i) The exclusion, wholly or in part, of Table A, in the case of a public company limited by shares. But other companies may, if they so desire, include the relevant provisions from Table A in their Articles of Association.
ii) Share capital—shares and their value and its division into equity and preference shares, if any.
iii) Rights of each class of shareholders and the procedure for variation of their rights.
iv) Procedure relating to the allotment of shares, making of calls and forfeiture of shares.
v) Increase, alteration and reduction of share capital.
vi) Transfer and transmission of shares.
vii) Lien of the company on shares allotted to the members for the amount unpaid in respect of such shares.
viii) Appointment, remuneration, power, duties etc. of the directors and officers of the company.
ix) Conversion of shares into stock.
x) Notice of the meetings, voting rights of members, quorum, poll, proxy, etc.
xi) Audit of Accounts, transfer of amount to the Reserves, declaration of dividend, etc.
xii) Borrowing Powers of the company and the mode of borrowing.
xiii) Adoption of preliminary contracts, if any.
xiv) Issue of share certificates.
xv) Issue of share warrants.
xvi) Keeping of different Registers.
xvii) Regarding winding up of the company.

The Articles of Association must be prepared carefully and it must contain rules in regard to all such matters which are required to be contained therein and which are necessary for the smooth functioning of the company.

But you must remember that the articles must not contain anything which is against the provisions of the Companies Act or the Memorandum of Association. For example, the Articles must not contain a rule permitting the payment of dividend out of capital, because according to Section 205 dividend can be paid only out of profits.

6.5 ALTERATION OF ARTICLES

You know that the Articles contain the rules and regulations for the internal management of the company. A company has a statutory right to alter its Articles of Association. Section 31 of the Companies Act, 1956 empowers a company to alter or add to its Articles of association. The articles can be altered by following the procedure laid down in the Act.

Section 31 of the Companies Act, provides that subject to the provisions of this Act and to the conditions contained in its Memorandum, a company may, by special resolution alter its Articles. It may be noted that a company cannot deprive itself of its power to alter Articles either by an agreement or by a provision to that effect in the Articles themselves.

However, no alteration made in the Articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government [Provisos to Section 31 (1)]. Any alteration made in the Articles of Association shall be as valid as if originally contained in the Articles [Section 31(2)].

The Companies Act gives wide powers to the members of the company to alter its Articles. However, the alteration should be made bona fide for the benefit of the company as a whole and not for the benefit of majority of the shareholders.

This power of alteration of Articles is subject to whatever is contained in the Companies Act, 1956 or the company's Memorandum of Association. In other words, the Articles of Association cannot be altered in such a way as to be contrary to whatever is given in the Company's Act, or the company's Memorandum of Association. For example, the Companies Act, 1956 prohibits a company from purchasing its own shares. Now, the company cannot alter its Articles in such a way as to empower itself to purchase its own shares. Thus, there are certain limits within which the alteration of Articles can be carried out.

Limitations on Power to Alter Articles

Though a company can alter its Articles at any time just by passing a special resolution, but a few restrictions are placed on such a power. These are:

i) The alteration in the Articles proposed to be made must not be in conflict with whatever is contained in Memorandum of Association.
ii) The alteration in the Articles must not be inconsistent with any provisions of the Companies Act, 1956. For example, Sections 106-107 deal with the procedure for variation of shareholder's rights. The Articles cannot be altered so as to include rules which are contrary to the provisions in Sections 106-107 of the Companies Act, 1956.
iii) The alteration in the Articles cannot be made in such a way as to include anything which is illegal either under the Companies Act, 1956 or any other law.
iv) The alteration must be bonafide being made for the benefit of the company as a whole. The following case of **Allen v. Gold Reefs of West Africa** illustrates this point. In this case; the original Articles gave the company a lien on all shares "not fully paid-up" for calls due to the company. S was the only member holding some fully paid-up shares, but he also owned money to the company for calls due on other shares. S died and his shares were inherited by his legal representatives. The company, thereafter, altered its Articles enabling the company to exercise lien on all shares—whether fully paid or not. Now the question arose whether the company could exercise lien even on fully paid-up shares.

It was held that the company could do so as it was done bona fide for the benefit of the company as a whole.

v) An alteration which has the effect of compelling a member to take or subscribe for more shares, or in any way increasing his liability to contribute to the share capital of the company is not binding on the existing members, unless he has given his consent in writing (Section 38).
vi) A company may pass a special resolution and convert the uncalled capital into a reserve liability to be called up only at the time of winding up (Section 99). But a reserve liability once created cannot be unreserved but may be cancelled on reduction of capital.
vii) No alteration in the Articles can be made so as to convert a public company into a private company without the approval of the Central Government (Section 31).
viii) No alteration to the Articles can be made which would discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter have been deprived.
ix) No alteration can be made so as to enable the company to commit a breach of contract with a third party. The company shall remain liable for damages for its breach.
x) The alteration must not be inconsistent with an order of the court. Such alterations can be made by the company only with the leave of the court.

A copy of the special resolution authorising the alteration must be filed with the Registerar within 30 days of passing the said resolution. According to Section 40 of the Act, alteration should be noted in every copy of the Articles of Association, and the Articles of association, issued after the date of alteration should be in accordance with the alteration.

Check Your Progress A

1) What is the purpose of Articles?

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2) What is the meaning of Articles?

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3) What is included in Table A of Schedule I?

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....

4) List any four items which are included in Articles?

....

....

....

....

5) State whether the following statements are True or False
   i) Articles of Association regulate the relationship of the company with Members.
   ii) A Private Company may adopt Table A.
   iii) Articles is the Charter of a Company.
   iv) Every company is required to frame its own Articles of Association.
   v) Articles of Association constitute a contract between members *inter se*.
   vi) Articles of Association must be signed by subscribers to the Memorandum.
   vii) Articles of a Company can contain matters inconsistent with the provisions of the Companies Act, 1956.
   viii) Articles of Association are not required to be registered in case of a private company limited by shares.
6) Fill in the Blanks.
   i) Articles of Association are subsidiary to ....
   ii) Articles of Association are the rules and regulations for the management of .... of the Company.
   iii) A public Company limited by shares may adopt .... as its Articles of Association.
   iv) Articles of Association can be altered by passing a ....

6.6 RELATIONSHIP BETWEEN MEMORANDUM AND ARTICLES

The Memorandum of Association is a fundamental document of a company just like a constitution of a country. It is the main document as placed alongwith Articles which is subordinate to and is controlled by the Memorandum of Association.

The Articles cannot confer powers on the company other than those given in the Memorandum of Association of the company. Therefore, at the time of framing the Articles or making alteration in the Articles, it must be ensured that the original regulations or the altered ones do not exceed powers of the company given by the Memorandum, nor give validity to any provision which is contrary to the Companies Act, 1956. For example, the Company's objects clause is divided into two parts and is given in the Memorandum of Association. The objects given in the 'Other objects' can be started only after following the procedure given in the Companies Act. In such a situation, the company cannot make a provision in the Articles empowering the company to start business in the other objects clause along with the objects given in the 'main objects clause' at the time when the company is incorporated.

The Memorandum is of interest to outsiders who wish to deal with the company, while the articles are of interest mainly to the shareholders and directors.

6.7 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The following are the main points of distinction between the Memorandum and Articles:

1) Memorandum of Association is the charter of the company. It lays down the scope and

powers of the company. In fact, Memorandum defines the area beyond which the actions of the company cannot go. Inside that area the shareholders may make such regulations for the governance of the company as they think fit.

2) Memorandum of Association is a fundamental ducument. Articles of Association are subordinate to and are controlled by the Memorandum of Association.
3) The purpose of Memorandum is two fold:
   i) to tell the intending purchaser of shares the scope of the activities of the company and the objects on which his money will be invested.
   ii) to tell those who deal with the company as to what the objects of the company are so as to enable them to enter into only those contracts with the company which are not *ultra vires*. The purpose of the of the Articles of Association is to provide rules and regulations for the internal management of the company. Thus, a company is not bound to an outsider, but it is bound to a member by whatever is contained in its Articles of Association.
4) Articles of Association is the basis of a contract between the company and its members, Memorandum of Association generally defines the relation between the company and outsiders.
5) A public company limited by shares need not frame its own Articles of Association. It may adopt Table A as its Articles. But every company, without exception, must prepare its own Memorandum of Association.
6) The clauses of the Memorandum cannot be easily altered. The company has to follow the strict procedure for the alteration of its clauses. In some cases alteration requires the approval of the Company Law Board or the Court. Whereas, Articles can be altered easily by passing a special resolution.
7) Any act which is beyond the powers given in the Memorandum is *ultra vires* and void and it cannot be ratified even by the whole body of shareholders. But any act which is *ultra vires* the Articles may be ratified by shareholders by passing a special resolution.

6.8 EFFECT OF MEMORANDUM AND ARTICLES

Section 36 provides that 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. Thus, the Memorandum and Articles constitute a binding contract between the company and each of its member. The legal effects can be studied under the following headings:

i) **Members bound to Company** : The memorandum and Articles constitute a contract binding the members to the company. Each member is bound by whatever is contained in them as if both these documents were signed by him.

   In **Boreland's Trustee v. Steel Brothers and Co. Ltd.** case, the Articles of the company provided that the shares of any member who became bankrupt would be sold to other persons at a price fixed by the directors. *B*, a shareholder became bankrupt and his trustee in bankruptcy claimed that he was not bound by the articles and could therefore, sell those shares at their true value. But it was held, that the trustee in bankruptcy was bound by the Articles as it constituted a binding contract between the members and the company.

   Similarly in **Bradford Banking Company v. Brigs** case where the Articles provided that the company shall have a first charge on the shares for the debts due to it by members. One of the members owing money to the company borrowed money from the bank on the security of shares. The bank gave notice of deposit of shares to the company. It was held that the company has priority over the shares.

   From the above, it is clear that company can sue its members for the enforcement of the Articles and can restrain its members through court from violating any provisions contained therein.

ii) **Company bound to the Members** : Since the Articles and Memorandum constitute a contract binding the company to its members, the company, in its turn, is also bound to the members by whatever is contained in them. For example, it must confine its activities to the objects clause in the Memorandum. If it proposes to enter into any *ultra*

vires contract, any member of the company can go to a Court and obtain an order of injunction restraining the company from doing so. Similarly, the company is bound to individual members in respect of their ordinary rights as members. For example, he can exercise his right to receive a share certificate, the dividend warrant, notice for the meeting etc; to vote at the meeting, to elect directors etc. according to the rules and regulations given in theArticles.

iii) **Member bound to Member :** The Memorandum and Articles do not constitute express contract between the members of the company. Yet each member is bound by these documents on the basis of an implied contract to the other members. The Articles regulate their rights *inter se*. As between members *inter se*, each member is bound by the Articles and Memorandum to the other members. However, this right can be exercised through the company only except in some exceptional cases. For example, if a member has committed a breach of the Articles, say, he has not paid his calls on his shares, another member has no right to sue him.

It is only the company which can sue a defaulting member. However, if a member holds a majority of the shares of the company and does not allow an action to be taken in the name of the company, the complaining members are entitled to maintain a suit in their own name against such a member provided the acts complained are a fraud on the minority or are *ultra vires* the company.

iv) **The company is not bound to outsiders :** The Articles of Association do not constitute any contract between the company and the outsiders therefore, outsider cannot sue the company. An outsider is not entitled to enforce the articles against the company for any breach of a right that is conferred on him by the articles. Even if the name of an outsider is mentioned in the Articles for any proposed business, the company is not bound by it. The following case of **Eley v. Positive Government Life Assurance Co. Ltd.** illustrates this point.

The Articles of the company contained a provision that Eley would be the solicitor of the company for life and would not be removed from office except for misconduct. Eley acted as solicotor to the company and also became a member of the company. The company, however, terminated his services. Thereupon, he sued the company for damages for breach of contract. *Held*, the Articles cannot be the basis of a contract between the company and an outsider. It would be noted here that he was trying to exercise his right as an employee and not as a member. A person can be a member of the company and at the same time may be a creditor or employee of the company. In the above case, he was trying to exercise his right as an employee of the company. There was no independent contract between the company and Eley apart from whatever was contained in the Articles. Therefore, his suit was dismissed.

6.9 CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

You have learnt that for incorporating a company, the Memorandum and Articles of Association are required to be registered with the Registrar of Companies. On registration, the Memorandum and Articles of Association become public documents. These documents are available for public inspection either in the Office of the company or in the office of the Registrar on payment of one rupee for each inspection.

Every person who deals with the company, whether shareholder or an outsider, is presumed to have read these documents and is deemed to know the contents of these documents. This type of presumed knowledge of these documents is termed the 'Constructive Notice' of Memorandum and Articles of Association.

Therefore, any person dealing with the company cannot argue that he has not read the documents, such as Memorandum, of the company. For example, if a person enters into a contract with a company and supplies some material to the company, but the company refuses to pay on the ground that this contract is *ultra vires* the company, then the supplier cannot, in his defence, take the plea that he did not know the provisions of the Memorandum of Association of the company.

Thus if a person deals with a company which is not covered by these documents, he cannot take the plea in a Court that he was unaware of the contents of the Memorandum and Articles. He is presumed to have not only notice of these documents, but to have read them and understood them accordung to their proper meaning. It is immaterial if he has not even seen them.

The above doctrine of Constructive Notice is, however, modified by the doctrine of Indoor Management.

6.10 DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management is an exception to the rule of constructive notice. The doctrine of indoor management imposes an important limitation on the rule of constructive notice. According to the rule of constructive notice, persons dealing with the company are presumed to have read and understood the contents of these two documents. Once they are satisfied that the company has got the power to enter into the proposed transaction, they are required to do no more. They are not bound to enquire into the regularity of any internal proceedings. They are entitled to assume that the provisions of the Articles of Association have been complied with by the company. This doctrine seeks to protect the outsiders against the company.

Therefore, if a transaction appears to be within the powers of the company, then the company cannot escape liability by showing that there was some irregularity in following the procedure. A person can be presumed to know the constitution of the company, but not what may or may not have taken place within the doors that are closed to him. This doctrine is known as the 'doctrine of indoor management' or the rule in **Royal British Bank v. Turquand**. The facts of this case were as follows: The directors of a company were authorised by the articles to borrow on bond such sums of money, as authorised from time to time, by a resolution of the company, in General Meeting. The directors borrowed money from Turquand and issued a bond to him. No resolution of the company, as was required to be passed according to the Articles of Association was passed. *Held*, Turquand could sue the company on the bond, as he was entitled to assume that whatever was required to be done as regards the internal management of the company was done. In other words, he was entitled to assume that the resolution of the company in General Meeting authorising the directors to borrow money on the basis of bond had been passed. He was not duty-bound to inquire whehter the resolution had been actually passed or not. However, he must have found out whether the company had the power to borrow or not, as that was the burden imposed upon him by the doctrine of Constructive Notice.

Exceptions

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

1) **Knowledge of Irregularity :** A person who has knowledge of an irregularity regarding the internal management of the company cannot claim protection provided by this doctrine. The knowledge of irregularity may be actual or constructive. In this connection the case of **Howard v. Pokent Ivony Co.** is relevant. The directors were empowered to borrow money upto £ 1,000 and sanction of the shareholders was required for an amount in excess of this. The directors themselves lent to the company an amount in excess of the borrowing powers without the consent of the shareholders. It was held that the directors had the notice of the internal irregularity and therefore the company was liable to them only for £ 1,000.

2) **Negligence :** If a person who deals with the company, does not take the trouble of reading these documents to find out whether the proposed transaction is within the scope of powers of the company or not, he cannot claim any benefit under the doctrine of indoor management.

3) **Acts Beyond Apparent Authority :** If an officer of the company does something, which would not ordinarily be within his powers, the person dealing with him must make proper inquiries and satisfy himself as to the officer's authority. If he fails to make proper inquiry in spite of suspicious circumstances, he cannot claim any protection under the doctrine of indoor management.

3) In **Anand Bihari Lal v. Dinshaw & Co.'s**, case the accountant of the company transferred some property of the company to the plaintiff. The transfer was held by the Court to be void, because the power to transfer property could not be considered within the apparent authority of the accountant. The plaintiff were put to suspicion as they should have enquired thoroughly before entering into the transaction.

4) **Forgery :** The rule is not applicable when the document relied upon by the outsiders turns out to be a forged one. A company is not liable for forgeries committed by its Officer.

   In the case of **Ruben v. Great Fingal Consolidated Company**, a share certificate was issued by the Secretary of the company under the two forged signatures of the directors as required by the articles. The holder of the share certificate wanted to be registered as a member of the company, but the company refused to accept him as a member of the company. The share certificate holder's plea was that he had no means to find out the genuiness of the signatures, therefore, he should be protected. But it was held that the doctrine of indoor management is not applicable to cases of forgeries.

Check Your Progress B

1) What is meant by constructive notice?

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   ....

   ....

2) What do you mean by doctrine of indoor management?

   ....

   ....

   ....

   ....

3) List the exceptions to the doctrine of indoor management?

   ....

   ....

   ....

   ....

4) State whether the following statements are True or False.
   i) Articles may explain any ambiguity included in the Memorandum.
   ii) Any one dealing with the company is presumed to have notice of the contents of the Memorandum and Articles.
   iii) Any one dealing with the company is not entitled to assume that whatever was required to be done as regards internal management of the company, has been done.
   iv) Articles of Association regulates the relations of company with its members.
   v) A person who could discover irregularity while dealing with a company cannot claim benefit of the doctrine of indoor management.

5) Fill in the blanks.
   i) Memorandum and Articles, when registered, bind a company and its ....
   ii) Every person dealing with a company is presumed to have notice of the contents of ....
   iii) Any one dealing with the company is .... to assume that whatever was required to be done in the internal management of the company has been done.

6.11 LET US SUM UP

Articles of Association is an important document of a company. It contains rules and regulations which govern the management of the internal affairs of the company. They

define the duties and rights of the company, its members and directors in their respective capacities.

Articles are subordinate to Memorandum of Association, which is considered to be the prime document of a company. However Articles can be made use of for explaining any ambiguity in the Memorandum.

A company has the statutory right to alter its articles by passing a special resolution. This right cannot be curtailed either by an agreement or a clause in the articles. However, alterations in the articles can be made subject to certain limitations. Alteration must not be inconsistent with the Memorandum of Association or the provisions of the Act. Both the documents—the Memorandum and Articles are considered to be public documents. Therefore anyone dealing with the company is presumed to have the knowledge of their contents. However, he is entitled to assume that whatever was required to be done as regards the internal management of the company, has been done. However, there are some exceptions to this rule.

6.12 KEY WORDS

Constructive Notice : A knowledge of the contents of documents on the part of those who are dealing with the company is presumed by law.

Inter se: Amongst themselves.

Public Document : Any document which is in the possession of an officer of the government, and is open to inspection is known as a public document.

Table A : Schedule I to the Companies Act includes Table A. This Table contains model rules and regulations for a company having a share capital.

6.13 SOME USEFUL BOOKS

Chawla R.C. and K.C. Garg, 1990. *Mercantile Law*, Kalyani Publishers: New Delhi (Chapter 5, Section on Company Law)

Kapoor N.D., 1990. *Elements of Company Law*, Sultan Chand and Sons: New Delhi (Chapter 6)

Kuchhal M.C., 1989-90. *Modern Indian Company Law*, Shree Mahavir Book Depot: Nai Sarak, Delhi (Chapter 6)

6.14 ANSWERS TO CHECK YOUR PROGRESS

A 5) i) True ii) False iii) False iv) False v) True vi) True vii) False viii) False
6) i) Memorandum of Association ii) Internal Affairs iii) Table A iv) Special resolution.

B 4) i) True ii) True iii) False iv) True v) True
5) i) Members ii) Memorandum and Articles of Association iii) entitled

6.15 TERMINAL QUESTIONS EXERCISES

1) What are Articles of Associations? How can they be altered?
2) "The power of altering Articles of Association is wide, yet it is subject to a large number of limitations." Explain.
3) What are the usual contents of the Articles?
4) Explain the legal effect of the Articles of Association. How far they are binding on outsiders?
5) Explain briefly the relation between Memorandum and Articles of Association.
6) What is the distinction between a Memorandum and Articles of Association.
7) Explain the 'doctrine of indoor management'. Are there any exceptions to this doctrine?

8) Answer the following problems giving reasons:

i) The secretary of a company issued a share certificate in favour of 'A', which apparently complied with the company's articles, is purported to be signed by two directors and the secretary and it had the company's seal affixed to it. In fact, the secretary had forged the signature of the directors and affixed the seal without authority. Is the certificate binding on the company?

ii) The Articles of a company contained a clause that prohibits any alteration. Is the clause valid?

iii) The majority of shareholders of a company passed a special resulution to alter its Articles of Association so as to give powers to the directors to require any shareholder who competed with company's business to transfer his share to any nominee of the directors. The plaintiff who carried on competing business challenged the validity of the alteration. Give your decision.

iv) The Articles of Association of a company contained a clause in which it was stated that A shall be the solicitor for the company and that he shall not be removed except on the ground of misconduct. Can the company remove A even though he is not guilty of misconduct?

v) Company 'A' lends money to Company 'B' on a mortgage of its assets and the procedure laid down in the articles was not complied with and the directors of the two companies were the same. Is the mortgage binding upon Company B?

HINTS

i) No. A forgery is a nullity. Therefore, certificate is not binding on the company (Refer to Ruben v. Great Fingal Consolidated Co.)

ii) No. The power to alter articles is a statutory power and therefore, it cannot be taken away.

iii) The alteration is perfectly valid as it is in the overall interest of the company.

iv) Yes, the company can remove A because the Articles of Association constitute no contract between the company and the outsider (Refer to Eley v. Positive Govt. Life Assurance Co. Ltd.).

v) No. The mortgage is not binding on Company B. The directors had knowledge of the irregularity.

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 7 PROSPECTUS

Structure

7.0 Objectives
7.1 Introduction
7.2 Meaning and Importance
7.3 Contents of Prospectus
  7.3.1 Matters to be specified in the Prospectus
  7.3.2 Reports to be set out in the Prospectus
  7.3.3 Registration of Prospectus with Registrar of Companies
7.4 Statement in lieu of Prospectus
7.5 Minimum Subscription
7.6 Misrepresentation in the Prospectus and its Consequences
  7.6.1 Remedies against the Company
  7.6.2 Remedies against Promoters and Directors of the Company
  7.6.3 Remedies against Experts
  7.6.4 Criminal liability for Misstatements in the Prospectus
7.7 Let Us Sum Up
7.8 Key Words
7.9 Some Useful Books
7.10 Answers To Check Your Progress
7.11 Terminal Questions/Exercises

7.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning and importance of prospectus
- describe the contents of prospectus
- explain the meaning of the statement in lieu of prospectus
- distinguish prospectus from a statement in lieu of prospectus
- describe the concept of minimum subscription
- explain the effects of misstatements in the prospectus and the remedies available.

7.1 INTRODUCTION

When a company is incorporated, the next step is to raise the necessary resources for carrying out the business of the company. It becomes an important duty of the first directors to raise the necessary capital. As you have learnt, a private company is prohibited from inviting public to subscribe to its share capital, the need of inviting public to subscribe to the share capital arises only in the case of a public company. Even in case of a public company if the directors are confident of arranging the required capital privately, they need not issue a prospectus, but the company has to file a statement in lieu of prospectus with the Registrar of companies. Generally a public company raises its capital by issuing a prospectus. The main objective of issuing a prospectus is to inform the investors about the company's business, financial position, capital structure, future prospects, management etc. In this unit, you will learn the meaning, need and importance of issuing a prospectus. You will also note the contents of a prospectus and how it is different from a statement in lieu of prospectus. At the end, the various remedies available for making misstatements in the prospectus are explained.

7.2 MEANING AND IMPORTANCE

Section 2(36) of the Companies Act, 1956 defines a prospectus as *any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.*

In simple words, a prospectus may be defined as an invitation to the public to subscribe to the shares or debentures of a company. You should note that any document inviting deposits from the public shall now be treated as a prospectus.

You must remember that a prospectus is not an offer by the company but it is only an invitation to offer. A company, by issuing a prospectus to the public at large, is inviting applications for the purchase of its shares or debentures. The persons who want to purchase shares in the company would fill up the share application forms and submit the same alongwith the share application money. This act of applicants amounts to making offers to the company to buy as many shares in the company as are mentioned in the share application form. The Board of directors of the company will then make the allotment of shares in response to the share application form. This act of the Board of directors amounts to acceptance of the offer of the applicant to purchase shares. Thus, a contract between the applicant and the company is made with all the contractual rights and obligations.

The definition of prospectus includes any notice, circular, advertisement or other document inviting deposits from the public. Thus, the invitation of public deposits by the companies is also regulated by the prospectus.

Meaning of Prospectus Issued to the Public

From the definition of prospectus, it must be clear to you that the invitation must be made to the public. In Section 67 of the Act the term 'public' has been explained as follows : *It includes any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.* Thus, if a document inviting persons to buy shares or debentures is issued to any section of the public, say to all the doctors or engineers or to all the clients of a particular share broker, it will amount to a prospectus. For deciding whether the invitation is made to the public or not, the language of the notice and the facts of the particular case has to be considered. It is not the number of copies of the prospectus or the persons to whom it is issued, is the deciding factor but the real test is as to who can apply for shares in response to the invitation. A single private communication does not amount to an invitation to the public. This is illustrated by the case of **Nash v. Lynde.**

A managing director of a company sent to his co-director several copies of a document marked "strictly private and confidential" and containing particulars of a proposed issue of shares, accompanied by share application forms. One of the copies was sent by the co-director to a solicitor, who in turn, gave it to a client who passed it on to a relation. The allottee (relative of the client of the solicitor) filed a suit for compensation for the loss sustained by him by reason of an omission in the document. It was held that the document did not amount to "prospectus issued to the public", as it was marked "strictly private and confidential".

A document is deemed to be issued to the public, if the invitation is such as to be open to any one who brings his money and applies for shares in the company, whether the prospectus was addressed to him or not. But if the invitation is capable of being accepted only by those to whom it has been made, then it should not be regarded as to have been made to the public. In **Sherwell v. Combined Incandescent Mantles Syndicate,** the invitation to subscribe to the shares of the company was issued to a few friends of the directors, it was held not amounting to an offer to the public.

7.3 CONTENTS OF PROSPECTUS

Section 55 provides that *a prospectus issued by or on behalf of a company, or in relation to an intended company shall be dated, and that date must, unless contrary is proved, be taken as the date of the publication of the prospectus.*

Section 56 provides that *a prospectus must (i) contain the matters specified in Part I of Schedule II and set out the reports specified in Part II of Schedule II of the Companies Act, 1956.* The Third Part of the schedule is explanatory of Part I and II.

7.3.1 Matters to be Specified in the Prospectus

Part I of Schedule II enumerates the following matters to be specified in the Prospectus:

1) The main objects of the company.
2) The names, occupations and addresses of the signatories to the Memorandum of Association and the number of shares subscribed for by them.
3) The number and classes of shares, if any.
4) The number of redeemable preference shares intended to be issued, with the date of redemption or, where no date is fixed, the period of notice required for redeeming the shares; and the proposed method of redemption.
5) The number of shares, if any, fixed by the articles, as the qualification shares of a director.
6) The names, addresses and occupations of the directors, the managing director, or manager together with any provision in the articles or a contract regarding their appointment, remuneration, or compensation for loss of office.
7) i) The amount of minimum subscription on the receipt of which the directors may proceed to allot shares; ii) the time of the opening and closing of the subscription list; iii) the amount payable on application and allotment on each shares; iv) If any allotment was previously made within the two preceding years, the details of the shares allotted and the amount, if any paid thereon.
8) The substance of any contract or arrangement giving to any person (such as a promoter) any option or preferential right to subscribe for any share in, or debentures of a company; together with the amounts payable and the period during which option is to be exercised by such persons, whose names, occupations and addresses must also be given.
9) Particulars of shares or debentures which, within the two preceding years, had been issued for consideration other than cash, and the amount of consideration for which they were issued.
10) The amount payable as premium on each share to be issued, stating the proposed date of issue; and where some shares of the same class are to be issued at different premiums or at par, or at a discount, and others at a premium, the reasons for the differentiation.
11) Where the issue of shares or debentures is underwritten, the names of the underwriters, if any, and the opinion of the directors that resources of underwriters are sufficient to discharge their underwriting obligations.
12) The names, occupations and addresses of vendors from whom the company has acquired any property, and the amount paid or payable in cash, shares or debentures to the vendors.
13) The names, descriptions, addresses and occupations of each person (including promoter or officer of the company) to whom any amount as commission for (i) subscribing or agreeing to subscribe for any shares or debentures or (ii) underwriting them is paid within the preceding two years together with the amount paid and the rate of underwriting commission as well as any benefit paid or payable to the promoter or officer.
14) The amount or estimated amount of preliminary expenses and the names of persons by whom any of those expenses have been paid or are payable.
15) Any amount or benefit paid or given within the two preceding years or intended to be paid or given to any promoter or officer and the consideration for the payment of the given benefit.
16) The dates of, parties to, and general nature of every contract appointing or fixing the remuneration of a managing director, or manager whenever entered into.
17) The names and addresses of the auditors, if any, of the company.
18) Full particulars of the nature and extent of the interest, if any, of every director or promoter i) in the promotion of the company, or ii) in any property acquired by the company within two years of the issue of the prospectus.
19) If the share capital of the company is divided into different classes of shares, voting rights and rights to dividend and the right as to capital attached to the several classes of shares.
20) Where the articles have imposed restrictions (a) upon the members of the company in respect of i) the right to attend, speak or vote in meetings of the company or ii) the right to transfer shares or (b) upon the directors of the company in respect of powers of management, the nature and extent of those restrictions.
21) In the case of an existing company, the length of time during which the company has carried on the business. If the company proposes to acquire a business, which has been carried on for less than three years, the length of time during which the business has been carried on.
22) If any reserves or profits of the company or any of its subsidiaries have been

capitalised, particulars of the capitalisation and particulars of any surplus arising from revaluation of assets during the preceding two years and the manner such surplus has been dealt with.

23) In case the company had been in business, the report of the auditors regarding profits and losses, and assets and liabilities, together with the rate of dividends paid, for five financial years immediately preceding the issue of the prospectus, giving particulars of each class of shares on which such dividends have been paid for any of those years.
24) A reasonable time and place at which copies of all balance sheets and profit and loss accounts, if any on which the report of auditors is based, may be inspected.
25) The name(s) of the stock exchange or stock exchanges to which application has been made for permission to deal in and for official quotation for the shares and debentures offered thereby.

The prospectus must contain a blank application form whereby it must be printed prominently that no application should be made in the name of a fictitious person. It should also be stated that applications must be made in single name only and not in joint names.

7.3.2 Reports to be Set Out in the Prospectus

In addition to the above matters, Part II of the Schedule requires the following report to be set out in the prospectus:

1) An auditor's report showing i) profits or losses in each of the last five years, ii) assets and liabilities at the date of the last accounts, iii) the rates of dividend paid by the company in respect of each class of shares during the preceding five financial years, and iv) similar details with regard to subsidiary companies, if any.
2) If the company proposes to acquire any business, a report should be made by a Chartered Accountant, whose name should be disclosed, upon i) the profits and losses of the business, ii) and assets and liabilities of the business, for the preceding five years.
3) If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly in the purchase of any business, then a report similar to the one in (2) above is required to be set up.

7.3.3 Registration of Prospectus with Registrar of Companies

Section 60 requires that a copy of the prospectus duly signed by every director or proposed director must be delivered to the Registrar of Companies before the date of its publication. Every copy of the prospectus, on its face, must state that a copy of the prospectus has been delivered to the Registrar of Companies. The prospectus must be issued within ninety days after the date on which a copy of the same is delivered to the Registrar. If it is issued after ninety days after its registration, it shall be deemed to be a prospectus a copy of which has not been delivered to the Registrar.

Further, the copy of the prospectus must have endorsed on, or attached to it the following documents;

i) the consent of the expert to the issue of the prospectus, if his report has been included therein and such expert must not be connected or interested in the formation, promotion or management of the company.
ii) a copy of every contract appointing or fixing the remuneration of a managing director or manager.
iii) a copy of every material contract unless it is entered into in the ordinary course of business within two years before the date of issue of the prospectus.
iv) When the persons making the reports relating to profits and losses, assets and liabilities etc. in respect of a business proposed to be acquired have made adjustments to them, a signed statement by them stating the adjustments and the reasons for the same.
v) the consent in writing of the person if any named in the prospectus as the auditor, adviser, attorney, solicitor, banker of the company to act in that capacity.
vi) consent of director or directors, named in the articles or prospectus, to act as such directors of the company.
vii) a copy of the underwriting agreement, if any.

7.4 STATEMENT IN LIEU OF PROSPECTUS

A public company may not invite the public to subscribe to its share capital. Instead, it may arrange capital privately. In such a situation, it is required by Section 70 to submit statement in lieu of prospectus with the Registrar of Companies, at least three days before it can make any allotment of shares or debentures. Schedule III of the Companies Act, 1956 contains a model form of Statement in lieu of prospectus in pursuance of Section 70.

Similarly, when a private company is converted into a public company in pursuance of Section 44 it may issue a prospectus inviting public to subscribe to its share capital, in case it wants to raise extra money. However, if it is not issuing a prospectus, then it is under an obligation to submit a statement in lieu of prospectus. Schedule IV to the Companies Act, 1956 contains a model form of a statement in lieu of prospectus when a private company is converted into a public company in pursuance of Section 44.

After going through Schedules III and IV to the Companies Act, 1956 one finds that the contents thereof are almost similar to the ones in the prospectus.

If allotment of shares or debentures is made by a company without filing the statement in lieu of prospectus with the Registrar of Companies, the allotee may avoid the allotment within two months after the statutory meeting is held or where the allotment is being made after the holding of the statutory meeting, then within two months of the date of allotment. If a statement in lieu of prospectus containing the requisite particulars and statement, is not filed with the Registrar of Companies, where it is required to be filed, then the company and every director shall be liable to a fine upto Rs. 1000.

Check Your Progress A

1) Define Prospectus.

....

....

....

2) When a prospectus is deemed to have been issued to public?

....

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....

3) What is a Statement in lieu of Prospectus?

....

....

....

4) State whether the following statements are True or False.
   i) A private company can allot shares only after it has submitted a Statement in lieu of prospectus with the Registrar of Companies.
   ii) A public company may allot shares without issuing a prospectus.
   iii) A company cannot issue a prospectus unless a copy thereof has been filed with the Registrar of Companies.
   iv) A document is not a prospectus unless it is an invitation to the public to subscribe for shares in, or debentures of, a body corporate.
   v) A prospectus must be dated and printed.
   vi) A prospectus must be issued within sixty days of its registration.
   vii) A public company issuing shares among friends and relatives need not issue a prospectus, but a statement in lieu of prospectus must be filed with the Registrar.
   viii) A prospectus containing statement by experts, must contain the consent of such expert.
5) Fill in the blanks.
   i) A notice inviting deposits from the public is ....
   ii) The contents of a statement in lieu of prospectus are similar to that ....

iii) A company should not issue a prospectus to the public unless a copy thereof has been delivered to the ....
iv) A statement in lieu of prospectus is submitted with the Registrar of Companies, by a .... company which does not invite public to subscribe to its share capital.

7.5 MINIMUM SUBSCRIPTION

Minimum subscription is the minimum amount equivalent to which the share applications must be received by the company. Otherwise application money becomes refundable to the applicants in accordance with Section 69. The amount of minimum subscription is required to be given in the prospectus and it must be subscribed or applied for within 120 days of the issue of the prospectus before the first allotment of shares can be made,

The directors of the company or the signatories to the Memorandum of Association decide the amount of the minimum subscription. It is the amount, which in their opinion, must be raised by the issue of shares to provide in respect of each of the following heads and distinguishing the amount required under each head:

i) the purchase price of any property bought or to be bought which is to be defrayed in whole or in part out of the proceeds of the issue;
ii) any preliminary expenses payable by the company including any commission, underwriting or otherwise for subscription of shares in the company;
iii) the repayment of any moneys borrowed by the company in respect of any of the foregoing matters;
iv) the working capital; and
v) any other expenditure, stating the nature and purpose thereof and the estimated amount in each case.

If the company has not received minimum subscription, and it has not been able to allot any shares within 120 days after the first issue of the prospectus, it must forthwith refund within next ten days without any interest all money received from the applicants. If the money is not repaid within 130 days of the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of 6 per cent per annum from the expiration of the 130th day. But a director, who can prove that the default in repayment was not due to any misconduct or negligence on his part, may escape liability.

7.6 MISREPRESENTATION IN THE PROSPECTUS AND ITS CONSEQUENCES

You have learnt that the investors apply for shares or debentures of a company on the basis of information given in the prospectus. The prospective buyer of shares is entitled to all true disclosures in the prospectus. A prospectus must, therefore, tell the truth, the whole truth and nothing but the truth. The prospectus must give a true picture of the company. Therefore, if there are untrue statements in the prospectus. The allottees have certain remedies against the company and the persons issuing the prospectus. However, these remedies are not available i) to a buyer of shares in the open market or ii) to a subscriber to the Memorandum of Association.

You should note that not only there should be no untrue statements in the prospectus, there should also be no concealment or omission of material facts from the prospectus. The following case of **Rex v. Kylsant** illustrates this point.

A company issued a prospectus which did not contain any untrue statements. One of the statements disclosed the rates of dividends paid for a number of years. This was a factual statement which was true. But the dividends had not been paid out of trading profits but out of realised capital profits. This fact was not disclosed in the prospectus. Held, that the non-disclosure of the fact that dividends were not distributed out of trading profits but out of realised capital profits is a very important statement the omission of which gives a right to the allottees of shares to avoid allotment and resort to other remedies available under the Companies Act.

If there is any omission in the prospectus calculated to mislead the public, it shall be considered to be untrue. In Peek **v. Gurney** case the prospectus issued did not mention about certain liabilities. This created a false impression about the company being very prosperous. The prospectus was held to be untrue.

An allottee of shares, who had applied for shares, on the faith of a prospectus i) containing untrue statements or ii) omitting material facts. has remedies against the company, its promoters and directors and experts.

It should be noted carefully that the right to claim compensation for any loss or damage is available only to a person who has 'subscribed' for shares or debentures on the faith of the prospectus containing untrue statements. Thus, a subsequent buyer of shares in the open market has no remedy against the company or the directors or promoters.

7.6.1 Remedies against the Company

Person who has bought shares from the company relying on the statements in the prospectus, may (i) avoid the contract to purchase shares, and (ii) claim damages if he can show that there is a misstatement in, or omission of material fact from, the prospectus. Further he has to show that the misstatement or omission was i) one of fact and not of law nor a mere expression of opinion; ii) material and iii) actually relied upon by him.

a) **Rescission of contract :** In case he wants to avoid the contract to purchase shares, he must do so i) within a reasonable time after the allotment of shares; ii) before proceedings to wind up the company have commenced and iii) before he does anything which is inconsistent with the right to avoid the contract e.g. he tries to sell the shares or attends a general meeting of the company or accepts dividends.
b) **Damages for fraud :** The second right of allottee, in case of misstatements in or omission of material facts from the prospectus, is to sue the company for damages for fraud. The company could be held liable only when it is proved that such a prospectus was issued by the company or by some one authorised by the company. In order to succeed, the allottee must, in addition to the three conditions given in (a) above, prove i) that those acting on behalf of the company acted fraudulently, ii) that those purporting to act on behalf of the the company were authorised to act on its behalf; and iii) that he has suffered a loss or a damage.

   It is worth remembering that the allottee of shares can not both retain the shares and get damages from the company.

7.6.2 Remedies against Promoters and Directors of the Company

Section 62 provides that where a prospectus is issued inviting persons to subscribe for shares in or debentures of a Company, the following persons shall be liable to compensate all those who subscribe for shares on the faith of the prospectus for any loss sustained by them by reason of any untrue and misleading statement included in the prospectus.

i) Every person who is a director of the Company at the time of the issue of the prospectus;
ii) Every person who has authorised himself to be named and is named in the prospectus as a director or as one having agreed to become a director, either immediately, or after an interval of time;
iii) Every promoter of the company; and
iv) Every person (including an expert) who has authorised the issue of the prospectus. But an expert is liable only in respect of his own untrue statements included in the report made by him and included in the prospectus.

An allottee of shares may also bring an action for fraud i.e., for fraudulent mis-representations included in the prospectus either against the company or the directors. If he decides to sue directors he need not receive the contract.

Defences Available: A promoter, director or anyone else responsible for issue of the prospectus (other than an expert) may escape liability, if he can prove any of the following:

i) that he withdrew his consent to act as director before the issue of the prospectus and that it was issued without his authority or consent; or

ii) that the prospectus was issued without his knowledge or consent, and on becoming aware of its issue, he gave reasonable public notice of that fact; or
iii) that he withdrew his consent after the issue of the prospectus but before allotment and gave a reasonable public notice of the withdrawal; or
iv) that he had reasonable ground to believe that the statements made were true and he honestly believed them to be true; or
v) the statement was correct and a fair summary or a copy of an expert's report; or
vi) the statement was made by an official or is an official document.

7.6.3 Remedies Against Experts

You have noted that many a times statements of experts are included in a prospectus. The term 'expert' includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him.

An expert is liable for in damages in respect of his own untrue statement, wrong report or valuation made by him and included in the prospectus. Also he is liable to pay compensation under Section 62. However he shall not be liable if he proves that:

i) having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration with the Registrar of Companies; or
ii) after delivery of prospectus for registration with the Registrar of Companies and before allotment, he on becoming aware of the untrue statement, withdrew his consent in writing, and gave reasonable public notice of the withdrawal and his reasons therefore; or
iii) he was competent to make the statement, and believed on reasonable grounds that it was true.

7.6.4 Criminal Liability for Misstatements in the Prospectus

Section 63 of the Act also provides for criminal liability for misstatements. It provides that where a prospectus contains a misstatement, every person who authorised the issue of the prospectus shall be punishable with imprisonment for a term which may extend to two years, or fine which may extend up to five thousand rupees, or with both, unless he proves

a) that the statement was immaterial, or
b) that he had reasonable ground to believe and did up to the time of the issue of the prospectus believe that the statement was true.

However, Section 63(2) exempts experts from liability under this section. The Act has also laid down penalty for fraudulently inducing persons to invest money. According to Section 68, any person who knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or dishonestly conceals material facts so as to induce or attempts to induce another person to subscribe to the shares of a company, shall be punishable with imprisonment for a term which may extend to five years, or with fine which may extend to ten thousand rupees, or with both.

Check Your Progress B

1) What is meant by "Minimum Subscription"?

....

....

....

2) Enumerate the remedies available for misstatements in the prospectus.

....

....

....

3) What is the criminal liability of a person who authorises the issue of a prospectus containing untrue statements?

....

....

....

4) State whether the following statements are True or False.
   i) No company can proceed to allot shares for the first time unless the amount stated in the prospectus as minimum subscription has been subscribed.
   ii) A person can avoid the contract to purchase shares in the company even if he has purchased shares in the open market and has not gone through the prospectus containing untrue statements.
   iii) The minimum subscription amount is that minimum amount which a subscriber to the Memorandum of Association must pay to the company.
   iv) An allottee of shares can retain the shares and can sue the company for damages in case he finds that the prospectus contained untrue statements.
   v) A director can avoid liability for misstatements in the prospectus if proves that he has reasonable ground to believe that the statement alleged to be untrue is true.
   vi) An expert is not criminally liable in respect of misstatements in the prospectus.
5) Choose the correct alternative in the following sentences.
   i) Where a prospectus contains untrue statements, the persons who authorised its issue are punishable with fine up to
      a) Rs. 1000
      b) Rs. 2000
      c) Rs. 5000
   ii) A statement in lieu of prospectus is to be issued by
      a) public company which arranges capital privately
      b) a private company
      c) every public company

7.7 LET US SUM UP

A prospectus is issued by a public company inviting members of the public to subscribe to its shares capital or debenture issue. In this way, a huge amount of money is collected by a company from people spread in the nook and corners of the country. In order to protect the interests of the investors, the Companies Act, 1956 has made elaborate provisions regarding the issue of prospectus.

The Companies Act, 1956 prescribes the contents of a prospectus. Every prospectus issued to the public must include all the matters and the reports which are required to be included by law. In this way, the investors get the complete information about the company. They can, then make up their mind as to subscribe to the share capital of a company or not.

The Companies Act expects those who issue prospectus to disclose each and every fact accurately as is required to be disclosed. Also if some material information is omitted from the prospectus, it will have serious consequences. Therefore, if some statements included in the prospectus are untrue, or omitted therefrom, then the law provides for civil and criminal liability of promoters, directors, experts etc.

The allottee of shares, in case he discovers misstatements in the prospectus can avoid the contract to purchase shares. Also he can claim damage for the loss sustained by him on account of misstatements in the prospectus.

7.8 KEY WORDS

Minimum Subscription: It is that amount, which in the opinion of promoters or directors must be raised by the issue of shares to provide for certain matters as are given in the Companies Act, 1956.

Prospectus: It is a document issued by a company inviting members of the public to subscribe to its share capital.

Statement in lieu of Prospectus: This statement is required to be filed with the Registrar of Companies by a public company which is arranging capital privately.

7.9 SOME USEFUL BOOKS

Chawla R.C. and K.C. Garg, 1990. *Mercantile Law*. Kalyani Publishers: New Delhi (Chapter 6, Section on Company Law)

Kapoor. N.D. 1990. *Elements of Company Law*. Sultan Chand and Sons: New Delhi (Chapter 7)

Kuchhal M.C. 1989-90. *Modern Indian Company Law*. Shree Mahavir Book Depot: Nai Sarak, Delhi (Chapter 7)

7.10 ANSWERS TO CHECK YOUR PROGRESS

A 4 i) False ii) True iii) True iv) True v) True vi) False vii) True viii) True.
5 i) Prospectus ii) Prospectus iii) Registrar of Companies iv) Public
B 4 i) True ii) False iii) False iv) False v) False vi) True.
5 i) c ii) a

7.11 TERMINAL QUESTIONS/EXERCISES

1) Define the term prospectus.
2) What is the purpose of a prospectus?
3) Enumerate some of the particulars which are required to be included in a prospectus.
4) What do you mean by " issued to the public"? Illustrate your answer.
5) What is a "statement in lieu of prospectus" ?
6) Write an explanatory note on "Minimum Subscription".
7) What are the remedies of an allottee of shares who applied on the faith of a prospectus containing untrue statements, against i) the company, ii) directors of the company.
8) Describe the defences which are available to directors who are sued by an allottee for compensation for misstatements in the prospectus.
9) Answer the following problems, giving reasons:
   i) Ramesh applied for 100 shares in a company in pursuance of a prospectus. Can he withdraw his application to buy shares?
   ii) A company issued a prospectus containing misstatements. Mohan received a copy of the prospectus but did not apply for shares. Subsequently, Mohan bought 1,000 shares in the open market. When he learnt about misstatements, he wanted to rescind the cantract. Will he succeed?
   iii) A prospectus contained untrue statements of material facts. A subscriber suffered some loss as a result of the misstatement. He wants to retain the shares and claim damages for loss. Can he do so?
   iv) The directors of a company authorised the issue of a prospectus containing some statements which they honestly believed to be true but in fact they were not ture. Can the directors be held liable?
   v) Naresh applied for 500 shares in a company in a fictitious name. The shares were allotted in the fictitious name. Will he be liable?
   vi) Suresh, an allottee of shares, came to know about the misstatements in the prospectus. But he did not take any action against the company for nine months an attended a general meeting of the company. Now he wants to rescind the contract. Will he succeed?
   vii) Gopal applied for shares in the company on the basis of a prospectus which contained a misstatement. Shares were allotted to Gopal who transferred them to Virendra. Can Virendra rescind the contract on the ground of misstatement?

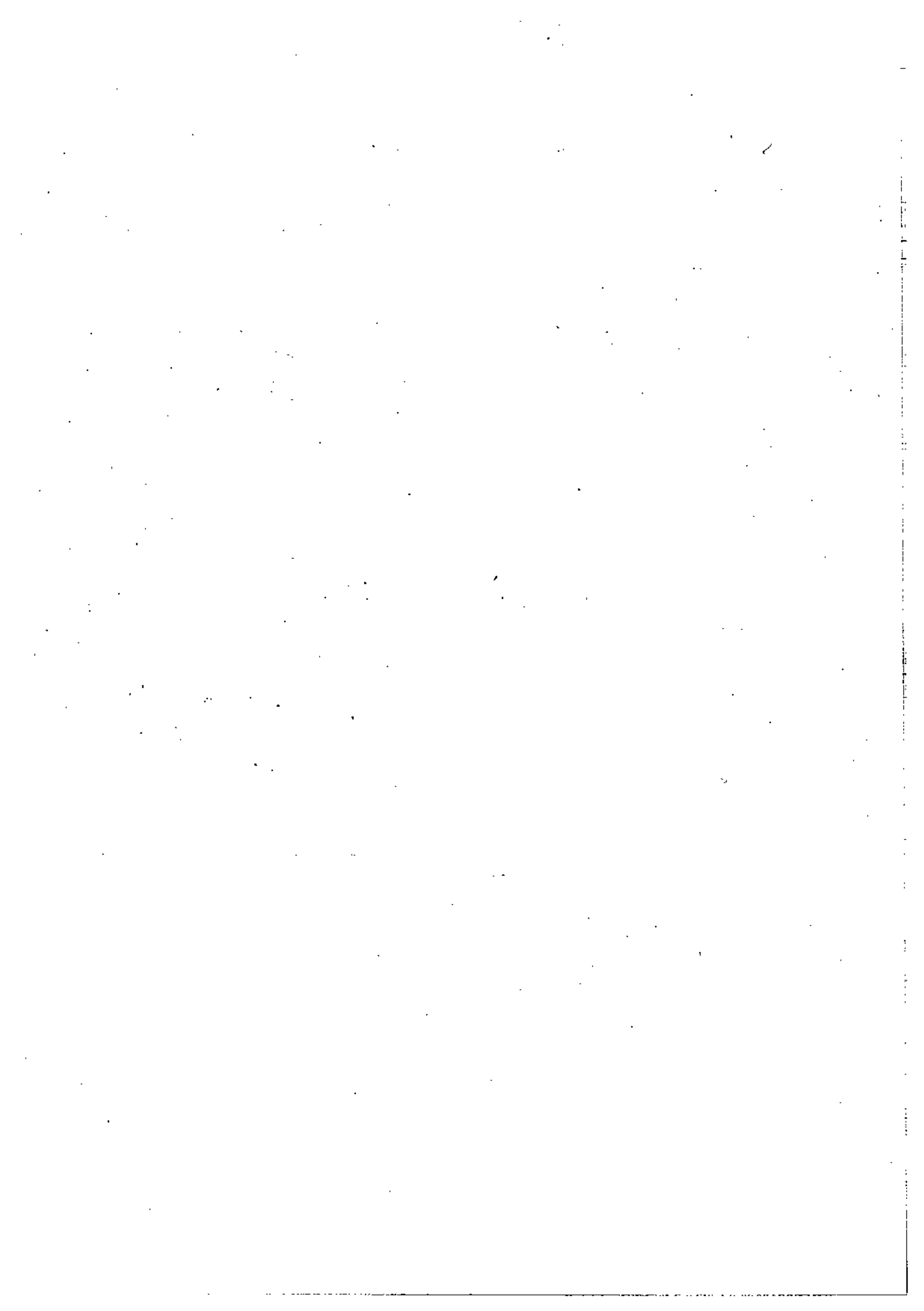
Hints

i) Ramesh can withdraw his offer anytime before allotment.
ii) No. Mohan cannot rescind the contract because he has bought shares in the open market and he is not induced by the prospectus.
iii) Yes, He can claim damages (Sec. 62)
iv) No. They can escape liability by proving that they honestly believed the statement to be true.
v) Yes, He can be imprisoned for a term up to five years.

vi) No. He cannot rescind the contract after nine months and by attending the general meeting, he has lost his right.

vii) Virendra cannot bring an action for rescission. Only the original allottee of shares can rescind the contract.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.



Uttar Pradesh
Rajarshi Tandon Open University

BBA-1.4(E2)

Company Law

Block

3

CAPITAL AND MANAGEMENT

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BLOCK 3 CAPITAL AND MANAGEMENT

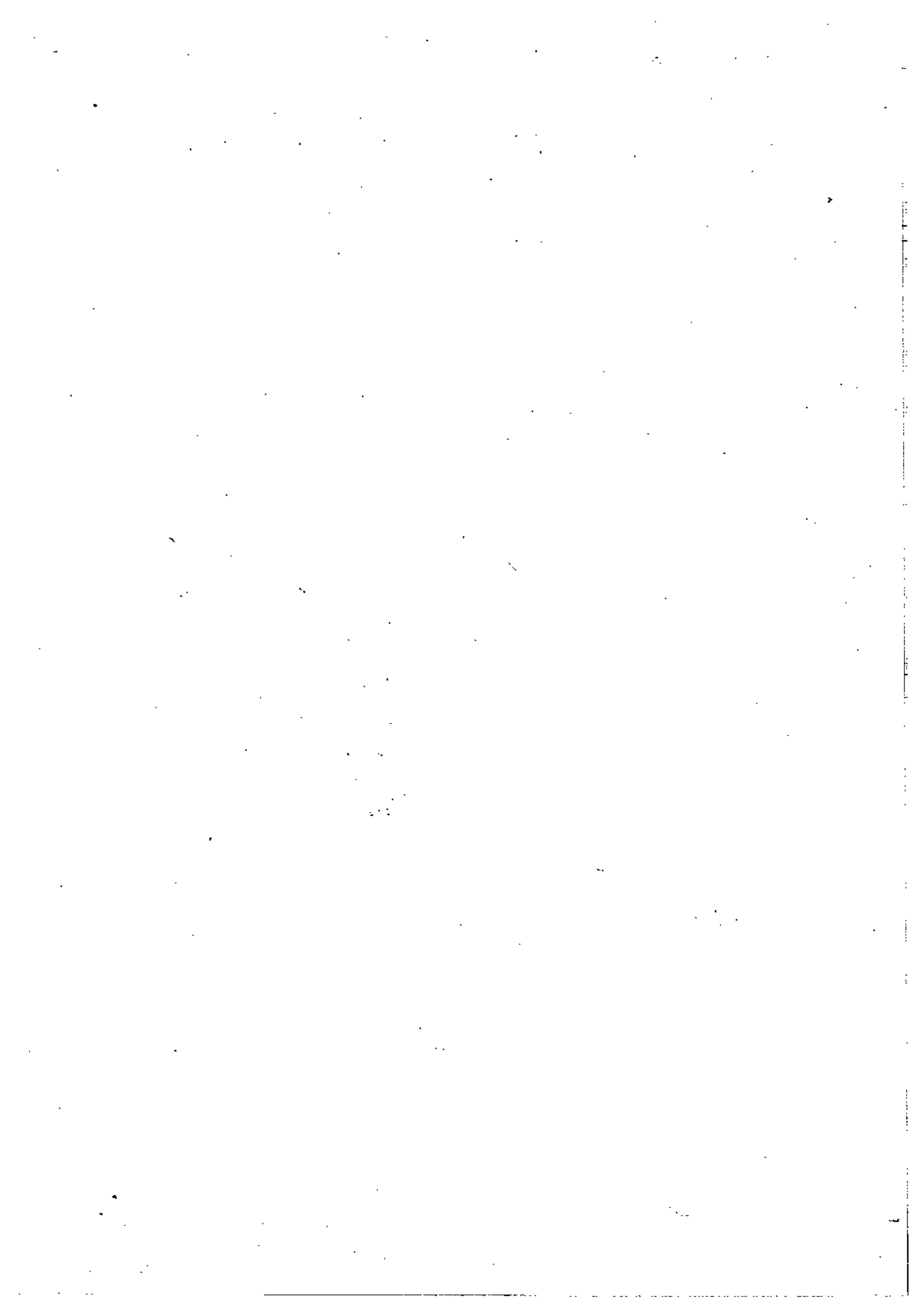
In Block 1 and 2 you learnt about the process of promotion and formation of a company, including the nature and significance of principal documents involved. After the company has been incorporated, the promoters have to take the next important step of raising funds for the company by issuing shares and debentures to the public. In this block, you will study about various types of shares and debentures that can be issued by a company and the procedure to be followed for their issue. This block also covers the rules relating to the membership of a company and the position of directors who are responsible for directing and controlling the affairs of the company.

Unit 8 explains the types of shares and debentures that can be issued by a company. It also discusses the rules relating to public deposits.

Unit 9 describes the rules for the allotment of shares, issue of a share certificate, calls on shares, and the forfeiture and surrender of shares.

Unit 10 deals with membership of a company. It explains the difference between a shareholder and a member and describes the modes of becoming a member, the procedure for transfer of membership, and the rules for the maintenance of a register of members.

Unit 11 explains the legal position of directors and the rules for the appointment, removal, etc. It also describes their powers, duties and liabilities.



UNIT 8 SHARE AND LOAN CAPITAL

Structure

8.0 Objectives
8.1 Introduction
8.2 Meaning and Types of Share Capital
8.3 Meaning and Types of Shares
- 8.3.1 Meaning of a Share
- 8.3.2 Types of Shares

8.4 Meaning of Stock
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- 8.5.1 Meaning and Characteristics
- 8.5.2 Types of Debentures

8.6 Difference Between Shares and Debentures
8.7 Public Deposits
- 8.7.1 Meaning of Deposits
- 8.7.2 Deposits and Loan
- 8.7.3 Deposits and Debentures
- 8.7.4 Rules Regarding Acceptance of Deposits

8.8 Let Us Sum Up
8.9 Key Words
8.10 Answers to Check Your Progress
8.11 Terminal Questions

8.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of shares and types of shares
- describe the types of capital
- distinguish between shares and stock
- explain the meaning of debenture
- classify debentures
- distinguish between shares and debentures
- explain the meaning of the term 'deposits'
- list the rules regarding acceptance of deposits by companies.

8.1 INTRODUCTION

You have learnt that a public company raises the necessary funds by issuing shares and debentures and by accepting deposits from the public. In this unit you will learn about the meaning of share capital, various types of shares, meaning and types of debentures and the rules regarding the acceptance of deposits from the public.

8.2 MEANING AND TYPES OF SHARE CAPITAL

You know that to carry on any business, some money is needed. The term 'capital' usually means a particular amount of money with which a business is started. In the case

of a company where large amount of money is required. it is raised by the issue of shares. The amount so raised is called the 'share capital' of the company.

A company limited by shares should state its amount of share capital in the memorandum of association. The capital clause of the memorandum of association also states the amount of capital and this amount is divided into specified number of shares of a fixed amount. For example, the share capital of a company may be divided into shares of Rs. 10 each. The persons contributing towards the share capital are known as 'shareholders'. **You should note that the money borrowed by the company by issuing debentures, is not part of the share capital of the company.** It is in the form of a long-term loan to the company.

In view of the stages involved in collecting the money on shares, the share capital of a company may be classified as follows:

1) **Nominal or Authorised Capital: It refers to the amount stated in the memorandum of association as the capital of the company with which it is to be registered.** This is the maximum amount of capital which a company is authorised to raise by issuing the shares. This is also known as 'registered capital', as this is the amount of capital with which the company is registered. This amount is divided into shares of a fixed amount. The amount of nominal capital is determined on the basis of present and future capital needs of the company. It can be increased or decreased by adopting the prescribed legal procedure.
2) **Issued Capital:** It is that part of the authorised capital which is issued to the public for subscription. It is not necessary for a company to issue all the nominal capital in the beginning itself. In fact, the term 'issued capital' means that part of the share capital which has been actually issued or allotted by the company. Therefore, the issued capital can never be more than the authorised capital. It can at the most be equal to the nominal capital. The balance of nominal capital remaining to be issued is called **'unissued capital'.**
3) **Subscribed Capital:** It is that part of the issued capital which has been actually subscribed by the public. In other words, it is that part of issued capital for which the applications have been received from the public and shares allotted to them. The amount of subscribed capital, therefore, cannot exceed the amount of issued capital. This is so, because the company cannot accept for subscription an amount greater than the issued amount. Where the shares issued for subscription are wholly subscribed, issued capital will be the same as the subscribed capital. **This distinction between the issued and subscribed capital is only relevant from the accountants point of view. The law does not recognise this difference and uses the two in the same sense.**
4) **Called-up Capital:** It is that part of nominal value of issued capital which has been called-up or demanded on the shares by the company. Normally, a company does not collect the full amount on shares it has allotted. It collects it in instalments known as application money, allotment money, first call, second call and so on. The amount of instalments which have been demanded for the time being are termed as 'alled-up capital' and the amount not yet demanded is termed as 'uncalled capital' and the shareholders continue to be liable to pay this amount as and when called.
5) **Paid-up Capital:** It is that part of the called-up capital which has actually been received from the shareholders. For example, a company has called-up Rs. 5 lakhs, but it has actually received Rs. 4,90,000, then Rs. 4,90,000 is the paid-up capital of the company. The amount not paid in respect of allotment and calls made is known as 'calls in arrears'. In the above example, Rs. 10,000 is the amount of calls in arrears. In case there are no calls in arrears, the paid-up capital will be the same as the called-up capital.
6) **Reserve Capital:** That part of the uncalled capital of a company which it has decided, by special resolution, not to call except in the event, and for the purpose of the winding up of the company, is called the 'reserve capital'. The company cannot demand such uncalled amount during its life-time. The reserve capital cannot be turned into equity capital without the permission of the court and cannot be cancelled at the time of reduction of capital. It is available only for the creditors on winding up of the company.

8.3 MEANING AND TYPES OF SHARES

8.3.1 Meaning of a Share

You learnt that the capital of the company is divided into different units of a fixed amount. Each of such unit is called a 'share'. Section 2(46) of the Companies Act defines a share, "as a share in the share capital of the company, and includes stock except where a distinction between stock and shares is expressed or implied." This definition is simple but is not exhaustive as it fails to bring out the true nature of a share.

In **Borland's Trustee v. Steel Bros.,** Justice Farewell defined the share as, "a share is the interest of shareholder in the company, measured by a sum of money for the purpose of liability and dividends in the first place, and of interest in the second, and also consisting of a series of contracts entered into by all the shareholders *inter se* in accordance with the provisions of the Companies Act and articles of association." Thus, a share is not a sum of money, but is an interest measured by sum of money and made up of various rights contained in the contract.

In the **Commissioner of Income Tax v. Standard Vacuume Oil Company,** the Supreme Court of India defined a share thus, "By a share in the company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company."

A share carries alongwith it certain rights and liabilities in the company. The rights of a shareholder are proportionate to the number of shares held by him in the company. **The holder of a share is issued a share certificate which shows that the holder thereof has a proportionate share or interest in the capital of the company.** The share certificate specifies the number of shares held by any shareholder.

A share in a company is a **chose-in-action,** which means that the property is not in the immediate physical possession of the person, but he has a right to the property which can be enforced by legal action. A share is also regarded as goods under Section 2(7) of the Sale of Goods Act. Section 82 of the Companies Act provides that the share is a movable property transferable in the manner provided by the articles of the company. But you must note that the share is not a movable property in the same way in which a bale of cloth or a bag of wheat is a movable property. Thus shares cannot be transferred by mere delivery as in the case of movable property. You should also remember that a share certificate, though it can be transferred to another person, is not a negotiable instrument.

8.3.2 Types of Shares

According to Section 86 of the Companies Act, 1956, the share Capital of a company limited by shares formed after the commencement of the Act of 1956, or issued after such commencement shall be of two types, namely, (a) preference share capital and (b) Equity share capital. Thus a public limited company can issue only two types of shares – (a) Equity shares and (b) preference shares.

Equity Shares: All shares which are not preference shares are 'equity shares'. These shares carry no special privileges and their rights and liabilities are governed by the articles of association of the company. In the eyes of law, equity shareholders are not the owners of the company, because a company has its own independent legal entity. Dividend is paid to the holders of these shares after the preference dividend at a fixed rate has been paid. The rate of dividend payable on these shares is not fixed and keeps on changing from year to year depending on the amount of profits available for distribution. On the liquidation of the company, the claims of equity shareholders are satisfied only after satisfying all other claims. Equity shareholders have a right to vote on various resolutions in proportion to his share of the paid-up equity capital, whereas preference shareholders have, generally, no voting rights.

Preference Shares

Under Section 85(1) of the Companies Act, a preference share is one which fulfils the following two conditons:

a) With respect of dividend, it carries a preferential right to be paid a fixed amount or an amount calculated at a fixed rate.

b) With respect of capital, it carries a preferential right to be repaid the amount of the capital paid-up in the event of winding-up of the company. In other words the amount paid on preference shares must be paid back before anything is paid to the equity shareholders.

The above two conditions clearly show that the preference shares carry a preferential right to receive dividend. However, the amount or rate of dividend is fixed. Similarly, at the time of winding up of the company, the preference shareholders are paid their amount prior to the payment to equity shareholders.

Types of Preference Shares: The preference shares may be of the following types:

i) **Cumulative Preference Shares:** These shares are entitled to dividend at a fixed rate whether there are profits or no profits. If in a particular year due to inadequate amount of profits, the dividend could not be paid, then the unpaid dividend shall be carried forward to the subsequent years and shall be paid in the succeeding year out of the profits alongwith the fixed dividends for that year. Since the dividends can be accumulated, they are called 'cumulative preference shares'. In the case of such shares the dividend keeps on accumulating until it is fully paid. You should note that all preference shares are presumed to be cumulative unless expressly stated in the articles to be non-cumulative.

ii) **Non-Cumulative Preference Shares:** These are the shares on which the dividend does not go on accumulating. If in a particular year there are no profits or profits are inadequate, the shareholders shall not get anything or receive a partial dividend and they cannot claim the arrears of dividends in the subsequent year. In simple words, on such shares the unpaid dividends do not accumulate but lapse, i.e., the shareholders lose them forever.

iii) **Participating Preference Shares:** The holders of such shares are entitled to receive dividend at a fixed rate and, in addition, they have a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders. In the event of winding up, if after paying back both the preference and equity shareholders, there are surplus assets, then the holders of such shares shall be entitled to share in the surplus assets as well. Such shares can be issued only if there is a clear provision in the memorandum or articles of association or the terms of issue.

iv) **Non-Participating Preference Shares:** The holders of such shares are entitled to only a fixed rate of dividend and do not participate further in the surplus profits. If the articles are silent, all preference shares are deemed to be non-participating.

v) **Convertible Preference Shares:** The holders of such shares have a right to convert these shares into equity shares within a certain period.

vi) **Non-convertible Preference Share:** The preference shares, where the holders have no right to convert their shares into equity shares are known as non-convertible preference shares.

vii) **Redeemable Preference Shares:** Ordinarily, the amounts received by the company on shares is not returned except on the winding up of the company. A company limited by shares, if authorised by its articles, may issue preference shares which are to be redeemed or repaid after a certain fixed period. Thus, the amounts received on such shares can be returned during the life-time of the company. Such shares are termed as redeemable preference shares. Under Section 80 of the Companies Act, a company may issue such shares subject to the following conditions:

a) Only such shares shall be redeemed which are fully paid-up.

b) Such shares shall be redeemed only out of the profits of the company available for dividends or out of the proceeds of a fresh issue of shares issued for this specific purpose.

c) If premium is payable on redemption, it should be provided for out of the profits or out of company's share premium account, before the shares are redeemed.

d) In case the shares are redeemed out of profits, then an amount equal to the amount payable on redemption should be transferred to a Capital Redemption Reserve Account.

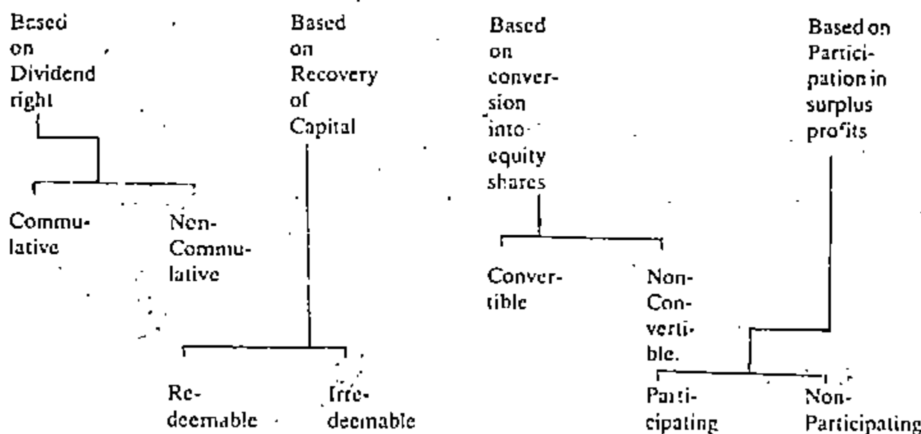
The Amendment Act of 1988 introduced a new Section 80-A, (effective from 15.6.1988) which provides for compulsory redemption of all unredeemed preference shares within five years from the commencement of the Amendment Act of 1988. According to Section 80(5-A) of the Amendment Act of 1988, no company can issue (after 15.6.1988) irredeemable preference shares or which are redeemable after the expiry of ten years from the date of its issue. Thus, now onwards, a company can issue only redeemable preference shares which are redeemable within ten years of its issue. You should, however, remember that the redemption of preference shares should not be considered as reduction in the amount of authorised capital of the company.

viii) **Irredeemable Preference Shares:** Such shares constitute permanent capital of the company. The amount of such shares cannot be refunded before the winding up of the company. The **Amendment Act of 1988 has prohibited the issue of such shares.** All existing irredeemable preference shares must be redeemed within five years from 15.6.1988 and if they are not redeemable before the expiry of ten years from the date of issue, then such shares must be redeemed as per the terms of issue or within a period of ten years from the commencement of the Amendment Act, 1988, whichever is earlier.

ix) **Cumulative Convertible Preference (CCP) Shares:** These shares were introduced by the Government of India by a notification issued in 1985. These shares can be issued to raise finance for new projects, for expansion, diversification, modernisation and also to meet the needs of working capital. The face value of such shares shall ordinarily be Rs. 100 and the rate of dividend shall be 10 per cent. These shares can be issued to the extent of issued equity shares. These shares are to be compulsorily converted into equity shares after the end of three years and before the end of five years.

From the above discussion, it is clear that there are different types of preference shares based on different factors. Figure 8.1 will help you in recapitulation of their classification.

Figure 8.1
Types of Preference Shares



8.4 MEANING OF STOCK

Stock is the aggregate consolidated holdings of the share capital of a person. In simple words, it means a number of shares put together in a bundle. The stock is expressed in terms of money and not as so many shares. Stock can be split into fractions of any amount without regard to the original face value of the share. The main advantage of stock is that the shareholder can transfer any portion of it as he likes.

You have learnt in Section 2(46) of the Act that a share includes stock except where a distinction is intended. Thus, a company, if authorised by its articles, can convert its fully paid-up shares into stock by passing an ordinary resolution. From this it should be clear to you that **a company cannot make an original issue of the stock.** When the shares are converted into stock, the company must give a notice to the Registrar of such conversion within thirty days of doing so. On conversion of shares into stock, the register of members must show the amount of stock held by each member instead of the amount of shares. For example, a member may be holding one thousand equity shares of Rs. 10 each, fully paid-up. When these shares are converted into stock, he becomes the stockholder owning Rs. 10,000 worth of stock.

Conversion of shares into stock does not alter the relationship between the holder and the company, the stockholder still remains a member. The holders of stock shall have the same rights as regards dividends, voting at meetings of the company as if they held the shares from which the stock arose. The stock is also transferable like shares. You should note that stock can also be reconverted into fully paid-up shares by an ordinary resolution.

Distinction Between Share and Stock; In Section 8.4 of this Unit you learnt that stock possesses all the features of a share, but there are many points of difference between the two. These are as follows:

	SHARE		STOCK
i)	A share may be partly paid up or fully paid up.	i)	Stock is always fully paid up.
ii)	Shares can be issued initally to the public.	ii)	Stock cannot be issued originally to the public.
iii)	A share has a nominal value.	iii)	A stock has no nominal value.
iv)	A share has a distinctive number which distinguishes it from other shares.	iv)	A stock has no such number but has a consolidated value.
v)	A share is transferable as a whole i.e. it cannot be transferred in fractions.	v)	A stock can be transferred in any fractions.
vi)	All the shares are of equal denomination.	vi)	The stock may be of unequal amount.
vii)	Shares can be issued by any company – public or private.	vii)	Stock can be issued only by a public company limited by shares.

Check Your Progress A

1) What is meant by share capital of a company?

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2) List the two kinds of share capital.

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3) Define a preference share.

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4) What is a reserve capital?

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5) What are redeemable preference shares?

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6) Read the following carefully and put a tick (√) mark against correct answer.

i) The authorised share capital of the company is:

a) specified in the memorandum of association ( )

b) specified in the articles of association ( )

c) not specified anywhere ( )

ii) Share capital of a company means:

a) equity share capital ( )

b) preference share capital ( )

c) equity and preference share capital ( )

d) equity and preference share capital and debentures ( )

iii) The subscribed capital of company is:

a) never more than the issued capital ( )

b) never less than the issued capital ( )

c) always equal to the issued capital ( )

iv) When shares are converted into stock, a notice:

a) is required to be given within 15 days to the Registrar ( )

b) is required to be given within 30 days to the Registrar ( )

c) is not required to be given to anyone except the shareholders ( )

v) A company may convert all or any of its fully paid up shares into stock:

a) by passing a special resolution ( )

b) by passing an ordinary resolution ( )

c) with the approval of the Company Law Board ( )

d) with the permission of the Central Government ( )

7) State whether the following statements are True or False.

i) Share capital means the capital raised by the company by the issue of shares and debentures.
ii) Reserve capital of a company is available for the creditors on the winding up of the company.
iii) Shares and stock can be directly issued to the public.
iv) Any company can convert its shares into stock whenever it desires.
v) Equity shareholders have a right to receive dividend at a fixed rate.
vi) Preference shareholders have, generally, no voting rights.
vii) A company cannot issue irredeemable preference shares.
viii) Redeemable preference shares cannot be redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption.

8.5 MEANING AND TYPES OF DEBENTURES

8.5.1 Meaning and Characteristics

The most common form of raising loan from the public is by issue of debentures. A certificate issued by the company under its seal acknowledging a debt due by it to its holder, is known as debenture. The most essential feature of a debenture is the admission or record of indebtedness. According to Chitty, J. "debenture means a document which either creates a debt acknowledges it, and any document which fulfils either of these conditions is a debenture." Section 2(12) of the Companies Act states that a 'debenture includes debenture stock, bonds and any other securities of the company whether constituting a charge on the Company's assets or not'. In simple words, it means a document which either creates a debt or acknowledges it. A debenture contains the terms and conditions of its issue. It may also be stated in the debenture that the company shall pay back the money at a specified date and till that date, interest at a fixed rate shall be paid to the debenture holders. A debenture usually carries a charge or mortgage on the assets of the company, but it may be without a charge as well because debentures may be unsecured.

From the above explanation of the term 'debenture', the main characteristics of a debenture can be summarised as follows:

1) A debenture is in the form of a certificate issued under the seal of the company. However, the seal of the company is not necessary for the validity of a debenture.
2) This certificate is an acknowledgement of debt by the company to its holder.
3) A debenture usually provides for the repayment of a specified principal sum on a specified date. However, there is no restriction on the issue of irredeemable debentures.
4) It usually provides for the payment of interest at regular intervals at fixed dates until the principal amount is completely paid back.
5) Usually a debenture contains a charge on the assets of the company. Such a charge may either be a fixed charge or a floating charge. However, a debenture may also be issued without any charge on company's assets.
6) Debenture certificates are freely transferable just like shares.
7) Debentures are generally issued in series but even a single debenture issued to one person is quite valid.
8) A debenture holder has no right to vote at any meeting of the company.

8.5.2 Types of Debentures

A company can issue various types of debentures which can be classified on the basis of security, permanence, convertibility, and records.

Let us now explain all of them one by one.

1) **Registered and Bearer Debentures:** Registered debentures are made out in the name of a particular person, whose name is recorded in the company's register of debentures. The name of the debentureholder appears in the debenture certificate. Such debentures are transferable in the same manner as shares by transfer deeds. Interest on such debentures is payable to the person whose name is registered with the company in the register of debentureholders. Bearer debentures are those which are payable to the bearer (i.e. the holder of the debenture). The company keeps no register of such debentureholders. Like negotiable instruments, bearer debentures are transferable by mere delivery. Interest on such debentures is payable on the basis of coupons attached with the debenture certificate.

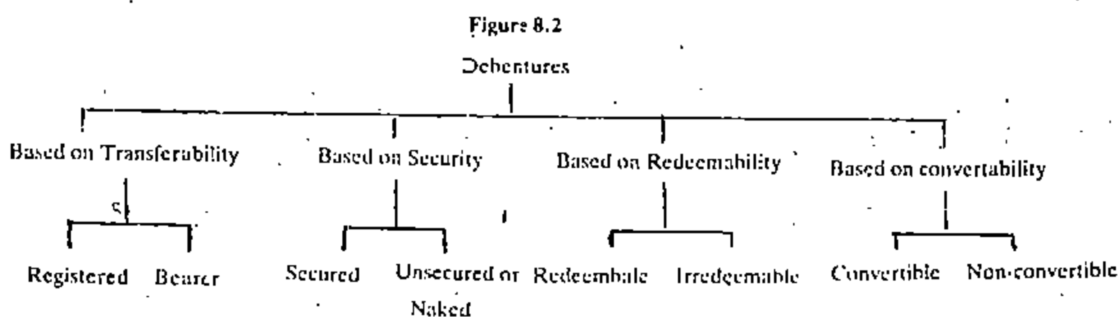
2) **Secured and Unsecured Debentures:** Secured debentures are those debentures which are secured either by the mortgage of a particular asset of the company known as 'Fixed Charge' or by the mortgage of general assets of the company known as 'Floating Charge'. Secured debentures are also known as 'Mortgage debentures'. Unsecured debentures, on the other hand are those debentures which are not secured by any charge or mortgage on any property of the company. Unsecured debentures are also known as 'Naked debentures'. The debentureholders of such debentures are the unsecured creditors of the company. Only good companies of strong financial standing can issue such naked debentures.

3) **Redeemable and Irredeemable Debentures:** Redeemable debentures means such debentures which are repayable after a specified period. A redeemed debenture may be re-issued until it is cancelled. Upon the re-issue of redeemed debentures, the debentureholders will continue to have the same rights and privileges as if the debentures had never been redeemed. Irredeemable debentures, on the other hand, are those debentures for which no fixed date is specified for repayment and the holders of which cannot compel the company to redeem them as long as the company is functioning and does not make default in interest payment. Irredeemable debentures are also known as perpetual debentures. **It should be noted that whether debentures are redeemable or irredeemable, they become immediately payable when the company goes into liquidation.** Normally companies issue redeemable debentures.

4) **Convertible and Non-Convertible Debentures:** Convertible debentures are those wherein the debenture holder is given an option to convert their debentures into equity shares in the company at a stated rate of exchange on the expiry of a specified period. On conversion, the debenture holders become the members of the company. Non-convertible debentures, on the other hand, are those debentures for which the debentureholder does not have any right for conversion into equity shares.

The classification of debentures is shown in Figure 8.2

Figure 8.2



8.6 DIFFERENCE BETWEEN SHARES AND DEBENTURES

You have learnt that just as shares are uniform parts of the share capital, debentures are uniform part of the loan capital of a company. But it is necessary to distinguish between a share and a debenture because the rights and privileges as also the liabilities accompanying these instruments are very much different from one another. The main points of difference are as follows:

1) Shareholders are owners of the company whereas the debenture holders are creditors of the company. Therefore, while the shareholders have a multi-faceted interest in the welfare of the company, the debentureholders have a very limited interest (limited to receiving interest on time) in the company.
2) A shareholder enjoys the rights of proprietorship of a company whereas a debentureholder can enjoy the rights of a lender only.
3) A shareholder has a right of control over the working of the company by attending and voting in the general meeting. They are able to decisively influence the composition of Board of Directors and other senior management positions. The debentureholders do not have any voting right, and therefore, they are unable to exercise any such influence.
4) A shareholder is entitled to receive dividend when there are profits. The rate of dividend varies from year to year depending upon the amount of profit. On the other hand, the debentureholders are entitled to interest at a fixed rate which the company must pay whether or not there are profits.
5) A debentureholder gets a fixed rate of interest per annum payable on fixed dates whereas a shareholder gets a dividend far higher if the company earns good profits.
6) In respect of shares, dividend is payable only when the proposal to pay dividend is passed by the shareholders at the annual general meeting of the company. There is no need of such approval in the case of payment of interest on debentures.
7) Dividend on shares is not a charge against profit. Interest on debentures, on the other hand, is a charge against profits and is deducted from profits for the purpose of calculating tax liability.
8) A shareholder has a claim on the accumulated profits of the company and is normally rewarded with bonus shares whereas a debentureholder has no such claims whatsoever after he has been paid the interest amount.
9) Shareholders cannot be paid back (except in case of redeemable preference shares) so long as the company is a going concern. Debentures are normally issued for a specified period after which they are repaid.
10) A company cannot purchase its own shares from the market whereas it can purchase its own debentures and cancel them or re-issue them.
11) In the event of winding up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debentureholders being secured creditors get priority in payment over the shareholders.

Check Your Progress B

1) What is a debenture?

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2) What is a bearer debenture?

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3) What are convertible debentures?

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4) Fill in the blanks:
   i) A debenture is the .... capital of the company.
   ii) A shareholder is the .... of the company and debentureholder is .... of the company.
   iii) Convertible debenture are converted into ....
   iv) Debentureholders .... vote at the meetings of the company.
   v) As regards return of principal, debentures will have a .... claim as compared to shares.
   vi) Debentures usually have a .... on the assets of the company.

5) State whether the following statements are True or False.
   i) A registered debenture is regarded as a negotiable instrument.
   ii) A debentureholder has the right to vote in the meetings of the company.
   iii) A debentureholder is usually a secured creditor of the company.
   iv) Redeemed debentures cannot be issued again.
   v) A company must maintain a Register of debentures.
   vi) In addition to the right of receiving interest at a fixed rate, debentureholders have a right to share in the profits as well.
   vii) Interest on debentures is payable only when the company has earned profits.

8.7 PUBLIC DEPOSITS

You have learnt about the two main sources of raising funds by a company i.e. shares and debentures. Public deposit is another important source of meeting short-term capital requirements. In order to attract deposits, companies often offered interest at a high rate and accepted deposits far beyond their capacities. As a result thereof, many companies failed to repay the deposits on due dates and some of them even went into liquidation. In order to protect the interest of depositors and to ensure that the companies do not indulge in wreckless borrowings, two new Sections 58A and 58B were introduced by the Amendment Act of 1974. Government has now the powers to regulate the limits, manner and conditions of acceptance of public deposits by companies. For this purpose **Companies (Acceptance of Deposits) Rules, 1975 have been framed.**

8.7.1 Meaning of Deposit

According to Explanation to Section 58A of the Companies Act, the term 'deposit' means any deposit of money with, and includes any amount borrowed by a company. Deposit includes all types of deposits – public or private. It includes inter-company deposits.

A number of amounts received by the company are not considered as deposits within the meaning of this section. The following amounts are not treated as deposits:

i) Any amount received from the central or a state government or from a local authority or a foreign government.

ii) Any amount received as a loan from any banking company or from State Bank of India or its subsidiaries or from a co-operative bank.

iii) Any amount received as a loan from financial institutions such as Industrial Finance Corporation of India, State Finance Corporations, Unit Trust of India, Industrial Development Bank, Life Insurance Corporation of India, etc.

iv) Any amount received by a company from any other company.

v) Amounts received by way of security deposits from employees.

vi) Amounts received as security or as an advance from any purchasing or selling agent or other agents in course of or for the purpose of business of the company or an amount of advance received from customers for supply of goods or for rendering of any service.

vii) Amounts received by way of subscriptions to any shares,stock or debentures pending their allotment.

viii) Amounts received in trust or any amount in transit.

8.7.2 Deposits and Loan

Some people say that deposits are nothing but a kind of loan, but this is not true. Whether a particular transaction is a deposit or loan, we should see the intention of the parties and all the circumstances of the case. Deposit and loan, both are repayable. The real point of distinction is when the repayment is to be made. A loan is repayable the minute it is incurred. But this is not so with a deposit. Deposits are repayable upon the maturity date fixed therefore or according to the terms of the agreement. In simple words, unlike a loan, there is no immediate obligation to repay in the case of a deposit.

8.7.3 Deposits and Debentures

Some persons put deposits and debentures in the same category because the element of indebtedness is common. But it is not true, deposits are repayable after the expiry of six months but not later than thirty six months from the date of acceptance or renewal of such deposits. Thus, the period of deposit is restricted while there is no such limit in case of debentures. Then, unlike debentures, deposits are not transferable.

8.7.4 Rules regarding Acceptance of Deposits

The acceptance of deposits by non-banking and non-financial companies are controlled by the Reserve Bank of India. As per the new Section 58A the control on acceptance of deposits by non-banking and non-financial companies has been shifted to the central government. The central government has delegated its powers and functions in this regard to the Company Law Board (CLB). The rules regarding acceptance of deposits by a company are as follows:

1) A company desirous of raising funds through public deposits has to give a public advertisement in the newspapers showing therein the financial position, management structure and other specified particulars of the company. The advertisement should also give brief particulars of the latest audited balance sheet of the company and the proposed utilisation of the money to be received as deposit.

   The company is required to deliver a copy of this advertisement to the Registrar of Companies. In case a company does not want to give a public advertisement then a statement in lieu of such advertisement should be filed with the Registrar.

2) The company should provide to a prospective depositor a form for making an application for deposit. This form should contain a declaration, to be signed by the depositor, to the effect that this deposit is not being made out of funds acquired by him by borrowing or by accepting deposits.

3) The company is required to furnish to each of the depositors a receipt in respect of each deposit containing the information such as date of deposit, name and address of depositor, amount of deposit, rate of interest and the date of repayment.

4) A company can accept deposits for a period which will not be less than six months and more than thirty six months. A finance company can accept deposits for a period of sixty months.

   A company may accept short-term deposits repayable not earlier than three months but not later than six months subject to the following two conditions:

   a) The funds are needed to meet short-term rquirement, and

   b) The amount of such short-term deposits does not exceed ten per cent of the paid-up capital and free reserves.

However, in no case, a company shall accept deposits repayable before three months.

5) A company cannot accept or renew deposits payable on demand.

6) A company can accept deposits upto 25% of the aggregate of its paid-up capital and free reserves. In addition, it can also raise upto 10% of the paid-up capital and free reserves in the form of any deposit against an unsecured debenture or from its shareholders or any deposit guaranteed by the Directors of the company.

A finance company is allowed to raise deposits upto ten times the amount of its capital and free reserves.

Paid-up Capital for this purpose will include both preference and equity capital.

7) No government company shall accept any deposits in excess of thirty-five per cent of its paid-up capital and free reserves.

8) No company shall invite or accept or renew any deposits in any form, on a rate of interest exceeding fourteen per cent per annum (w.e.f. 1.4.87).

9) Every deposit accepted by a company, shall unless renewed, be repaid in accordance with the terms and conditions of such deposit. Where any deposit is accepted by a company in contravention of the provisions of the Act or Rules made by the Central Government, the deposit must be refunded within thirty days from the date of acceptance of such deposit. This period of 30 days may be extended by the Central Government by another period but not exceeding 30 days.

10) If a company fails to make repayment of a deposit in accordance with the above provisions, the company shall be punishable with a fine which shall not be less than twice the amount not repaid and the court shall pay the amount of deposit remaining unpaid to the depositor out of the amount of fine realised. In addition, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine.

11) Where a company accepts or invites any deposit in excess of the limits prescribed or in contravention of the provisions of Section 58A(2) the punishment shall be:

a) where the contravention relates to the acceptance of deposit, the amount of fine shall not be less than the amount of the deposit so accepted.

b) where the contravention relates to the invitation of any deposit, the company shall be punishable with fine which may extend to Rs. 1 lakh, but which shall not be less than Rs. 5,000.

In both these cases of acceptance or invitation of deposit in contravention, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine.

12) Every company accepting deposits is required to maintain one or more registeres of deposits containing all the required information and should be preserved in good order for a period of not less than eight calendar years from the financial year in which the last entry is made in the register.

13) Every company accepting deposits shall also file Returns of Deposits as on 31st March every year before 30th June every year with the Registrar of companies and the Reserve Bank of India.

Section 58A has been amended by the Companies (Amendment) Act, 1988 to provide that in the event of the failure of a company to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board may either on its own motion or on the application of the depositor, direct the company to make repayment of such deposit forthwith or within such time and subject to such conditions as may be specified in the order. However, before making any order the CLB shall give a reasonable opportunity of being heard to the company and to other persons interested in the matter.

Whoever fails to comply with any order made by CLB shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than Rs. 50 for every day during which such non-compliance continues.

Check Your Progress C

1) What is meant by deposits?

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2) List four items which are not considered as deposits?

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3) Give the time limit for which deposits can be accepted?

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4) Fill in the blanks:

   i) Rules relating to acceptance of deposits have been laid down in Section .... of the Companies Act.

   ii) A company can accept upto .... of the sum total of its paid-up capital and free reserves from public as deposits.

   iii) A finance company can raise upto .... the sum of its paid-up capital and free reserves as deposits.

   iv) The maximum period for which a non-finance company can accept deposit is .... months.

   v) A company .... accept or renew deposits payable on demand.

8.8 LET US SUM UP

Capital usually means the amount of money with which the business of a company is started. The memorandum of association of the company contains the capital clause which provides the amount with which the company is going to be registered. this is known as the authorised or registered capital of the company. Issued capital is the amount which is actually issued and allotted to the public.

The share capital of a company is divided into shares of different types. A company can issue only two types of shares – Preference and Equity. Equity shareholders are the real owners of the company but they don't have any preferential right as to dividends or to the repayment of capital. They are entitled to receive dividend only after the payment to the preference shareholders. Equity shareholders have a right to attend and vote at the meetings of the company. On the other hand preference shareholders have two preferential rights – (i) right to receive dividend at a fixed rate and (ii) right to the return of capital in the event of winding up of the company. Preference shares may again be of several types such as cumulative and non-cumulative, participating and non-participating, redeemable and irredeemable, convertible and non-convertible.

A company can also borrow money by issuing debentures. Debenture is an acknowledgement of debt by the company. Debentureholders are entitled to receive

interest at a fixed rate irrespective of the fact whether there are profits or not. Debentures are generally secured. They may be convertible or non-convertible.

A company can also raise funds by accepting deposits from the public. But there are certain restrictions regarding the maximum amount of deposits by a company. The deposits are accepted for a minimum period of six months and a maximum period of 36 months. The rate of interest payable on deposits is prescribed by the Company Law Board, at present the rate of interest is 14%. The Government has laid down rules regarding the acceptance of deposits from public and strict compliance is expected failing which penalties shall be imposed.

8.9 KEY WORDS

Share: A unit into which the capital of the company is divided.

Issued Capital: The amount of capital that is issued by a company to public.

Preference Shares: Shares which carry preferential rights with reference to dividend and the repayment of capital in the event of winding up of the company.

Stock: Aggregate of fully paid-up shares of a member.

Reserve Capital: That part of uncalled capital which can be called up only in the event of winding up of the company.

Debentures: A document acknowledging a debt by a company.

Bearer Debentures: Debentures which are transferable by delivery only.

Naked Debentures: Debentures which are not secured by any mortgage of asset.

Secured Debentures: Debentures which are secured by the mortgage of some assets of the company.

Convertible Debentures: Debentures that are fully or partly convertible into equity shares of the company.

Redeemable Debentures: Debentures which are repayable after the stipulated period.

Deposit: Any deposit of money with, and includes any amount borrowed by a company.

8.10 ANSWERS TO CHECK YOUR PROGRESS

A 6) i) a ii) c iii) a iv) b v) b
7) i) False ii) True iii) False iv) False
v) False vi) True vii) True viii) False

B 4) i) loan ii) owner, creditor iii) shares
iv) cannot v) prior vi) charge
5) i) False ii) False iii) True iv) False
v) True vi) False vii) False

C 4) i) 58A ii) 25 p.c. iii) ten times
iv) thirty six v) cannot.

8.11 TERMINAL QUESTIONS

1) What is meant by 'Registered Capital'? What are the two kinds of share capital?
2) What is a reserved capital? Can a charge by created on reserve capital?
3) What do you mean by the term 'Share'? Distinguish between 'Share' and 'Stock'.
4) Enumerate the provisions for redemption of preference shares.

5) Distinguish between shares and debentures.
6) State the manner, limits and conditions subject to which a company may accept public deposits.
7) What are the consequences if a company contravenes any of the provisions of the Companies (Acceptance of Deposit) Rules, 1975.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answer to the University. These are for your practice only.

UNIT 9 ALLOTMENT OF SHARES

Structure

9.0 Objectives
9.1 Introduction
9.2 Allotment of Shares
- 9.2.1 Notice of Allotment
- 9.2.2 Rules Regarding Allotment of Shares
- 9.2.3 Procedure of Allotment
- 9.2.4 Returns as to Allotment

9.3 Irregular Allotment and its Consequences
9.4 Issue of Shares at a Discount
9.5 Issue of Shares at a Premium
9.6 Share Certificate
- 9.6.1 Issue of Share Certificates
- 9.6.2 Effects of a Share Certificate
- 9.6.3 Duplicate Share Certificate

9.7 Share Warrant
- 9.7.1 Rules regarding Share Warrants
- 9.7.2 Distinction Between a Share Certificate and a Share Warrant

9.8 Calls on Shares
- 9.8.1 Essentials of a Valid Call
- 9.8.2 Payment of Calls in Advance

9.9 Forfeiture of Shares
9.10 Re-issue of Forfeited Shares
9.11 Surrender of Shares
9.12 Let Us Sum Up
9.13 Key Words
9.14 Answers to Check Your Progress
9.15 Terminal Questions

9.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of allotment of shares
- describe the rules relating to allotment of shares
- explain the consequences of irregular allotment
- list the circumstances under which the shares can be issued at a discount and at a premium
- explain the meaning of a share certificate and a share warrant, and distinguish between the two
- explain the essentials of a valid call
- describe the circumstances under which the shares can be forfeited and reissued
- explain the rules for the surrender of shares.

9.1 INTRODUCTION

In Unit 8 you learnt about the various kinds of shares and debentures that can be issued

by a company. The Companies Act has laid down detailed procedure for the issue and allotment of shares which a company has to follow. In this unit you will learn about such procedure including the detailed rules relating to the allotment of shares. In addition, you will study the consequences of irregular allotment, the rules relating to the issue of shares at a premium or at a discount, and the procedure for the forfeiture and reissue of forfeited shares.

9.2 ALLOTMENT OF SHARES

You know that a public limited company invites subscriptions from the public and for this purpose a prospectus is issued. In response to this invitation, the prospective investors offer to buy shares by submitting the prescribed application form. If the application is accepted by the company, it proceeds to allot him the shares. With the issue of the letter of allotment, the offer stands accepted thereby giving rise to a legally binding contract between the company and the shareholder. Thus, **an allotment is the acceptance by the company of the offer to purchase shares.**

The term 'Allotment' has nowhere been defined in the Companies Act. It may be said that allotment is an appropriation by the Board of directors of a certain number of shares to a specified person in response to his application. In other words, allotment means the appropriation out of the previously unappropriated capital of a company, of a certain number of shares to a person.

9.2.1 Notice of Allotment

An allotment is the acceptance of an offer to take shares by an applicant, and like any other acceptance, it must be communicated. There can be no binding contract unless the acceptance of the offer is properly communicated. Thus, notice of allotment must be given to the allottee. If the letter of allotment is properly posted i.e., it is correctly addressed and stamped, a contract will arise even if the letter of allotment is delayed or lost in the course of transit. In this letter of allotment, besides other details of the number of shares applied for, the number of shares allotted etc., the allottee is asked to pay the money due on allotment to the company's bankers within a specified time unless there is partial allotment and the allotment money is appropriated out of the excess application money.

9.2.2 Rules regarding Allotment of Shares

The rules regarding allotment of shares can be discussed under the two broad headings – (a) general rules and (b) the legal rules.

General Rules

You know that the allotment is the acceptance of an offer to purchase certain number of shares. Therefore, the general rules relating to valid acceptance of an offer must be followed. The general rules regarding allotment of shares are as follows:

i) **The allotment must be made by proper authority:** It is the duty of the Board of directors to allot the shares. However, the Board may delegate this authority to some other person or persons as per the provisions of the articles of association. Allotment of Shares made by an improper authority will make it void.

ii) **The allotment should be made within a reasonable time:** The offer to purchase shares of the company must be accepted within a reasonable time otherwise the applicants may refuse to take shares because after a reasonable time the offer lapses. What is the 'reasonable time' is a question of fact in each case.

iii) **It must be communicated:** The allotment of shares should be communicated to the applicants. Posting of a properly addressed and stamped letter of allotment will be taken as a valid communication. Even if this letter of allotment is delayed or lost in transit, the allottee will be liable. 'G' applied for certain shares in a company. The letter of allotment was despatched to him but it never reached. It was held that 'G' was liable as a shareholder **(Household Fire Insurance Co. Ltd. v. Grant).**

iv) **It must be absolute and unconditional.** The allotment of shares must conform to the terms and conditions of the application. If the allotment is not according to the terms and conditions, the applicant may refuse to accept the shares even though allotment has been made to him. If the conditions are not fulfilled, the applicant must reject the shares promptly. His silence or acceptance will debar him from this right.

Legal Rules

You should note that so far as the private companies are concerned, the Act does not lay down any restrictions as to the allotment of shares. But the Act has laid down certain restrictions regarding the allotment of shares by public companies.

When no public offer is made: Where a public company does not offer its shares to the public but arranges the capital privately, the company cannot proceed with the allotment unless it files with the Registrar of Companies at least three days before the first allotment, a statement in lieu of prospectus. If the allotment is made in contravention to this provision, it will be termed as 'irregular allotment' and it shall be voidable at the option of the allottee. In addition to this, every officer of the company, who is a party to such allotment shall be punishable with fine which may extent to Rs. 1,000.

When an Offer is made to the Public: Where a company offers to shares to the public:

i) a **prospectus** must be issued and a copy of the same should be filed with the Registrar. You should note that the company cannot allot the shares immediately after issuing the prospectus. No allotment can be made until the beginning of the fifth day from the date of issue of prospectus. The fifth day is to be counted from the date of issue of prospectus was published or was otherwise notified to the public. The beginning of the fifth day is known as 'the time of the opening of the subscription lists'. The object of this provision is to enable the public to go through the prospectus and to decide whether to apply for the shares. The Companies Act, however, does not specifically provide for the time of closing the subscription list. It means that the company may keep the subscription list open for any length of time it wants. According to stock exchange regulations where the shares are listed on any stock exchange, the subscription list must be kept open for at least three days. In such cases, the prospectus usually mentions the time of closing of the subscription lists.

ii) **Minimum subscription:** No company can proceed to allot shares to the public until the minimum subscription (which is 90% the issue amount) has been subscribed, and the sum payable on applications for it has been received by the company in cash. If the company does not receive the minimum subscription of 90% of the issue amount, the entire subscription will be refunded to the applicants within 90 days from the date of closure of the issue. If there is a delay in refund of such amount by more than ten days, the company is liable to pay interest at the rate of 15% per annum for the delayed period.

iii) **Application money:** It is the amount which is payable on each share alongwith the application for purchase of shares. The amount payable on application on each share shall not be less than 5 per cent of the nominal amount of the share.

iv) **Application money to be deposited in a scheduled bank:** All the money received from applicants must be deposited in a scheduled bank and it shall remain there until the certificate to commence business is received.

v) **Allotment of shares to dealt in on stock exchange.** According to Section 73(1) of the Companies Act, every company intending to offer shares to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for the shares to be dealt with in the stock exchange. Thus, now it is made compulsory that the shares must be listed on a recognised exchange. The prospectus must state the name of the stock exchange or each of such exchanges where the application has been made. If the permission has not been granted before the expiry of ten weeks from the date of closing of the subscription lists, the company must immediately repay the money received from the applicants. If it is not repaid within eight days, the directors shall be liable to repay it with interest at such rate, which shall not be less

than four per cent and more than fifteen per cent per annum. However a director may escape liability if he can prove that there was no negligence or misconduct on his part.

Subsequent allotment of shares: The rules regarding the subsequent allotment of shares are the same as discussed above except the rule regarding minimum subscription.

9.2.3 Procedure of Allotment

When the company receives from bankers all the share applications, a share application list is prepared. You should remember that only the names of such applicants should be recorded who have paid the application money because an application without application money is void. The directors will see that all the legal rules regarding allotment have been complied with, then they will proceed with the allotment of shares. If the issue has been just fully subscribed, then there is no problem in allotment, the directors can allot to each applicant the number of shares asked for.

But the real difficulty arises in case of over-subscription. An issue is said to be over-subscribed if the number of shares applied for is greater than the number of shares available for allotment. In case of over-subscription, the applicants will have to be allotted less number of shares than applied for, it is known as partial allotment. **A scheme of basis of allotment is framed in consultation with the stock exchange where the shares are to be listed.** In its guidelines the Government has emphasised that the scheme of allotment should be framed in such a manner that the interests of genuine small investor are promoted and the widest dispersal of the shareholding takes place. In order to ensure that no one corners a major portion of the shares available, the multiple application from the same person have been prohibited.

In case of over-subscription, the shares are allotted either by draw of lots (lottery); or on pro-rata basis i.e. by alloting shares to each applicant in the proportion to the number of shares applied for. In order to ensure that an applicant may not refuse to accept a smaller number than applied for, the application form usually contain a clause saying "I/We agree to accept such shares or any smaller number that may be allotted to me/us."

According to the latest guidelines issued by the Controller of Capital Issues, the case of equity shares, the companies are allowed, at their option, to retain over-subscribed equity to the extent of 15 per cent of the amount for which consent of the CCI has been sought.

You should remember that when lesser number of shares are allotted to an applicant, the excess application on money is not refunded to him but it is transferred to his allotment amount and adjusted against the allotment money due from him.

In case of under-subscription, the Board of directors has only to ensure that the minimum subscription has been received, then they can proceed with the allotment work. When the Board of directors pass a resolution confirming the allotment and, if for some reason, no shares are allotted to an applicant, then a letter of regret is sent to him alongwith a crossed cheque for the refund of the share application money.

9.2.4 Return as to Allotment

You learnt the rules and the procedure of allotment of shares. Section 75 of the Companies Act provides that when a company having a share capital makes any allotment of its shares, the company must within 30 days of the allotment, file with the Registrar a report known as "return as to allotment". The return must contain particulars relating to the number and nominal amount of shares allotted, the names, addresses and occupation of the allottees and the amount due or paid on allotment.

Where shares are allotted for consideration other than cash, the company will produce for the inspection of the Registrar, a contract in writing constituting contract of sale or for services for which the shares are being allotted.

Where shares are issued at a discount, a copy of the resolution passed by the company authorising such issue together with the order of the Company Law Board sanctioning

the issue shall also be filed with the Registrar.

In the case of bonus shares, the return must state the number and nominal amount of such shares and names, addresses and occupations of the allottees and a copy of the resolution authorising the issue of such shares.

A company is not required to file a return of allotment when forfeited share are reissued, because it does not amount to allotment, it is simply a resale of shares.

9.3 IRREGULAR ALLOTMENT AND ITS CONSEQUENCES

An allotment of shares shall be termed irregular [illegible] made without fulfilling the conditions precedent to a regular allotment. The allotment of shares is irregular in the following cases:

1) Where an allotment is made without receiving the minimum subscription.
2) Where an allotment is made without receiving atleast five per cent of the nominal value of shares as application money.
3) Where an allotment is made without depositing the application money in a scheduled bank.
4) In the case of a company which does not invite public to subscribe its shares, if the allotment is made without filing with the Registrar the 'Statement in lieu of prospectus' at least three days before the first allotment of shares.
5) [illegible]here the company fails to apply for listing of its shares in one or more recognised stock exchanges before the tenth day after the first issue of prospectus or where such permission has been applied for before that day but the permission has not been granted by the stock exchange before the expiry of ten weeks from the date of the closing of the subscription list.
6) Where the allotment is made before the expiry of the fifth day after the date of issue of the prospectus.

Consequences: The consequences of an irregular allotment are as follows:

i) **Voidable at the option of the allottee:** In the first four cases discussed above the allotment is voidable at the option of the allottee. But this right should be exercised by the allottee within two months after the holding of the statutory meeting by the company or where the company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, within two months after the date of allotment. It is not necessary that the allottee must commence legal proceedings within the said period, what is required is that he must give a notice to the company of his intention to avoid the allotment. The option to avoid the allotment can be exercised even after the company has gone into liquidation and is in the course of liquidation.

ii) **Fine:** Where time limit regarding the opening of the subscription list is not observed, the allotment remains valid but the company and every officer who is in default are liable to a fine upto Rs. 5,000 each.

iii) **Allotment is void:** In the fifth case discussed above if the application for listing of shares has not been made or such a request for permission of shares to be dealt in the stock exchange has not been granted within the prescribed time, the allotment shall be void. In this case the money must be returned within eight days, failing which the directors are liable to pay it with interest at such rate which shall not be less than 4 per cent and not more than 15 per cent as may be prescribed, having regard to the length of the period of delay in making repayment.

iv) **Director's liability:** The directors of the company who are responsible for irregular allotment, are liable to compensate the company and the allottee for any loss, damages or cost suffered or incurred by them. However, the action to recover such loss or damage or cost must be started within two years of allotment.

9.4 ISSUE OF SHARES AT A DISCOUNT

You have learnt that the share capital of a company is divided into shares of fixed face value. A company, may issue shares at a price less than the face value of the share. In that case, it is termed as 'issue of shares at a discount'. For example, if a share of Rs. 10 is issued at Rs. 9 per share, it means that the share is issued at a discount of Re. 1. Generally, the issue of shares at a discount is discouraged and that is why the Companies Act has imposed strict restrictions on the issue of shares at a discount.

Section 79 of the Companies Act provides that a company may issue shares at a discount, if the following conditions are satisfied:

1) The shares offered at a discount must be of a class already issued i.e., the first issue cannot be at a discount.
2) At least one year must have elapsed since the company became entitled to commence issue. It means that in the first year of its working, shares cannot be issued at a discount.
3) The issue must be authorised by an ordinary resolution passed in the general meeting of the company and this must be confirmed by the Company Law Board.
4) The resolution must specify the maximum rate of discount which in no case shall exceed 10%. However, a higher rate of discount may be allowed if the Company Law Board agrees to a higher rate.
5) The shares must be issued within two months after receiving the sanction of the Company Law Board or within such extended time as the Company Law Board may allow.
6) Every prospectus shall contain particulars of the discount allowed on the issue of shares or so much of that discount as has not been written off on the date of issue of the prospectus.

Where the shares are issued at a discount in contravention of the above provisions, the company and every officer of the company responsible for the contravention are liable to a fine up to Rs. 50. Further, the allottees of such shares who allow themselves to be registered as members, shall be required to pay the full value of their shares.

9.5 ISSUE OF SHARES AT A PREMIUM

There can be cases when the company may issue shares at a price higher than the face value of the shares. This is termed as issuing the shares at a premium. For example, when a share of Rs. 10 each is issued at Rs. 12 per share, it is an issue at a premium, the amount of premium being Rs. 2 per share. There is no restriction on the issue of shares at a premium, if the company's reputation is good then it can sell shares at a premium.

Though the Companies Act does not provide for any conditions for the issue of shares at a premium, it regulates the disbursement of the amount collected as premium.

The premium amount cannot be treated as profits and as such it cannot be used for paying dividends. The premium amount must be transferred to a separate amount known as 'Share Premium Account'. Where the shares are issued at a premium for consideration other than cash, an amount equal to the amount of premium must be transferred to 'Share Premium Account'.

The amount of 'Share Premium Account' can be used only for the purposes specified under Section 78 of the Act. These purposes are:

i) issue of fully paid bonus shares to the members of the Company.
ii) writing off the preliminary expenses of the company.
iii) writing off the expenses, commission paid or discount allowed on the issue of the shares of the company.
iv) to provide for the premium payable on the redemption of preference shares or debentures of the company.

The balance sheet of the company must disclose the amount of share premium, and if it has been disposed of, partly or wholly, it must also disclose the manner in which it has been disposed of. The share premium amount should not be treated as free reserves as it is in the nature of the capital reserve.

Check Your Progress A

1) What is meant by allotment of shares?

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2) What is meant by 'opening of the subscription list'?

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3) List four important conditions which must be satisfied before a company can proceed to allot the shares.

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4) What is irregular allotment?

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5) What are the effects of irregular allotment?

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6) List the purposes for which the share premium amount may be utilised.

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7) Fill in the blanks:

i) The allotment of shares in a company must be made by a resolution of ....

ii) The amount payable on application on each share must not be less than .... per cent of the nominal value of share.

iii) If a company does not receive .... per cent of the issue amount, it cannot allot the shares.

vi) If the company does not receive the amount of minimum subscription within .... days from the date of closure of issue, it must return the amount within .... days.

v) A company can issue shares at a discount with the sanction of ....

vi) Reissue of forfeited shares .... be termed as allotment of shares.

vii) The date of opening of the subscription list means the beginning of the .... from the day of the issue of prospectus.

8) State whether the following statements are true or false.

   i) A company can allot shares immediately after the issue of prospectus.

   ii) A company cannot allot shares unless the minimum subscription has been subscribed.

   iii) When an issue is over-subscribed, the directors may alot all the shares applied for.

   iv) A company cannot issue shares for consideration other than cash.

   v) A company can issue shares at a discount within six months of the date on which it beca[illegible] entitled to commence business.

   vi) Ther[illegible] no restrictions on the issue of shares at a premium.

   vii) Di[illegible]d can be paid out of the share premium amount

   viii) An irregular allotment is void.

9.6 SHARE CERTIFICATE

A share certificate is a certificate issued by the company under its common seal specifying the shares held by any member and the amount paid on each share. A share certificate is an evidence of title of the allottee or transferee to the shares. It is a declaration that the person in whose name the certificate is made out and to whom it is given, is a shareholder in the company. However, it should be remembered that it is not a negotiable instrument.

The share certificate may be in any form, but a valid share certificate must have the following contents:

i) Name of the company; ii) Name and address of the shareholder; iii) Number of shares held by him; iv) Distinctive number of shares; v) Amount paid on each share; vi) Date of issue; vii) Share certificate number; viii) Stamp; ix) Signatures of two directors and the Secretary.

Every person whose name is entered as a member in the Register of members is entitled to receive one share certificate for all his share without payment. A share certificate is considered to the prima facie evidence of the title of the member to the shares mentioned in the certificate.

9.6.1 Issue of Share Certificates

The Companies Act has laid down time limits within which the share certificate must be delivered. According to Section 113 of the Act, every company must deliver within three months of the date of allotment and within two months after the date of registration of transfer, a share certificate to the allottee or transferee of shares. However, in appropriate cases the Company Law Board may extend this period upto a further period of nine months.

If default is made in complying with these provisions, the company and every officer of the company who is in default, shall be liable to fine upto Rs. 500 for every day during which the default continues.

If a company makes default in issuing the share certificate, the member can file a complaint with the Company Law Board. The CLB will then issue a notice to the company to make good the default. If the default is not made good within ten days of the service of the notice, the CLB may make an order directing the company and any officer of the company to make good the default within such time as may be specified in the order.

9.6.2 Effects of a Share Certificate

You have learnt that share certificate is prima facie evidence of the title of the member to the shares specified therein. Following are the effects of a share certificate:

i) **Evidence of title:** When the share certificate is issued, the company is estopped from denying the title of the person to the shares whose name is mentioned in the certificate, provided that person has acquired the shares in good faith and under a genuine transfer for value. However, it is not a conclusive proof of the title of the holder. If a person has obtained some shares on the basis of a forged transfer, the company can refuse to register the transfer of shares. You should remember that share certificate is only an evidence of title and is not a document of title. It is not a negotiable instrument which can be transferred by mere delivery of the certificate.

ii) **Estoppel as to payment:** You know that the share certificate states the amount paid on them. A company is estopped from stating that the amount stated as having been paid on the shares has not been paid. For example, if the share certificate states that the full amount on the shares has been paid, then the company is prevented from saying that the shares are not fully paid.

9.6.3 Duplicate Share Certificate

A certificate may be renewed or a duplicate of a certificate may be issued if such a certificate

a) is proved to have been destroyed or lost; or

b) having been defaced, mutilated or torn, is surrendered to the Company.

The fact of being a duplicate share certificate must be mentioned on the certificate. The company may charge a fee not exceeding Rs. 2 per certificate while issuing a duplicate one.

If a company renews a share certificate or issues a duplicate one with intent to defraud, then the company shall be punishable with fine which may extend to Rs. 10,000 and every officer of the company who is in default shall be punishable with imprisonment for a term upto six months or with fine upto Rs. 10,000 or with both.

9.7 SHARE WARRANT

A share warrant is a bearer document of title to the specified shares. A share warrant is a document issued under the common seal of the company stating that the bearer is entitled to the specified number of shares. Since it is a bearer document, it can be transferred by mere delivery. Thus, the holder of a share warrant is entitled to the shares specified therein.

9.7.1 Rules regarding Share Warrants

A public company limited by shares may issue share warrants under its common seal in the following circumstances:

a) if it is authorised by its articles;
b) shares are fully paid-up; and
c) previous approval of the Central Government is obtained.

From the above it should be clear to you that share warrants can be issued only by public companies in respect of fully paid shares. **It is a substitute for the share certificate.**

When a share warrant is issued, the company strikes out the name of the member from the register of members of the company and makes a note about the issue of a share warrant. The date of issue of share warrant is also recorded.

The holder of the share warrant, whenever he desires, can surrender it to the company for cancellation. Subject to the articles of the company, the holder is entitled to have his name recorded as a member in the register of members by paying such fee to the company as the Board of directors of the company may from time to time determine.

Since the name of the shareholder is struck off from the register of members, it shall not be possible for the company to know as to whom the dividends are to be paid. Therefore, coupons are attached to a share warrant to provide for the payment of dividends.

Ordinarily, the holder of a share warrant is not considered as a member of the company. But, if the articles so provide, the bearer of the share warrant could be treated as a member of the company and he can attend the meetings of the company and cast his vote therein.

9.7.2 Distinction between a Share Certificate and a Share Warrant

You have learnt about the nature of a share certificate and share warrant. Now you should be able to distinguish between the two. The distinction between the two may be noted as follows:

i) A share certificate can be issued by private as well as public companies, whereas share warrants can be issued only by public companies.

ii) A share certificate is issued in respect of partly or fully paid shares, whereas a share warrant can be issued only in respect of fully paid shares.

iii) The issuing of a share certificate is a statutory obligation and it requires no approval of the Central Government, but for the issue of share warrants the sanction of the Central Government must be obtained.

iv) The holder of a share certificate is a member of the company. But the bearer of the share warrant is ordinarily not considered as a member of the company because on the issue of share warrant, the name of the shareholder is struck off from the register of members. However, if the articles so provide, the bearer of the warrant may be treated as member for the purposes defined in the articles.

v) The share certificate can be transferred by executing a transfer deed and delivering the share certificate alongwith it, while share warrants can be transferred by mere delivery.

vi) Stamp duty is payable on transfer of shares, while no stamp duty is payable on transfer of share warrants.

vii) A share certificate is not a negotiable instrument, while a share warrant is considered to be a negotiable instrument.

Check Your Progress B

1) What is a share certificate?

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2) What is the purpose of issuing a share certificate?

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3) A share certificate creates two kinds of estoppel against a company. List them.

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4) What is a share warrant?

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5) List the conditions for issue of share warrants.

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6) Fill in the blanks:
   i) A share certificate is a ....
   ii) Every company shall issue share certificates within .... months of the date of allotment.
   iii) A share warrant is transferable by ....
   iv) Dividends on share warrants is paid by ....
   v) Share warrants can be issued only by ....

7) State whether the following statements are true or false.
   i) The approval of Central Government is necessary for issuing share certificate.
   ii) A share certificate may be partly or fully paid.
   iii) A share certificate can be transferred by delivery alone.
   iv) A shareholder is entitled to a duplicate share certificate if it is proved that the original certificate has been lost or destroyed.
   v) Share warrant is a negotiable instrument.
   vi) Share warrants cannot be issued originally.
   vii) The articles must authorise the issue of share warrants.

9.8 CALLS ON SHARES

When a company issues shares, the applicants are generally not required to pay the full value of the shares in one instalment. To start with they are required to pay the application money only.

The balance amount is to be paid later on. Some amount is payable at the time of allotment. It is termed as 'allotment money'. The balance amount is called by the company in instalments. Each instalment is termed as a 'call'. You must remember that the amount paid on application and allotment are not termed as calls.

A call may be defined as a demand by the company on the shareholders to pay whole or part of the balance remaining unpaid on each share, made at any time during the life-time of the company.

9.8.1 Essentials of a Valid Call

According to Section 36(2) of the Act, the unpaid money on a share is a debt due from member. Therefore, once a call has been made, the shareholder is under an obligation to pay the amount called. But the liability to pay this debt or call will not arise until a valid call has been made. The essentials of a valid call are as follows:

i) The call must be made under a resolution of the Board of directors. The resolution must be passed in a properly convened meeting of the directors.

ii) The resolution must specify the amount of call, and the time and place of payment of calls.

iii) Call should be made on a uniform basis, on all shares, falling under the same class i.e., no differentiation should be made between shareholders of the same class.

iv) The power to make call is in the nature of trust and therefore, the directors must exercise this power in good faith and for the benefit of the company. The directors should not make calls for their own benefit, if it is for their own benefit, it shall be an invalid call.

v) The call must be made according to the provisions of the articles of association, some of the rules are:

   a) The maximum amount per call shall not be more than 25 per cent of the nominal value of shares.

   b) There must be at least one month's interval between two calls.

   c) At least fourteen days' notice must be given to each member.

   d) The directors have the discretion to revoke or postpone a call.

If a call is made in contravention to the rules mentioned above, it is termed as an invalid call and the shareholders are not bound to pay it.

9.8.2 Payment of Calls in Advance

Section 92(1) of the Companies Act empowers the company to receive from shareholders the money not yet called up. It provides that a company may, if so authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up.

However, the shareholder shall not be entitled to any extra voting rights in respect of the money paid in advance, until the same become payable by a valid call. You must note that advance calls should be received only for the benefit of the company.

According to Section 93 a company may, if so authorised by its articles, pay dividends in proportion to such amount. **Articles may provide for the payment of interest on calls in advance, but it shall not be more than 6 p.c. per annum unless the company in general meeting otherwise decides.** Shareholders who have paid calls in advance are treated as the creditors of the company for the amount of interest due to them. Where it is decided to pay interest on calls in advance, it may be paid out of capital, if profits are not available. Later on, when the company makes the calls, the money received in advance is accordingly adjusted and then the shareholders get the necessary voting right in respect of them.

9.9 FORFEITURE OF SHARES

You have learnt that the company does not require the shareholders to pay the full amount of shares in one instalment. It makes calls on them as and when the money is needed. If a shareholder fails to pay a valid call within the stipulated time, the company has two options: (1) the company may file a suit for the recovery of the amount, or (2) the company may forfeit the shares. The first option is a lengthy process. Therefore, the company generally decides to forfeit such shares.

The term 'forfeiture' means taking them away from the member. It deprives the shareholder of his property. The shares can be forfeited only if there is a provision to this effect in the articles of the company. You must note that shares can be forfeited only for non-payment of any call or instalment of a call and not for any other debt due from a member.

The following rules are applicable relating to the forfeiture of shares:

i) The power to forfeit shares must be given in the articles of the company.

ii) Shares can be forfeited only for non-payment of calls. A forfeiture on any other ground is invalid.

iii) The company must serve a proper notice on the defaulting member asking him to pay the amount within a fixed period, failing which the shares shall be forfeited. The shareholder must be given at least fourteen days notice to pay the amount. The

notice must indicate the exact amount to be paid. If there is a slight defect in the notice, the forfeiture will become invalid.

iv) The Board of directors must pass a resolution for the forfeiture of shares.

v) The power for forfeiture must be exercised in good faith and for the benefit of the company. A forfeiture for the purpose of relieving a friend from liability shall be invalid.

Effects of Forfeiture

a) The shareholder ceases to be a member of the company in respect of such shares. He loses all his rights. The money paid on such shares is forfeited. On forfeiture, his name is removed from the register of members.

b) The shareholder cannot be sued by the company for unpaid calls. The articles of the company may, however, make him liable for the unpaid calls. Any action must be taken within three years from the date of forfeiture.

c) The former shareholder can be placed on the 'B' list of contributories, if the company is wound up within twelve months of the date of forfeiture.

d) After forfeiture, the shares become the property of the company and the company can dispose them of in any manner it likes. Generally, the forfeited shares are reissued.

If the shares have been forfeited wrongfully, the concerned shareholder can sue the company for cancelling the forfeiture. But if it is not possible on account of the reissue of forfeited shares, he can sue the company for damages.

9.10 RE-ISSUE OF FORFEITED SHARES

When the shares are forfeited, they become the property of the company and, to that extent, the paid-up capital of the company stands reduced. Therefore, the forfeited shares are generally reissued by the company. **The forfeited shares can be reissued at any price i.e., even at discount. But the amount of discount must not exceed the amount forfeited on such shares.** The reissue is done by a resolution of the Board of directors. After the reissue, the buyer of such shares shall become liable to pay all the future calls due on shares, including the calls for which the shares were forfeited. The name of the buyer shall be recorded in the register of members and if the original shareholder has surrendered the share certificate, the same shall be transferred in the name of the buyer, otherwise a new share certificate shall be issued.

The title of the buyer shall not be affected by any irregularity or invalidity in proceedings with reference to forfeiture. It should however be noted that reissue of forfeited shares is a sale of shares and it does not amount to an allotment. Therefore, return of allotment need not be filed with the Registrar.

9.11 SURRENDER OF SHARES

Surrender is a voluntary act of the shareholder under which the shares are returned to the company for purposes of cancellation. Neither the Companies Act nor Table 'A' provides for the surrender of shares. But, the articles may provide for the surrender of the partly paid-up shares under circumstances where forfeiture seems to be justified.

You must note that when shares are surrendered to the company, no amount is refunded to the shareholder. It is so, because if some money is refunded it will amount to a purchase by the company of its own shares which is prohibited by Section 77 of the Companies Act.

Srrender of shares may be allowed in the following cases if its acceptance is authorised by the articles of the company:

i) When shares are surrendered in exchange for new shares of the same nominal value, as it does not amount to any reduction of capital.

ii) When the circumstances are such where forfeiture is justified, because surrender is a short-cut to forfeiture.

If the surrender of shares is accepted by the company for any other reason, other than the reasons given above, it will be invalid.

On a valid surrender of shares, the member ceases to be a member of the company, but his name can be placed on list 'B' contributories. Because if the company is wound up within twelve months of the surrender of shares, he shall be liable as a past member. If the surrender of shares is proved to be illegal, the shareholder may apply for the rectification of register of members after lapse of any number of years, provided the shares have not been reissued in the meantime.

Forfeiture and surrender of shares, both lead to the termination of membership. But in case of forfeiture it is compulsory or a forced action, while in case of surrender it is a voluntary act on the part of the member to avoid the disgrace of forfeiture.

Check Your Progress C

1) What is meant by a call?

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2) List three essentials of a valid call.

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3) Give the reason for forfeiting shares.

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4) When is surrender of shares lawful?

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5) State whether the following statements are true or false.

   i) Any director of a company can make a call on his own.
   ii) The call notice must specify the amount payable, the date and place of payment.
   iii) The calls on shares should be made on a uniform basis.
   iv) Forfeiture of shares does not amount to reduction of capital.
   v) Shares can be forfeited for non payment of call or any other debt.
   vi) Forfeited shares may either be cancelled or reissued at the discretion of the Board of directors.
   vii) Forfeited shares can be reissued at a discount, but the amount of discount must not exceed the amount forfeited on such shares.
   viii) Surrender of shares is the same thing as forfeiture of shares.

9.12 LET US SUM UP

Allotment of shares is an important step in the process of raising the funds by the issue of shares or debentures. When a person applied for a certain number of shares of the company in response to an advertisement or prospectus and the company accepts his offer and allot him the shares, it results in a valid contract between the company and the applicant. The allotment must not be made until the minimum subscription has been received by the company.

The allotment should not be made unless the application money is at least five per cent of the nominal value of shares and the money is deposited in a scheduled bank. The shares of the company should be listed in one or more recognised stock exchanges. If shares are not listed, the allotment shall be irregular.

Shares can be issued at par or at a discount, or at a premium. Shares can be issued at a discount only when it is authorised by a resolution passed at the meeting of the shareholders and is sanctioned by the Company Law Board. When shares are issued at a premium, the premium amount can be utilised only for writing off preliminary expenses or for writing off capital losses or for issuing bonus shares.

Share certificate is the evidence of title of the member to such shares. When the shares are allotted to a person, he is entitled to receive a share certificate from the company. The share certificate is issued under the seal of the company and it contains the name and address of the member, certificate number, number of shares, amount paid up in respect of them etc.

If the original share certificate is lost, destroyed or torn, the company may issue a duplicate share certificate on certain conditions.

Share warrant is a document which shows that the bearer of the warrant is entitled to the number of shares mentioned therein. It can be transferred by mere delivery.

The entire amount in respect of shares is not demanded in one instalment. After the shares have been allotted, the company requires the members to pay the remaining money in one or two instalments known as 'calls'. The call must be made under a resolution of the Board of directors, on a uniform basis, for the benefit of the company and in accordance with the provisions of the articles of the company.

If a shareholder fails to pay the call money within the stipulated time, the shares can be forfeited. Before forfeiting the shares the company must send a proper notice to the member. Forfeiture shall be valid only when it is made under a resolution of the Board of directors. Forfeited shares can be reissued, it does not amount to allotment but it is simply a sale of shares already issued. Surrender of shares means voluntary return of shares by the shareholder to the company for cancellation. Surrender of shares may be accepted only when forfeiture is justified.

9.13 KEY WORDS

Allotment: An appropriation of a certain number of shares to a specified person in response to his application.

Issue of shares at a discount: Issue of shares at a price which is less than the nominal value of the share.

Issue of shares at a premium: Issue of shares at a price which is more than its face value.

Share Certificate: A certificate issued under the seal of the company, specifying the shares held by any member and the amount paid.

Share Warrant: a document issued under the seal of the company stating that the bearer is entitled to a specified number of shares.

Call: An instalment which a shareholder is required to pay to the company.

Forfeiture: Taking back the share for non-payment of calls thereby depriving the shareholder of his right to the shares.

Surrender of Shares: Voluntary return of the shares to the company.

9.14 ANSWERS TO CHECK YUOUR PROGRESS

A 7 i) Board of directors ii) five iii) 90% iv) ninety v) Company Law Board vi) cannot vii) Fifth

i) False ii) True iii) False iv) False v) False vi) True vii) False viii) False

B i) evidence of title ii) three iii) delivery iv) coupons v) public companies.
i) False ii) True iii) False iv) True v) True vi) True vii) True

C i) False ii) True iii) True iv) True v) False vi) True vii) True viii) False

9.15 TERMINAL QUESTIONS

1) Explain the procedure of allotment of shares.
2) What is an irrgular allotment? What are its consequences?
3) What is meant by return of allotment?
4) Under what circumstances can a company issue shares at a discount?
5) When shares can be issued at a premium? For what purposes the premium amount can be utilised?
6) What is a share certificate? When must it be issued? Can a company issue a duplicate share certificate, if so when?
7) What is share warrant? Distinguish between a share certificate and a share warrant.
8) What is meant by 'call'? What are the requisites of a valid cell?
9) Explain the procedure of forfeiting the shares. What is the effect of forfeiture? How forfeiture is different from surrender of shares?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the Uiversity. These are for your practice only.

UNIT 10 MEMBERSHIP IN A COMPANY

Structure

10.0 Objectives
10.1 Introduction
10.2 Members and Shareholders
- 10.2.1 Definition of a Member
- 10.2.2 Distinction Between Member and Shareholder
- 10.2.3 Who can become a Member?
- 10.2.4 Number of Members

10.3 Modes of Becoming a Member
10.4 Termination of Membership
10.5 Rights of Members
10.6 Liability of Members
10.7 Transfer of Shares
- 10.7.1 Procedure of Transfer of Shares
- 10.7.2 Blank Transfer
- 10.7.3 Forged Transfer

10.8 Transmission of Shares
10.9 Distinction Between Transfer and Transmission
10.10 Register of Members
- 10.10.1 Index of Members
- 10.10.2 Foreign Register
- 10.10.3 Inspection of Register
- 10.10.4 Closure of Register
- 10.10.5 Rectification of Register

10.11 Let Us Sum Up
10.12 Key Words
10.13 Answers to Check Your Progress
10.14 Terminal Questions

10.0 OBJECTIVES

After studying this unit you should be able to:

- explain the meaning of a member
- distinguish between a member and a shareholder
- describe the modes of becoming a member
- discuss the circumstances when a person ceases to be a member

10.1 INTRODUCTION

You have learnt that a registered company has a corporate entity of its own which is distinct from the members who constitute it. The terms 'member' and 'shareholder' are used interchangeably. But, in law, there is a fine distinction between the two. In this unit you will learn about the exact meaning of the term 'member', modes of becoming a member, the circumstances under which a person ceases to be a member, and the rights and liabilities of members. In addition, you will lea: about the procedure for transferring the shares, and distinction between transfer and transmission of shares. and the rules regarding the maintenance of Register of Members.

- list the rights and duties of members
- explain the procedure for the transfer of shares
- distinguish between transfer and transmission
- explain the rules relating to the maintenance of the register of members.

10.2 MEMBERS AND SHAREHOLDERS

In normal usage the two terms 'member' and 'shareholder' are used synonymously. But, legally, there is a difference between the two. A shareholder is a person who holds or owns the shares in a company, whereas a member is one whose name is recorded in the register of members. In some cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member. For example, in the case of companies limited by guarantee having no share capital it will have members but no shareholders. Similarly, a shareholder who has sold his shares to another person ceases to be a shareholder but he continues to be a member of the company until the name of the transferee is recorded in the Register of Members.

10.2.1 Definition of a Member

According to Section 41 of the Companies Act, 1956, a member means (i) the subscribers of the memorandum of association of the company; and (ii) every other person who agrees in writing to become a member of a company and whose name is entered in its register of members. Thus, a person who puts his signature on the memorandum as a subscriber becomes a member before any shares are allotted to him. In other cases, a written application for the allotment of shares is necessary before the name of the person can be entered as a member in the register of members. The real test of membership is whether the name of a person appears on the company's register of members. If his name appears on the register of members, then only can he be treated as a member of the company.

10.2.2 Distinction between Member and Shareholder

Though the two terms 'member' and 'shareholder' are used synonymously, yet there is a difference between the two. Following are the main points of difference:

i) A company limited by guarantee having no share capital will have only members but no shareholders.

ii) When a person transfers his shares, he ceases to be a holder of those shares but continues to be the member of the company until his name is replaced by the name of the transferee.

iii) The legal representatives of a deceased member become shareholders immediately on the death of the member but they do not become members until their names are entered in the register of members.

iv) The holder of a share warrant is a shareholder but he is not a member. You have learnt that when share warrants are issued the holder's name is struck off from the register of members. However, the articles of association of the company may give membership rights to holders of share warrants.

v) A person whose shares are forfeited or who has surrendered his shares to the company, may be held liable as a member to contribute to the assets of the company, if winding up commences within twelve months of his ceasing to be a member, though he is no longer the shareholder of the company.

In **Kedarnath Agarwal v. Jay Engineering Works Ltd.** it was held that a member may be a shareholder, but a shareholder may not be a member.

From the above discussion it should be clear to you that person holding shares of a company are shareholders, while members are persons who constitute the company as a corporate entity and whose names are entered in the register of members

10.2.3 Who can become a Member?

The Companies Act does not specifically lay down as to who can be a member of a company. It also does not prescribe any disqualification for any person which would debar him from becoming a member of a company. The Act simply provides that any person who agrees in writing to become a member of a company can become a member. You know that a contract to purchase shares in a company is like any other contract. Therefore, only such persons can become members of a company who are competent to contract. However, as regards competency of a member, the provisions of the Indian Contract Act shall apply. This means that **minors, persons of unsound mind and those who have been disqualified by law from contracting, cannot become members of a company.**

Let us now discuss the position of a few special type of members:

i) **Minor:** According to Section 11 of the Indian Contract Act, a minor is incompetent to contract, therefore, he cannot become a member of the company. In **Palaniappa v. Official Liquidator, Pasupati Bank Ltd.** an application was made by a father as guardian of his minor daughter describing her as mir... The company went into liquidation. It was held that the allotment was void an... ither the minor nor her guardian could be held liable as contributories. But i... ignorance of the fact of minority, a minor is allotted shares, the company can repudiate the allotment and remove his name from the register of members. The minor may also rescind the allotment any time during his minority. In either case, the company has to refund all moneys received from minor in respect of the shares allotted to him. If neither party repudiates allotment, the name of the minor shall continue to appear on the register of members, but even then a minor incurs no personal liability.

   After the minor attains majority, he can still repudiate his liability even if he had received dividends during his minority **(Sadiq Ali v. Jai Kishori)**. But he cannot repudiate the same if he had received dividends after attaining majority and intentionally permitted the company to believe him to be a shareholder **(Fazalbhoy v. The Credit Bank of India Ltd.)**. Thus, it is in the interest of the companies to allot only fully paid shares to the minor because otherwise he will not be liable for the unpaid amount on shares.

   There is nothing in the Act to bar a minor from becoming a transferee of fully paid shares. In **Miss Nandita Jain v. Bennet Coleman and Company Ltd.**, the Company Law Board held that the contract entered into by a minor for registration of transfer of fully paid shares, through the natural guardian was a valid and binding contract. In such a case the entry in the register of members will be made as follows, "A, (a minor) through .... guardian.

   If shares are transferred to a minor, the transferor will continue to remain liable for all future calls on such shares even if he was ignorant of the minority of the transferee. If the company is aware of the minority of the transferee at the time of transfer, it can refuse to register the transfer in favour of a minor unless the shares are fully paid.

ii) **Company:** A company being a legal person, is competent to contract. Therefore, a company may become a member of another company if it is authorised by its memorandum or articles. However, a subsidiary company cannot become a member of its holding company.

iii) **Partnership firm:** A partnership firm is not a legal person. Therefore, it cannot buy shares in its own name. A firm may hold shares in the names of individual partners who may be entered as joint holders in the register of members. However, it can become member of a non-profit making company licensed under Section 25 of the Act.

iv) **Hindu undivided family:** A HUF can have shares in a company in the name of its Karta. Thus, the Karta will be a member of the company as his name alone will be entered in the register of members.

v) **Insolvent:** If any member is declared insolvent, he remains a member of the company till his name appears on company's register of members. He is entitled to vote in respect of shares held by him, but the dividend on shares will be paid to Official Assignee or Official Receiver.

vi) **Foreigners:** A foreigner may become a shareholder with the general or special permission of the Reserve Bank of India under the Foreign Exchange Regulation Act, 1973. But if he becomes an alien enemy, his rights as a member shall be suspended.

vii) **Married woman:** A married women is competent to contract and as such can become a member of a company.

viii) **Trustee:** Section 153 of the Act lays down that no notice of trust, express or implied or constructive, shall be entered in the register of members. Therefore, a trustee cannot become a member of a company in his capacity as such. But a trustee can be a member in his own name.

ix) **Joint Holders:** The shares of a company may also be held jointly by two or more persons. In a public company, even joint shareholders are counted as separate members but in a private company, joint holders are treated as a single member for purposes of Section 3(1)(iii) of the Act. The joint holders of shares may get themselves registered in any order they like and may split their joint holdings in a manner so as to enable all of them to attend and vote. Unless the articles provide otherwise, a company is not bound to deliver more than one share certificate. The company may pay dividend to the person whose name is first written in the register of members. Similarly, a notice served by the company on the joint holder named first in the register of members will be deemed to be served properly on all of them. You should, however, remember that joint holders are jointly and severally liable for payment of calls. The transfer of shares by the joint holders will be effective only if it is made by all of them jointly.

10.2.4 Number of Members

You have learnt that the minimum number of members for a public company is seven and for a private company the minimum number is two. It must therefore, be carefully looked that the number of members must not fall below the statutory minimum. According to Section 45 if the number falls below the minimum and the company carries on business beyond the period of six months, then the liability of members shall become unlimited. Also, a company whose number of members falls below the statutory minimum, may be wound up by the court.

10.3 MODES OF BECOMING A MEMBER

A person may become a member in a company in any of the following ways:

1) **By subscribing to the memorandum:** A signatory to the memorandum automatically becomes a member of the company on its incorporation. Neither application nor allotment of shares is necessary to constitute them members of the company. Even if his name is not entered in the register of members, he will still be treated as a member of the company.

2) **By application and allotment of shares:** A person who agrees in writing to become the member of the company and whose name is entered in the register of members is also a member of the company. An application for shares is an offer to take shares and allotment is the acceptance of that offer. The rules regarding offer and acceptance (Law of Contract) are applicable. Thus, if a person applies for shares subject to certain conditions, the allotment by the company must be made according to those conditions, otherwise the allottee shall not be bound to accept the shares.

3) **By transfer of shares:** You know that the shares of a public company are freely transferable. Thus, a person may buy shares in the open market and get those shares registered in his name. On the registration of transfer of shares, the transferee becomes the member of the company.

4) **By transmission of shares:** A person may become a member by operation of law i.e., by transmission. On the death of a member, his legal representatives have the right to get the shares of the deceased member registered in their names. No instrument of transfer is necessary in this case.

5) **By agreeing to take qualification shares:** When a director of a public company signs and files with the Registrar an undertaking to take and pay for his qualification shares, he is in the same position as subscriber to the memorandum and he is deemed to have become member of the company on incorporation.

6) **By estoppel:** If the name of a person is improperly placed on the register of members and he knows and assents to it, he will then be estopped from denying that he is a member. But in view of the rule laid down in Section 41 that the person must agree in writing to be a member, a person cannot be treated as a member of a company simply because his name is entered in the register of members.

10.4 TERMINATION OF MEMBERSHIP

You learnt that a person becomes a member of the company when his name appears in the register of members. Accordingly, a person ceases to be a member of a company when his name is removed from the register of members. A person may cease to be a member in any one of the following ways:

1) **Transfer of Shares:** When he transfers his shares to another person and the transfer is duly registered by the company, the name of the transferor is removed from the register of members.
2) **Transmission of Shares:** On the death of a member, his shares get transmitted to his legal representatives.
3) **Forfeiture of Shares:** Shares may be forfeited for non-payment of calls and other reasons contained in the articles. The membership terminates on share forfeiture.
4) **Surrender of Shares:** When a member validly surrenders his shares to the company, he ceases to be a member.
5) **Insolvency of member:** When a member is declared insolvent, his shares vest in the Official Receiver or Official Assignee. The Assignee or Receiver may sell these shares and when the transferee's name is entered in the register of members, insolvent member ceases to be a member.
6) **Winding up of company:** Membership terminates on the winding up of the company, but he continues to be liable as a contributory.
7) **Repudiation of Contract:** If he repudiates the contract to take shares on the ground of misrepresentation or mistake in the prospectus or on the ground of irregular allotment.
8) **Enforcement of lien:** When the company has a lien on the shares and the shares are sold by the company to enforce this lien or if the shares are sold in the execution of a decree of the court, the membership terminates.
9) **Redemption of Shares:** If a member is holding redeemable preference shares, then on their redemption his membership terminates.
10) **Issue of Share Warrants:** When share warrants are issued in exchange of fully paid shares, his name is removed from the register of members although he continues to be a shareholder of the company.
11) **Court's order:** When the court passes an order for the purchase of shares of a member under Section 402 of the Companies Act, his membership terminates.

10.5 RIGHTS OF MEMBERS

A number of rights have been confered on the members by the Companies Act, some of the important rights are as under:

i) Right to receive copies of memorandum and articles of association on request and on payment of the prescribed fee.

ii) Right to receive share certificate within the prescribed period.

iii) Right to transfer his shares according to the articles of association.

iv) Right to have his name entered in the register of members.

v) Right of priority to have shares offered in case of increase of capital.

vi) Right to receive notice of meetings, to attend, to appoint a proxy and vote at the meeting.

vii) Right to participate in the appointment of directors, auditors etc., at the annual general meeting.

viii) Right to inspect register of members, register of debenture holders and copies of annual returns.

ix) Right to apply to the Company Law Board for rectification of register of members.

x) Right to request the Company Law Board for calling an annual general meeting when the Board of directors fail to call such meeting or apply for an extraordinary meeting of the company whenever necessary.

xi) Right to receive copies of Balance Sheet, Profit and Loss Account and Director's report before the annual general meeting.

xii) Right to receive proper notice of resolutions requiring special notice.

xiii) Right to have on request minutes of proceedings at a general meeting.

xiv) Right to apply to the Central Government for ordering an investigation into the affairs of the company.

xv) Right to present petition to the Company Law Board for relief in cases of oppression and mismanagement.

xvi) Right to present petition to High Court for the winding up of the company.

xvii) Right to share in the surplus assets of the company on winding up.

From the above you must have noted that these rights are very valuable to keep the management of the company on the right track. How far these rights are exercised effectively by members is a different question.

10.6 LIABILITY OF MEMBERS

Liability of members of a company depends upon the nature of the company. This is discussed accordingly as follows:

i) **Unlimited company:** Every member of such a company is liable for all debts contracted by the company during the period when he was a member.

ii) **Company limited by guarantee:** Every member is liable to contribute to the extent of the amount guaranteed by him which is given in the liability clause of the memorandum.

iii) **Company limited by shares:** The majority of the companies belong to this category. In the case of such companies, the liability of a member is limited to the amount unpaid on the shares held by him. If he has paid full amount on shares, his liability is nil.

You should remember that all money payable by any member to the company under the memorandum or articles are a debt due from his to the company. If a shareholder dies and he was holding partly paid-up shares, then his estate will be liable or the legal representatives will be liable for the unpaid amount.

If at any time the number of members is reduced below the statutory number (seven for public company and two for private company), and the company carries on business for more than six months while the number is so reduced, every member becomes severally liable for the debts of the company contracted after the said period of six months.

Check Your Progress A

1) What do you mean by the term 'member' of a company?

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2) Distinguish between a member and a shareholder.

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3) List the four ways of becoming a member of the company.

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4) Give three cases when a person ceases to be the member of a company.

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5) State whether the following statements are true or false:

i) The terms 'member' and 'shareholder' mean the same thing.

ii) A minor cannot become member of a company.

iii) A foreign national cannot become a member of a company.

iv) A person ceases to be a member of the company when his shares are forfeited.

v) A member has a right of priority to have shares offered in case of increase of capital.

vi) A member cannot repudiate the contract to take shares in the company on the ground that the prospectus was misleading.

vii) Membership of a person in a company does not come to an end when share warrants are issued in exchange of fully paid shares.

10.7 TRANSFER OF SHARES

You know that the shares of a public company are the movable property and they can be transferred in accordance with the articles of association. The articles of association can lay down the manner of transfer but it cannot absolutely restrict the right of the member to transfer his shares. A private company with a share capital, by Section 3(1)(iii) restricts the right to transfer its shares by its articles. In the case of a public company shares can be transferred subject to the rules laid down in the Act and in the articles.

Any person who is a member of the company and whose name appears on the register of members can make a valid transfer. **The legal representative of a deceased member can also make a valid transfer even though he is not a member.** The legal rules relating to the transfer of shares are contained in Sections 108 to 112 of the Companies Act, 1956.

10.7.1 Procedure of Transfer of Shares

The process of transfer starts with the delivery of an application, for transfer of shares, to the company. This is technically called an instrument on deed of transfer. Instrument of transfer should be duly stamped and signed by both the transferor and the transferee, otherwise transfer of shares shall not be registered. It must contain particulars regarding the name, address and occupation of the transferee. The instrument of transfer must be accompanied with the share certificate or the letter of allotment.

Every instrument of transfer must be in the prescribed form and before anything is written on it, it should be presented to the prescribed authority who shall stamp on it the date on which it is so presented. In this form the distinctive number of shares to be transferred, the price for which they are being transferred and the signatures of the transferor and transferee must be given.

Every instrument of transfer must bear the stamps of the requisite value as per the Indian Stamp Act, 1899 and the stamps should be duly cancelled. If the instrument is not stamped properly, the instrument shall be considered as incomplete.

When the instrument of transfer is complete in all other respects, it must be delivered to the company:

i) in the case of shares which are dealt in or quoted on a stock exchange before the closing of register of members for the first time or within twelve months from the date of presentation to the prescribed authority, whichever is later.

ii) in any other case, within two months from the date of such presentation to the prescribed authority [Sec. 108(1-A)].

Where the application is made by the transferor and it relates to partly paid shares, the transfer must not be registered unless the company gives notice of the application to the transferee and the transferee makes no objection to the transfer within two weeks from the receipt of notice [Sec. 110(2)].

When the duly executed and stamped transfer deed is delivered to the company within the prescribed time alongwith the share certificate or letter of allotment, the transfer of shares is complete irrespective of the fact whether the company registers it or not.

If a company refuses to register a transfer of shares, it must within two months send notice of refusal to the transferee and the transferor, giving therein reasons for such refusal. The persons affected may appeal to the Company Law Board against such refusal, but the appeal must be made within two months of the notice of refusal.

The Board of directors in their meeting considers all such applications for transfer of shares and if the secretary or the committee appointed for this purpose recommends the transfer, a resolution approving the transfer is passed at the meeting.

After the resolution is passed by the Board, necessary endorsements are made on the back of the share certificate indicating the name of the transferee as the shareholder. You should note that the transferee becomes a member of the company only when the transfer is registered by the company.

On registration of the transfer, the name of the transferor is removed from the register of members and in his place the name of the transferee is recorded. The transferor continues to be the holder of shares until his name is removed.

A new share certificate may be issued to the transferee or the old share certificate may be indorsed in the name of the transferee.

10.7.2 Blank Transfer

A blank transfer is an instrument of transfer which is signed by the transferor wherein the name and other particulars about the transferee are not filled in, and is handed over with the share certificate to the transferee.

Because the name of the transferee is not filled in the transfer deed, he can further sell off the shares merely by delivering the blank instrument of transfer. The transferee need not sign the instrument of transfer while selling the shares. Thus, blank transfer facilitates the sale of shares without complying with the formalities prescribed for transfer of shares. The process of purchase and sale of shares can be repeated any number of times with the blank transfer deed.

Besides the convenience of transfer; stamp duty and registration fee is also saved. The last transferee who wants to get the shares transferred in his name, fills up his name, address etc. and can get himself registered as the member of the company. The first seller is treated as the transferor and until the transfer is registered with the company, he continues to be the owner of shares. All the intervening sellers and buyers save the stamp duty. The blank transfer helps in avoiding or reducing the tax liability because the transaction is not shown in the books at all.

The blank transfer deed is a valid transfer deed, but it cannot be treated as a negotiable instrument. The person who receives the share certificate alongwith a blank transfer deed has the authority to fill in his name and get himself registered as a member of the company.

The practice of blank transfer was found to have been misused, therefore, some restrictions have been imposed on the period of currency of blank transfers. The Act now provides that the instrument of transfer must be dated and stamped by the Registrar of companies and the instrument is valid for twelve months only in the case of listed securities and two months in all other cases. Thus, now it can remain in circulation only for twelve months and the indefinite circulation of the instrument of blank transfer has been effectively checked.

10.7.3 Forged Transfer

Any instrument on which the signature of the transferor is forged is called a forged instrument of transfer and the transfer made on the basis of such instrument of transfer is termed 'forged transfer'.

A forged transfer deed is legally ineffective and confers no title on the transferee of shares. If a company has removed the name of the true owner on the basis of forged document, the true owner can compel the company to restore his name on the register of members.

If the company has issued a new certificate to the transferee on the basis of forged document, who has purchased the shares for value and without notice of such forged transfer, then the company cannot deny his title to the shares because the certificate estops it from doing so. However, the person lodging the transfer must indemnify the company against loss by forgery. To prevent such a situation companies normally inform the transferor of the transfer so that he can object if he wishes.

10.8 TRANSMISSION OF SHARES

You know that the transfer is a voluntary act of the shareholder. As against this transfer of shares on account of operation of law is termed as transmission of shares. Normally, a company registers the transfer only when a properly executed transfer deed is lodged with the company. But in the case of death, lunacy or insolvency of a member it is not possible to have the transfer deed, then by operation of law shares are transferred to legal representative or the Official Assignee or Official Receiver. The articles usually contain provisions relating to transmission of shares.

In case of transmission of shares no instrument of transfer is necessary, but the person claiming the title to the shares has to apply to the company for transmission of shares in his name. The company can register the shares on the basis of will or death certificate or succession certificate.

In the case of death of a member, his legal representatives can validly transfer these shares to any person, although he may himself not be a member on the date of execution of the transfer deed.

A company may refuse to register a transmission, but this power must be exercised in good faith and in the interest of the company. However, in case of refusal, the aggrieved party can appeal to the Company Law Board in the same manner as in the case of refusal to register transfer of shares.

In case of transmission of shares, since there is no instrument of transfer, no stamp duty is required to be paid.

10.9 DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

A transfer of shares is a voluntary act of the transferor while a transmission is by operation of law. In both the cases, the ultimate effect is the same i.e., the ownership of shares passes from one person to another. Following are the main points of difference between transfer and transmission of shares:

	Transfer	Transmission
i)	It is a deliberate act of the holder.	It results by operation of law.
ii)	An instrument of transfer has to be executed.	It requires only proof of title of the transferee.

iii)	Stamp duty is payable on its execution.	No stamp duty is payable in this case
iv)	Shares are transferred for some consideration	Shares passes to another person without any consideration.
v)	Company charges for registering a transfer	No charges are levied for registering transmission.

Check Your Progress B

1) What do you understand by transfer of shares?

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2) What is a forged transfer?

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3) What is a blank transfer?

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4) List the cases when transmission of shares take place.

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5) State whether the following statements are True or False.

   i) The shares in a company are movable property transferable in the manner provided in the articles.
   ii) The right to transfer shares in a public company can be curtailed by articles of the company.
   iii) It is not necessary that the instrument of transfer should be in the prescribed form.
   iv) An instrument of transfer shall be presented to the prescribed authority before any entry is made therein.
   v) An instrument of transfer need not be stamped.
   vi) If a company refuses to register transfer of shares, it must within two months send notice of refusal to the transferor and the transferee.
   vii) A transferee becomes a member of the company when the instrument of transfer is presented to the company.
   viii) Transmission of shares take place by operation of law.
   ix) In case of forged transfer, the true owner can compel the company to get his name entered in the register of members.

10.10 REGISTER OF MEMBERS

Section 150 of the Companies Act, 1956 requires every company to maintain a register of its members containing the following particulars:

i) the name, address and occupation, if any, of each member.

ii) the shares held by each member with their individual numbers and the amount paid or agreed to be considered as paid on the shares of each member;

iii) the date on which each person was entered in the register as a member;

iv) the date on which each person ceased to be a member; and

v) where the shares have been converted into stock, the register show the amount of stock held by each member instead of the amount and particulars relating to shares.

In the case of joint shareholders, names of all the joint shareholders must be entered in the register and the notices etc., be sent to the first named joint shareholder.

No notice of any trust, express or implied is allowed to be entered on the register of members.

In case any default is made in maintaining the register in the above manner, the company and every officer of the company, who is in default, is punishable with a fine which may extend to Rs. 50 for every day during which the default continues.

The register must be kept uptodate containing all changes that might be taking place from time to time.

The register must be kept at the registered office of the company unless some other place (though it must be in the city, town or village where the registered office is situated) has been approved by a special resolution in the general meeting and the Registrar of Companies has been given in advance a copy of the proposed special resolution.

Section 164 of the Act provides that the **register of members shall be a prima facie, but not conclusive, evidence of membership.** It is a prima facie evidence of matters required or authorised to be contained therein.

The form of the register is prescribed bsy the government. The companies can either adopt this form or any other form closely resembling to this. Separate registers in different colours should be maintained for different types of shares.

10.10.1 Index of Members

You learnt that every company is required to maintain a register of members. If the number of members is large then to enable the company to locate the account of each member easily an index must be prepared.

Section 151 of the Companies Act, requires that every company having more than fifty members shall keep an index of members alongwith the register. If the register of members is in such form that it can serve the purpose of index, no separate index of members need be maintained.

The index must be kept at the same place as the register of members. The index must contain sufficient indication to enable the account of each member in the register of members to be easily found.

If any alteration is made in the register of members, the company must make the necessary alteration in the index within 14 days after the date on which the alteration is made in the register.

10.10.2 Foreign Register of Members

A company, may, if so authorised by its articles, keep in any state or country outside India a branch register (called as foreign register) of its members resident in that state or country. The company shall within thirty days from the date of the opening of any foreign register notify the Registrar about the place where such register is kept. Any change in the situation of the office or of its discontinuance shall be duly notified to the Registrar within thirty days of the date of change or discontinuance.

A foreign register shall be deemed to be part of the company's register of members. The company must keep a duplicate of every foreign register. A copy of every entry made in the foreign register must be transmitted to the head office in India, which shall record the same in the duplicate register maintained by it.

10.10.3 Inspection of Register

A company's register of members is a public document and open to public inspection. The register of members and index must be open to inspection by members free and by any other person on payment of rupees ten for each inspection. The register must remain open for at least two business hours each day except when the register is closed under the provisions of the Act. The right to inspect also includes the right to make extracts from the register.

The company is also bound to supply a copy of the register, index etc. on payment of rupee one for every one hundred words or fractional part thereof required to be copied. The company should send the copy within a period of ten days, exclusive of non-working days.

If inspection is refused or a copy is not sent within a period of ten days, the company and every officer of the company in default shall be punishable in respect of each offence with fine upto Rs. 50 for every day during which the default continues.

10.10.4 Closure of Register

According to Section 154 of the Act, a company may close the register of members for a period not exceeding 45 days in a year. However, at one time the register cannot be closed for more than 30 days. For closing the registor at least seven days notice should be given by advertisement in some newspaper circulating in the district in which the registered office of the company is situated.

It is compulsory to close the register of members before annual general meeting of the shareholders and before declaring the bonus issue. During the period of closure of the register of members, no transfer of shares is registered. Contravention of these provisions will entail a fine of Rs. 500 for each day of wrong closure.

10.10.5 Rectification of Register

You have learnt that the register of members is the prima facie evidence of the correctness of the contents stated therein. In case there are some inaccuracies in the register, it may affect the interest of a member.

Section III of the Companies (Amendment) Act, 1988 provides that if –

a) the name of a person is entered, without sufficient cause, or
b) after having been entered in the register, is, without sufficient cause, omitted therefrom, the aggrieved party may apply to the Company Law Board for rectification of the register.

The Company Law Board shall hear the concerned parties and after hearing them may either dismiss the appeal or reject the application or by order direct the rectification of the register. The CLB may also direct the company to pay damages, if any, sustained by the aggrieved party.

Check Your Progress C

1) What is meant by register of members?

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2) When should a company keep index of members?

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3) Where the register and index of members should be kept?

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4) What should a company do when it wants to close the register of members?

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5) Who can inspect the register of members?

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6) Sate whether the following statements are True or False.

   i) It is optional for a company to maintain a register of members.
   ii) An index of members must be maintained by a company when its membership exceeds one hundred.
   iii) The register of member must remain open for inspection by its members for at least two hours on every day except when the register is closed.
   iv) A company may close its register of members in a year for a period not exceeding thirty days.
   v) At any one time the company may close its register of members for a period not exceeding twenty one days.
   vi) No transfer of shares can take place during the period when the register of members is closed.
   vii) In case of some inaccuracy, the aggrieved party can apply to the court for rectification of register of members.

10.11 LET US SUM UP

Any person whose name appears on the register of members of a company is known as a 'member'. The terms member and shareholders are used synonymously. But a shareholder may not necessarily be a member and a member may not necessarily be a shareholder. Companies having no share capital have members only.

Any person who is competent to contract, can become a member of the company. The minimum number of members in a public company must not fail below seven and in case of private company, it must not be less than two.

A person may become a member of a company in any of the following ways: (1) by subscribing to the memorandum (ii) by agreeing in writing to take shares, (iii) by taking qualification shares; (iv) by estoppel; (v) by transfer and by transmission of shares.

A person may cease to be a member, if (i) he transfers his shares; (ii) he dies or becomes of unsound mind or is declared insolvent; (iii) his shares are forfeited; (iv) he surrenders his shares; (v) he is declared insolvent; (vi) the company is wound up; (vii) he repudiates the contract, (viii) the company enforces the right of lien on shares; (ix) the shares are redeemed; (x) share warrants are issued; and (xi) by an order of the court.

Shares of a public company are freely transferable in accordance with the provisions of articles and the Act. Shares can be transferred by executing an instrument of transfer

also known as 'transfer deed'. This instrument must be presented before the prescribed authority who will affix the date on it. This instrument is valid for twelve months in case of listed securities and two months in other cases. Share certificate should be deposited with the company along with the instrument of transfer. If everything is in order, the Board of directors shall pass a resolution and register the transfer. If the transfer is refused, the transference should be informed about such refusal within two months of the application for transfer.

Transfer of shares by operation of law is known as transmission of shares. On the death, lunacy or insolvency of a member on furnishing the necessary proof about their title, the shares are transferred in the name of the legal heir. In case of transmission of shares no stamp duty is payable and there is no consideration.

Every company is required to maintain a register of its members in the prescribed form, continuing the prescribed information about members. The register must be kept at its registered office and shall be open for inspection for two hours every day.

Every company having more than fifty members must keep an index of members. A company, may, after giving not less than seven days notice by advertisement in a local daily, close the register of members, for a period not exceeding 45 days in a year, but not exceeding 30 days at any one time.

A person can apply to the Company Law Board for rectification of the register of members if his name has been wrongly entered into the register or if his name has been wrongly omitted from the register.

10.12 KEY WORDS

Member: Anyone whose name is entered in the register of members.

Shareholder: A person who holds or owns the shares.

Transfer of Shares: Transfer of ownership of shares which is done voluntarily by executing the instrument of transfer.

Transmission of Shares: Transfer of shares by operation of law.

Blank Transfer: Transferor signs the instrument of transfer leaving all other particulars blank.

Forged Transfer: Instrument of transfer bearing the forged signature of the transferor.

Register of Members: A register containing the names, addresses and other particulars of all the members.

Index of Members: For locating the account of a member easily, index is to be maintained.

Foreign Register: Register of members for members residing outside India.

Closure of Register: The period when the register is closed and no transfer can be registered after closure.

Rectification of Register: In case of some inaccuracy, a person can apply to Company Law Board for rectification of the register.

10.13 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) True ii) True iii) False iv) True v) True vi) False vii) False

B 5 i) True ii) False iii) False iv) True v) False vi) True vii) False viii) True ix) True

C 6 i) False ii) False iii) True iv) False v) False vi) True vii) False

10.14 TERMINAL QUESTIONS

1) Distinguish between a member and a shareholder.
2) Who can become a member of the company? Can a minor, partnership firm become member of the company?
3) Can a person become a member of company without there being an agreement in writing?
4) When does a member ceases to be a member of the company?
5) Explain briefly the rights and liabilities of a member.
6) Explain the procedure of transfer of shares.
7) Distinguish between transfer and transmission of shares.
8) What is a blank transfer? What are its evils? How they have been overcome?
9) What are the provisions of the Companies Act, 1956 relating to the closure of register of member? Is it compulsory to close the register of members before every annual general meeting?
10) What are the statutory provisions regarding rectification of register of members?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answer to the University. These are for your practice only.

UNIT 11 DIRECTORS

Structure

11.0 Objectives
11.1 Introduction
11.2 Definition of a Director
11.3 Position of Directors
11.4 Number of Directors and Directorships
11.5 Qualifications of a Director
11.6 Disqualifications of Directors
11.7 Appointment of Directors
11.8 Vacation of Office by Directors
11.8.1 Retirement of a Director
11.8.2 Resignation by a Director
11.9 Removal of Directors
11.10 Powers of Directors
11.11 Duties of Directors
11.11.1 Statutory Duties
11.11.2 General Duties
11.12 Liabilities of Directors
11.13 Meetings of Directors
11.14 Let Us Sum Up
11.15 Key Words
11.16 Answers to Check Your Progress
11.17 Terminal Questions

11.0 OBJECTIVES

After studying this unit you should be able to:

- define a director
- explain the legal position of directors
- describe the qualifications and disqualifications of a director
- explain the procedure of appointment of directors
- list the circumstances when the director's office falls vacant
- explain the mode of removing a director
- describe the powers, duties and liabilities of directors
- explain the rules relating to the meetings of director.

11.1 INTRODUCTION

In Unit 10 you learnt about the membership of a company. You know that the number of members of a company is usually large and are spread all over the country. Hence, they elect some persons to manage this affairs of the company. Such persons are known as directors who are responsible mainly for determining the business policies and directing and controlling the overall affairs of the company. In this unit you will learn the legal position of directors, their qualifications and disqualifications, the method of their appointment, and their powers and duties, and liabilities.

11.2 DEFINITION OF A DIRECTOR

The directors are the persons elected by the shareholders to direct, conduct, manage or supervise the affairs of the company. They manage and control the overall affairs of the company. The day to day working of the company is left to other managerial person appointed for the purpose.

Section 2(13) of the Companies Act defines a director as "any person occupying the position of director by whatever name called." This is an inclusive and not an exhaustive definition. To explain the meaning of the term 'director' we can say that directors are the individuals who direct, control, manage or superintend the affairs of a company.

According to explanation 1 to Section 303 of the Act, any person, in accordance with whose directions or instructions, the Board of Directors of a company is accustomed to act, shall be deemed to be director of the company. If a person performs the functions of a director, he will be deemed to be a director, even if he is not so designated. Thus, it is immaterial by what name he is called. However, the experts who give professional advice, shall not be deemed to be directors.

You should note that only an individual can be appointed as a director. According to Section 253 of the Act no body corporate, association, or firm shall be appointed as a director of a company.

11.3 POSITION OF DIRECTORS

It is not easy to explain the legal position of the directors because the same have not been defined by the companies Act clearly. 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." Thus, the real position of a director is not merely that of an agent, or trustee of managing partner, but a combination of all these positions. Let us now discuss their position under various headings as follows:

As Agents: The company being an artificial person cannot manage its affairs on its own. It has to be entrusted to some human agency known as directors. They are elected representatives of the shareholders and may be termed as agents of the company. The relationship between the company and its directors is that of principal and agent. Therefore, the general principles of the law of agency govern the relations of the company and its directors. As agents, it is their duty to carry on the business with reasonable care and diligence. They must act within the authority conferred upon them by the Act, memorandum and articles and while entering into contracts on behalf of the company within the scope of this authority, they will bind the company. In other words, if they act beyond the scope of their authority, they will be held personally liable. However, you should note that the acts done beyond the powers of the directors may be ratified by the shareholders in general meeting of the company provided such acts are not beyond the powers of the company.

To bind the company, the directors must act in the name of the company. **Directors are the agents of the company and not of the individual shareholders.**

It is, however, not correct to say that directors are the agents of the company because agents are not elected but appointed and secondly, the agents have no independent powers while the directors have independent powers on certain matters.

As Trustees: The 'trustee' means a person who holds and manages the property for the benefit of other persons. Though in the strict legal sense, directors are not the trustees of the company, but, to some extent, they have been treated as trustees of the company. They are the custodians of the money and properties of the company and as such are responsible for the proper use of such money and property. If they misuse the money or property, they have to refund or re-imburse the same.

The directors must exercise their powers in good faith and for the benefit of the company, and not for their own benefit. The directors stand in a fiduciary capacity in relation to the company. The same degree of integrity and standard of conduct is expected from the directors as it is expected from a trustee. **You should note that directors are trustees for the company and not of individual shareholders.**

However, you should remember that directors are not the trustees in the strict sense, because unlike a trustee a director does not enter into contracts in his own name. He enters into contracts for the company of which he is a director and he does not hold any property in trust, because the property is held by the company in its own name.

As Managing Partner: Directors have been described as the managing partners because on the one hand, they are entrusted with the management and control of the affairs of the companies, and on the other hand, they are the shareholders of the company. They manage the affairs of the company for their own benefit as a shareholder and for the general benefit of the company.

But they are not managing partners in the strict sense, because the liability of the director is limited to the value of shares held by him whereas the liability of a partner is unlimited. Further, unlike a partner, a director has no authority to bind the other directors and shareholders.

As Employees: Directors are the elected representatives of the shareholders. As such, they are not employees or servants of the company. But under a special contract with the company a director may hold a salaried employment in the company and in that case he will be treated as an employee or servant of the company and he will enjoy all the rights available to an employee.

Thus, it is clear from the above discussion that **directors are neither the agents, nor the trustees, nor managing partners, nor employees of the company. In fact, they combine in themselves all these positions.** They stand in a fiduciary position towards the company in respect of their powers and capital under their control.

11.4 NUMBER OF DIRECTORS AND DIRECTORSHIPS

The Companies Act has fixed the minimum number of directors which a company must have. According to Section 252 of the Act:

a) every public company shall have at least three directors, and

b) every other company shall have at least two directors.

The Companies Act has prescribed only the minimum number of directors but is silent on the maximum number of directors. Subject to this statutory minimum, the articles of association of a company may prescribe the minimum and maximum number of directors for its Board of directors. Within the limits laid down in its articles, the company can increase or decrease the number of its directors, by passing an ordinary resolution in the general meeting [Section 258].

If a public company or a private company which is a subsidiary of a public company wishes to increase the number of directors beyond the limit laid down in the articles, it can do so only with the approval of the Central Government. However, if the increase in the number of directors does not make the total number of directors more than twelve, the approval of the Central Government will not be necessary [Section 259].

Number of Directorships: A person cannot be a director in more than twenty companies at the same time. If a person is already holding the office of director in twenty companies and is appointed as a director in some other company, then in such a case, the new appointment shall not be effective unless within fifteen days of such appointment he has vacated his office in any one of the companies in which he was already a director. His new appointment shall become void if he fails to make a choice within the said fifteen days.

While calculating the number of twenty companies, the following shall be excluded:

i) an unlimited company;

ii) a private company which is neither a subsidiary nor a holding company of a public company;
iii) an association not carrying on business for profit;
iv) alternate directorships.

Any person who holds office or acts as a director of more than twenty companies, shall be punishable with fine which may extend to Rs. 5,000 for each company after the first twenty companies.

11.5 QUALIFICATIONS OF A DIRECTOR

The Companies Act does not lay down any academic qualification for appointment as a company director. The Act does not lay down any share qualifications for a person to be a director. A director need not hold any shares and need not be a member of the company. **However, the articles of association of the company usually provide for the share qualification of a director.** Such shares are known as qualification shares. The directors are required to have these shares so that they also have some financial stake in the company. Regulation 66A of Table A provides that a director must hold at least one share. The articles specify the number or value of shares to constitute qualification shares.

Where the articles provide for qualification shares, a director must obtain qualification shares within two months of his appointment. Any provision in the articles requiring a person to hold qualification shares within a period shorter than two months of his appointment shall be void. You should note that it is not necessary that a person must acquire qualification shares before his appointment.

The nominal value of the qualification shares must not exceed Rs. 5,000 or the nominal value of one share where it exceeds Rs. 5,000. Any provision in the articles which requires a director to take qualification shares of more than this amount, shall be invalid.

The holder of a share warrant shall not be deemed to be holder of the shares specified in the warrant [Section 270(4)].

If a director does not acquire the qualification shares within two months of his appointment or thereafter does not possess such shares of any time, his office shall automatically become vacant. Further, he shall be punishable with fine which may extend to Rs. 50 for every day from the date of expiry of two months upto the date he acted as a director.

The qualification shares may be obtained by him either directly from the company or from the market.

The provisions regarding qualification shares do not apply to (i) technical directors unless expressly provided in the articles; (ii) directors representing special interest; (iii) directors appointed by Central Government and (iv) in the case of an independent private company.

11.6 DISQUALIFICATIONS OF DIRECTORS

The circumstances in which a person cannot be appointed as a director of a company are listed in Section 274 of the Companies Act. A person shall not be capable of being appointed director of a company if:

i) he has been found to be of unsound mind by a competent court;
ii) he is an undischarged insolvent;
iii) he has applied to be adjudicated as an insolvent and his application is pending;
iv) he has been convicted by a court of any offence involving moral turpitude and sentenced to imprisonment for not less than six months and a period of five years has not elapsed since the expiry of his sentence;

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

vi) he has been disqualified by an order of the Court under Section 203, of an offence in relation to promotion, formation or management of the company of fraud or misfeasance in relation to the company.

The Central Government may, by notification in the Official Gazette, remove the disqualifications listed under clause (iv) and (v) above.

A private company which is not a subsidiary of a public company may, by its articles, provide for additional grounds for disqualification. Thus, a public company or a private company which is a subsidiary of a public company cannot provide for additional disqualifications in its articles.

Check Your Progress A

1) Define a director.

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2) Enumerate the positions in which a director acts.

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3) What is the minimum number of directors in a public and a private company?

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4) What do you mean by 'share qualification' of a director?

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5) How can a company increase the number of directors?

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6) List four cases when a person becomes disqualified for appointment as director of a company.

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7) State whether the following statements are True or False.

   i) Every public company must have at least five directors and every other company at least three directors.

   ii) Only an individual can be appointed as the director of a company.

   iii) Directors are trustees for the company and not for individual shareholders or for third persons who have entered into contracts with the company.

   iv) A company may increase or reduce the number of directors, within the limits fixed by its articles, by passing a special resolution in the general meeting.

v) A person can be a director in more than twenty companies at the same time.

vi) Directors must obtain qualification shares within three months of their appointment.

vii) If a company proposes to increase the total number of directors beyond twelve, it must be approved by the Central Government.

viii) A person who fails to pay the calls in respect of shares held by him for more than six months, cannot be appointed as a director of the company.

11.7 APPOINTMENT OF DIRECTORS

You know that only individuals can be appointed as directors of the company. **Any person who is competent to contract and who holds the qualification shares is eligible for appointment as a director of the company.** Directors may be appointed in any of the following ways (i) by the articles; (ii) by the shareholders in the general meeting; (iii) by the Board of directors; (iv) by the Central Government and (v) by third parties. Let us now discuss them in detail.

1) **By Articles:** The names of the first directors are usually given in the articles of the company. In case they are not named in the articles then the subscribers to the memorandum are deemed to be the first directors of the company and they shall hold office until the directors are appointed at the first annual general meeting.

   A person cannot be appointed as director by articles, or named as a director, or named as a proposed director in the prospectus unless he or his authorised agent

   i) has signed and filed with the Registrar his consent in writing to act as such director; and

   ii) has either (a) signed the memorandum for his qualification shares; or (b) taken the qualification shares from the company and paid or agreed to pay for them; or (c) signed and filed with the Registrar an undertaking in writing to take from the company his qualification shares and pay for them; or (d) filed with the Registrar an affidavit that his qualification shares, if any, are registered in his name.

   The above restrictions, however, do not apply to (i) a company not having a share capital; (ii) a private company; (iii) a company which was a private company before becoming a public company; (iv) a company which issues a prospectus after the expiry of one year from the date on which the company became entitled to commence business.

2) **By Shareholders in General Meeting:** The first directors of the company shall hold the office till the first annual general meeting. According to Section 255 of the Act, directors of a public company must be appointed every year in its annual general meeting. Unless the articles provide for retirement of all the directors at every annual general meeting, at least two-thirds of the total number of directors must retire by rotation. Thus, only one-third can be the permanent or non-retiring or ex-officio 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 who have been longest in office since their last appointment shall retire, but in case if the date of appointment is the same, the retirement will be determined by an agreement among them and if there is no agreement, it shall be determined by draw of lots.

   The retiring directors are eligible for re-election. If a person other than a retiring director wishes to contest the election for directorship, he must give a notice in writing to the company at least fourteen days before the meeting. The company is then required to inform the members either by individual notices or by advertisement of at least seven days before the meeting about such a candidature.

   If the vacancies could not be filled up in the annual general meeting, the meeting is

adjourned for the next week to be held at the same time and at the same place. If at the adjourned meeting also the place of the retiring director is not filled up and that meeting has not expressly resolved not to fill the vacancy, then the retiring directors shall be deemed to have been re-appointed as directors.

It should be noted that the appointment of each director in the general meeting must be made by a separate resolution, unless the meeting unanimously decides otherwise. In other words, two or more directors cannot be appointed by one resolution.

3) **By Board of Directors:** The Board of directors may also appoint directors in the following cases:

   i) **Additional Directors:** The Board of directors may, if authorised by the articles, appoint additional directors. But care should be taken to see that the total number of directors including the additional director must not exceed the maximum number fixed by the articles. **Such an additional director shall hold office only upto the date of the next annual general meeting.**

   ii) **Alternate Director:** The board may appoint the alternate director if the articles authorise such an appointment. An alternate director is appointed to act in place of a director who remains absent for more than three months from the state in which the meetings of the Board are ordinarily held. Such an alternate director shall hold office till the time when the original director (in whose place he was appointed) returns or on the expiry of the original director's term.

   iii) **Casual Director:** If the office of any director falls vacant for some reason before the expiry of his term of office, such a casual vacancy may be filled by the Board of directors according to the regulations of the articles. Such a vacancy may be caused by death, resignation, insanity, insolvency etc. The person who is appointed by the Board to fill up the casual vacancy, shall hold the office only upto the date upto which the director in whose place he is appointed, would have held the office.

4) **By Central Government:** To safeguard the interest of the company, or its shareholders, or the public, the Central Government may appoint such number of directors as the Company Law Board may, by order in writing, specify. **Such directors are appointed to prevent oppression and mismanagement of the affairs of the company.** The Company Law Board may pass such an order on a reference made to it by the Central Government, or on the application of at least one hundred members, or of member holding at least ten per cent voting rights. Such directors are not required to hold qualification shares and they are not liable to retire by rotation. However, such directors can be removed by the Central Government at any time and appoint some other person in his place.

5) **By Third Parties:** The articles of the company may authorise the third parties to appoint persons on the Board of directors as their nominee. But the number of directors so nominated must not exceed one-third of the total number of directors. The term 'third parties' here means the debentureholders, financial institutions or banks, etc., who have lent money to the company. The idea behind such appointment is to ensure that the money lent is used only for the purposes for which it has been lent. Such directors are not liable to retire by rotation.

You have learnt that for the appointment of every director, a separate resolution has to be passed. Normally, they are elected by a simple majority. As a result it is possible that the minority of the shareholders may not be in a position to send their representative on the Board of directors. Therefore, Section 265 of the Act provides them an opportunity to have their representative on the Board. This is done by adopting the system of proportional representation. The articles may have a provision to this effect by which not less than two-third of the total number of directors of the company be appointed by the single transferable vote, or by a system of cumulative voting or otherwise. Such appointments may be made once in three years and any casual vacancy may be filled up by the Board of directors.

11.8 VACATION OF OFFICE BY DIRECTORS

According to Section 283 of the Companies Act, the office of a director shall become vacant if –

i) he fails to obtain or ceases to hold the qualification shares;

ii) he is found to be of unsound mind by a competent court;

iii) he applies to the court to be adjudged an insolvent;

iv) he is declared insolvent;

v) he is convicted of any offence involving moral turpitude and sentenced to six month's imprisonment;

vi) he fails to pay any call for six months on shares hold by him;

vii) he absents himself from three consecutive meetings of the Board of directors or from all the meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board. But if this absence is not deliberate (he might be ill) then it will not result in the vacation of office;

viii) he accepts a loan or any guarantee or security for a loan from the company without the previous approval of the Central Government;

ix) he fails to disclose to the Board his interest in any contract entered into by the company as required by Section 299;

x) he becomes disqualified by an order of the court under Section 203 which restrains fraudulent persons from managing the affairs of companies;

xi) he is removed by an ordinary resolution of the company;

xii) he had been appointed a director by virtue of his holding any office and he ceases to hold such office;

xiii) he is convicted of an offence in connection with the inspection of books of accounts and other records by the Registrar.

A private company which is not a subsidiary of a public company may, by its articles, provide for additional grounds on which the office of a director shall fall vacant.

The grounds mentioned above for vacating the office of director apply to all companies – public or private. On the happening of any of the above events, the director will have to vacate the office. These rules are applicable to all directors by whomsoever appointed and for whatever period appointed. The Board has no power to waive the event or condone the act.

11.8.1 Retirement of a Director

You know that two-third of the directors are liable to retire by rotation and if a director retires at an annual general meeting and is not re-elected, he ceases to hold the office.

11.8.2 Resignation by a Director

A director may resign in accordance with the rules laid down in the articles. If the articles contain no such rule, he can resign at any time by giving a reasonable notice to the company, it is immaterial whether the company accepts his resignation or not. A resignation once made will take effect immediately when the intention to resign is made clear. A resignation cannot be withdrawn, except with the consent of the company concerned.

The resignation letter should be sent to the company at the registered office of the company. The resignation should preferably be in writing, but sometimes even oral resignation may be effective, for example, if it is made at the general meeting of the company.

11.9 REMOVAL OF DIRECTORS

A director can be removed from office before the expiry of his term by (a) shareholders;

or (b) Central Government; or (c) Company Law Board. Let us now discuss them in detail.

a) **Removal of Shareholders:** A company may remove a director by giving a special notice and passing an ordinary resolution. However, they cannot remove (i) director appointed by the Central Government; (ii) a life time director in a private company; (iii) a director representing special interests e.g., creditors or debentureholders; and (iv) a director elected by proportional representation.

Special notice of fourteen days must be given for the resolution to remove a director at any meeting. On receipt of such a notice, the company must forthwith send a copy thereof to the director concerned, who has a right to be heard on the resolution at the meeting.

If the director concerned has sent a written representation to the company, the company may send a copy of the same to all the members. If the representation could not be send because of the shortage of time, it may be read at the meeting.

A vacancy created by the removal of a director may be filled up by the appointment of another director in this place provided special notice of such appointment has been given to members. A director so appointed shall hold office only for the remaining period of the director removed. Such a vacancy can also be filled up a casual vacancy. **A removed director cannot be reappointed, but he can claim compensation for loss of office.**

(b) **Removal by Central Government.** The Central Government may remove a director on the recommendation of the Company Law Board. The Central Government may refer the matter to the Company Law Board if it feels that the person has been guilty of fraud, misfeasance, negligence or breach of trust, or that the business of the company has not been conducted according to prudent commercial principles or the company is managed by such a person in such a manner as to cause or likely to cause serious injury to trade, industry or business. If the Company Law Board is satisfied, it shall recommend the removal of such director. The director so removed shall not hold the office of a director or any other office connected with the conduct and management of the affairs of the company for a period of five years. However, the Central Government may, with the previous concurrence of the Company Law Board, remit or reduce this period.

A director who is so removed is not entitled to any compensation for loss of office.

c) **Removal by Company Law Board.** The Company Law Board is also empowered to remove the director on an application made to it for prevention of oppression or mismanagement. Such a person cannot be appointed in any managerial capacity in the company for a period of five years. Also he cannot sue the company for compensation for loss of office.

Check Your Progress B

1) How are the first directors of a public company appointed?

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2) Who are rotational directors?

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3) What do you mean by an alternate director?

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4) When can the Central Government appoint a director?

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5) List four grounds when the office of a director falls vacant.

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6) How can the shareholders of a company remove a director?

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7) State whether the following statements are True or False.

i) The first directors are usually named in the articles.

ii) Unless the articles provide for the retirement of all directors at every annual general meeting, at least one-third of the total number of directors are liable to retire by rotation.

iii) A retiring director cannot be re-appointed.

iv) An alternate director can hold office upto the next annual general meeting.

v) The office of a director falls vacant if he fails to obtain his qualification shares within two months of his appointment.

vi) The office of the director does not become vacant if he fails to disclose his interest in any contract with the company before the Board.

vii) A resignation by a director is effective immediately when the intention to resign is made clear.

viii) A director cannot be removed before the expiry of his term of office.

ix) A director who is removed by Company Law Board is not entitled to any compensation for loss of office.

x) If a new director is to be appointed, a notice in writing shall be given to the company at least twenty one days before the meeting.

11.10 POWERS OF DIRECTORS

You know that the directors are appointed to manage and supervise the overall affairs of the company. Therefore, the Board of directors has the power to do all such things which the company is authorised or empowered to do. **The directors derive their powers from the memorandum or articles of the company and from different provisions of the Companies Act, 1956.**

Section 291 of the Act provides that, subject to the provisions of the Act, the Board of directors of a company shall be entitled to exercise all such powers, and do all such acts and things, as the company is authorised to exercise and do. Thus, the Board of directors cannot exercise such powers which can only be exercised by the company in the general meeting.

The powers of the company are thus divided into two parts: (i) powers to be exercised by the Board of directors, and (ii) powers to be exercised by shareholders in a general meeting. **Within the limits laid down by the Act and the articles, the powers of the directors are supreme and the shareholders cannot alter or restrict their powers by passing a unanimous resolution.** The shareholders can amend the articles or take steps to remove the directors or refuse to re-elect director whose actions they disapprove and appoint other persons replacing them.

Directors are required to act collectively in the form of Board. Directors individually cannot take any decision regarding company's affairs, decisions must be taken at the meetings of the Board or by circulation of proposal among the members of the Board. But the Board has the power to delegate authority in certain respects to an individual director or to a committee of directors.

Though, the shareholders cannot generally interfere or restrict the powers of the directors, but, in the following exceptional cases, the general meeting of shareholders may exercise powers conferred on the Board of directors:

i) where the directors act mala fide and against the interest of the company, for example, when their personal interest clash with their duty towards the company;

ii) where the Board of directors for some valid reasons become incompetent to act, for example, all the directors are interested in a particular transaction;

iii) where there is deadlock in management i.e., the directors are unwilling to exercise their powers, for example, when the directors are equally divided and, therefore, cannot come to any decision.

Powers to be exercised by Board only: According to Section 292 the following powers can be exercised by the Board only by means of resolutions passed at meetings of the Board:

a) the power to make calls;
b) the power to issue debentures;
c) the power to borrow money otherwise than on debentures;
d) the power to invest the funds of the company; and
e) the power to make loans.

The first two powers cannot be delegated by the Board to any committee but the remaining three powers can be delegated to any committee or sub-committee, if any. However, such delegation can be made by the Board by passing a resolution at the meeting of the Board which must specify the nature and extent of power which can be exercised by the delegate. The shareholders, in general meeting, can impose restrictions or conditions on the exercise by the Board of any of the above powers.

Other powers to be exercised at Board Meetings. In addition to powers to be exercised at Board meetings under Section 292, there are some other powers which can be exercised only at a meeting of the Board, they are as follows:

i) the power to fill up the casual vacancies on the Board;

ii) the power of sanctioning a contract on which a director is interested;

iii) the power to appoint or employ a person as managing director or manager, if he is already a managing director or manager of another company;

iv) the power of making investments in shares or debentures of companies under the same management;

v) the power of receiving notice of disclosure of shareholdings by directors and persons deemed to be directors;

vi) the power to make declaration of solvency in the case of member's voluntary winding up.

Among the above-mentioned powers, the powers under clause (iii) and (iv) are to be exercised by the Board with the consent of all the directors present i.e., unanimously. You should remember that each director shall have only one vote and all matters will be decided [except (iii) and (iv)] by simple majority of votes. A director cannot appoint a proxy to attend and vote at the meetings of the Board.

Powers to be exercised with the sanction in general meeting: Section 293 of the Act imposes certain restrictions on the powers of the Board of directors. There are certain powers which can be exercised by the Board of directors only with the consent of the company in the general meeting, they are:

i) the power to sell, lease or otherwise of the company's undertaking;

ii) the power to remit or give time for the repayment of any debt due by a director;

iii) the power to invest, otherwise than in trust securities, the compensation received for compulsory, acquisition of the company's undertakings or property;

iv) the power to borrow money in excess of the total of the paid-up capital of the company and its free reserves; and

v) the power to contribute to any charitable or other funds not directly connected with the business of the company or the welfare of the employees beyond Rs. 50,000 in a year or 5 per cent of the average net profits for the last three financial years, whichever is greater.

In case the directors sell or lease the company's property without obtaining the consent in the general meeting, the title of the buyer or other person who buys or takes a lease in good faith and after exercising due care and caution, will not be affected. Besides, a company whose ordinary business is to sell or lease property is not governed by this rule. You should note that the above restrictions are not applicable to an independent private company. It should also be noted that as regards contributions to National Defence Fund or any other fund approved by the Central Government for the purpose of national defence, Section 293-B empowers the Board of directors to make such contributions without any limit and without obtaining the sanction of the company in general meeting.

Other restrictions on the powers of the Board: In addition to the restrictions imposed by Section 293, there are two more restrictions:

i) **Restriction on making political contributions:** According to Section 293-A, Government companies and companies which have been in existence for less than three financial years are prohibited from making political contributions. Any other company may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person. The amount of such contribution must not exceed five per cent of its average net profits during the three immediately preceeding financial years. Further, for making such contributions, a resolution authorising such contribution, should be passed at the meeting of the Board of directors.

   Every company is required to give the necessary information in its profit and loss account regarding the amount of contribution and the name of the party or the person to whom the amount has been given.

ii) **Restriction on appointment of sole selling or buying agents:** The Board can appoint a sole selling or buying agent of the company for any area only after obtaining the sanction in the general meeting of the company and the appointment can be made only for a term not exceeding five years at a time.

Managerial Powers of Directors

The directors are the elected representatives of shareholders and are entrusted with the power to manage the affairs of the company in the best interest of shareholders. The Board of directors has the following managerial powers:

i) power to make contracts with third parties on behalf of the company;

ii) power to recommend dividends;

iii) power to allot, forfeit and transfer shares of the company;

iv) power to appoint director to fill up the casual vacancy;

v) power to take decision regarding the terms and conditions for the issue of debentures;

vi) power to appoint managing director, manager or secretary of the company;

vii) power to form policy and issue instructions for the efficient running of the business; and lastly

viii) power of control and supervision of work of subordinates.

11.11 DUTIES OF DIRECTORS

You have learnt that directors of a company occupy an important position in the management of the company and they have vast powers. However, it is expected of

them to exercise these powers for the public good and protect and safeguard the interests of the company and shareholders.

The duties of directors depend upon the nature and size of the company. While discharging their duties, they must comply with the provisions of the articles and the Companies Act. The duties given in the articles will certainly vary from company to company. A director is not bound to give continuous attention to the affairs of the company, his duties are of an intermittent nature, to be performed at periodical board meetings.

The duties of directors can broadly be classified under the following two heads:

1) Statutory duties; and
2) General duties.

11.11.1 Statutory Duties

Some of the statutory duties of directors are:

i) Every director must disclose his shareholdings in the company [Sec. 308].
ii) Every director must disclose his personal interest in contracts to be entered into by the company [Sec. 299].
iii) Directors must not receive any loan from a public company or its subsidiary of which he is a director in contravention of Section 295.
iv) To hold statutory and annual general meetings and lay before the company a Balance Sheet and Profit and Loss Account and other reports.
v) To convene extraordinary general meeting on the requisition of the specified number of members.
vi) Directors must not receive remuneration in contravention of Section 309 read with Section 198.
vii) To file with the Registrar the reports and resolutions as required by the Act.
viii) To maintain books and registers required under the Act and articles.
ix) To perform all such duties as required under the Act and articles.

11.11.2 General Duties

There are some duties of a general nature which every director must discharge. The following are some of the general duties:

i) **Duty of good faith:** The directors occupy a fiduciary position in a company. Fiduciary position means a position of trust and confidence. Therefore, directors must act honestly and diligently in the interest of the company and shareholders. They must not make any secret profits from their dealings with the company. If a director makes some secret profits by utilising his position, he shall be liable to account for it.
ii) **Duty of reasonable care:** The directors should discharge their duties with reasonable care. The degree of care expected from him is the same as is reasonably expected from persons of their knowledge and status. If the directors fail to exercise due care and skill in the performance of their duties, they shall be liable for negligence. But they cannot be held liable for mere errors of judgement.
iii) **Duty to attend the Board Meetings:** The duties of directors are of an intermittent nature to be performed at periodical board meetings. Therefore, it is the duty of every director to attend such meetings. Although a director is not expected to attend all the meetings of the Board, but if he fails to attend three consecutive meetings or all meetings of the Board for a consecutive period of three months (whichever is longer) without obtaining permission, his office shall automatically falls vacant.
iv) **Duty not to delegate:** The directors must perform their duties personally. They are appointed because of their skill, competence and integrity, therefore, the maxim delegatus non potest delegare (a delegate cannot delegate further) is applicable to them. But if permitted by articles of the company, the directors can delegate certain functions to the extent permitted by the Act of the articles.

v) **Duty to disclose interest:** The fiduciary position of a director requires him to disclose to the Board his personal interest in any contract to be entered by the company. This is necessary to prevent any conflict between the personal interest of the director and his duties towards the company. It should be noted that there is no ban on company entering into a contract in which a director is interested. What is required is that he must disclose this interest.

11.12 LIABILITIES OF DIRECTORS

The liabilities of directors can be discussed under various heads.

1) **Liability as shareholder:** The director's liability as shareholder is usually the same as that of any other shareholder. But a company may alter its memorandum and make the liability of all or any of the directors unlimited. This, however, will be effective only if the concerned director has given his consent to it. Further; the directors are liable to pay the calls whenever made, within the permissible time. If calls are in arrear for more than six months, he shall have to vacate the office of director.

2) **Liabiliyt to outsiders:** Directors act for the company, as such they cannot be held personally liable to outsiders for any acts done by them on behalf of the company. They would, however, be personally liable to outsiders in the following circumstances:

   i) When they enter into contracts in their own names and not in the name of the company. For example, when they sign a negotiable instrument without mentioning the name of the company, they shall be personally liable.

   ii) Where the directors act ultra vires the company i.e., beyond their powers, in such a case company will not be liable but directors will be liable to their parties for breach of implied warranty of authority.

   iii) Where they have permitted the issue of a prospectus which contains misstatements or which does not present the true position, the directors shall be personally liable.

   iv) Where the directors fail to return the application money within the specified time, if the minimum subscription is not subscribed.

   v) Where there is irregular allotment of shares.

   vi) Where the directors act fraudulently, for example, when they purchase goods or incur liability at a time when they know that the company will never be liable to pay the amount.

3) **Liability to Company:** Directors have some duties towards the company by virtue of their office. The directors are liable to the company in the following cases:

   i) **Ultra vires Acts:** Directors are personally liable to the company for ultra vires acts i.e., acts which are beyond their powers. For example, if they pay dividends out of capital, they will be liable to the company for any loss or damage suffered due to such ultra vires acts.

   ii) **Negligence:** If the directors perform their functions in a negligent manner, they incur personal liability to the company. They are, however, not liable for errors of judgement.

   iii) **Breach of trust:** The directors occupy a fiduciary position towards the company. They must act honestly and in the interest of the company. If the directors make some secret profits or use the company's property for their personal use, then they shall be liable to the company.

   iv) **Misfeasance:** The misfeasance means wilful misconduct or wilful negligence resulting in some loss to the company. The company can take action against the directors for damages in case of misfeasance.

4) **Criminal liability:** If the directors fail to comply with the provisions of the Act, they incur criminal liability involving fine or imprisonment or both. Some of the provisions of the At under which the directors incur criminal liability are:

i) Issue of a prospectus containing an untrue statement.

ii) Failure to deposit application money in a schedule Bank.

iii) Fraudulently inducing persons to invest money in the company.

iv) Accepting deposits or inviting any deposit in excess of the prescribed limit.

v) Destruction, multilation, alteration or falsification of any books, papers or documents.

vi) Failure to file annual returns.

vii) Default in holding the annual general meeting.

viii) Granting loans to directors without the approval of Central Government.

ix) Failure to maintain proper accounts etc.

5) **Liability for acts of co-directors:** A director is not liable for the acts of his co-directors unless he was a party to it. A director is not the agent of his co-directors. He cannot be held liable on the ground that he ought to have discovered the fraud. But a managing director or the chairman signing the accounts without understanding its implications cannot escape liability.

11.13 MEETINGS OF DIRECTORS

You have learnt that directors exercise their powers collectively at periodical meetings of the Board. The rules relating to meetings of directors are following:

i) A meeting of the Board of directors of every company must be held once in every three calendar months and at least four such meetings must be held every year. The Central Government may, however, by notification in the Official Gazette, exempt any class of companies from the above mentioned rule. This has been done to help small sized companies where it is not necessary to hold meeting once in every three months.

   Though the Act does not state anything about the place where the meetings of the Board should be held, but since register of contracts and other books are kept of the registered office, the intention is that such meetings should be held at or near the place of the registered office of the comany.

ii) Notice of every meeting of the Board must be given in writing to every director in India at his usual address. The Act prescribes no particular form of notice or mode of service or length of period of notice. Thus even a few minutes notice would be sufficient. The failure to give notice to any director renders the meeting invalid.

iii) The quorum for a meeting of the Board of directors of a company shall be one-third of its total strength (any fraction to be rounded off as one) or two directors, whichever is higher. If at any time there are some interested directors whose number exceeds or is equal to two-thirds of the total strength, then the remaining directors who are not interested shall form the quorum during that time, provided their number is not less than two. In a Board meeting quorum must be present throughout the meeting and not merely at the commencement of the meeting.

iv) If a meeting of the Board could not be held for want of quorum, it shall stand adjourned till the same day in the next week at the same time and at the same place. If that day happens to be a public holiday, then it will be held on the next following day, which is not a public holiday.

v) It is essential that all the proceedings of every meeting of the Board should be recorded in writing in a book called the minute book. Minutes of every meeting must be signed by the chairman in whose presence those resolutions were passed or by the chairman of the next succeeding meeting. As per Section 289, the resolution may also be passed by circulation.

Check Your Progress C

1) How do the directors of a company exercise their powers?

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2) List four powers of directors which can be exercised only at Board meetings.

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3) Name four important duties of a director.

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4) Who is an 'interested director'?

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5) What are the legal rules as regards the frequency of Board meetings?

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6) What is the quorum in a director's meeting?

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7) State whether the following statements are True or False.
   - i) The directors of a company have the power to do all such acts as the company is authorised to do.
   - ii) The power to issue debentures can be exercised only with the consent of shareholders in general meeting.
   - iii) The Board has the power to recommend the rate of dividend to be declared by the company.
   - iv) Casual vacancies can be filled up by the Board of directors.
   - v) The director can remit or give time for the repayment of any debt due by a director.
   - vi) A director must always act in the general interest of the company.
   - vii) A director interested in a contract must disclose his interest in such contract at the general meeting of shareholders.
   - viii) A meeting of the Board of directors must be held at least once in every four months and at least three such meetings must be held in every year.
   - ix) The quorum for a Board meeting is one-third of its total strength or two directors, whichever is less.

11.14 LET US SUM UP

Since a company is an artificial person created by law, it can act only through human

agents. These agents are known as directors. The directors collectively are called as 'Board of Directors'. Directors are the persons, who are responsible for directing, controlling the overall affairs of the company.

A public company must have at least three directors, and every other company must have at least two directors. A public company which is subsidiary of a public company cannot have more than twelve directors unless the Central Government gives permission for more. No individual can be a director of more than twenty companies at the same time.

All persons appointed as directors of the company must file with the Registrar their consent in writing to act as such. A director is required to have qualification shares so long he continues to be a director. The value of the qualification shares must not exceed Rs. 5,000 or the value of one share where it exceeds Rs. 5,000.

Director's legal position is quite interesting – sometimes they act as agents of the company, sometimes as trustees and sometimes even as managing partners of the company. They are also treated as officers of the company.

A person who is competent to contract can become a director. But a person of unsound mind, undischarged insolvent, persons convicted for moral turpitude and sentenced to six months imprisonment are disqualified to act as directors.

Directors can be appointed by articles, by share holders in general meetings, by the Board, by the parties and by Central Government. The directors may be appointed on the basis of proportional representation.

The office of the director shall fall vacant on various grounds, such as if he fails to obtain qualification shares within two months or ceases to hold qualification shares, his calls are in arrears for six months, he deliberately fails to attend three consecutive meetings without obtaining permission, he fails to disclose his interest in any contract etc.

The directors of a company can also be removed by shareholders, by Central Government and by Company Law Board.

The Act has given wide powers to directors which must be exercised by them in good faith and for the benefit of the company. There are certain powers which can be exercised by them only at the meetings of the Board and certain powers can be exercised by them with the consent of the shareholders in general meeting.

The directors are liable to the company for negligence, breach of trust, for ultra vires acts and for wilful misconduct. The directors are liable to third parties in some cases e.g., when he acts in his own name, for misstatements in the prospectus etc. The directors also incur criminal liability for non-compliance of the various provisions of the Act.

10.15 KEY WORDS

Director: One who performs the functions of a director.

Trustee: One who holds some property in trust for the benefit of another person or persons.

Share Qualification: The minimum number of shares required to be held by the director so long he is a director.

Casual Vacancy: A vacancy caused by the death, insanity or insolvency of a director.

Alternate Director: A director who is appointed in place of the original director.

Rotational Director: Directors who are liable to retire by rotation.

Ultra-vires the company: Beyond the powers of the company.

Misfeasance: Wilful misconduct or wilful negligence.

Criminal Liability: Punishment by way of fine or imprisonment or both.

Quorum: Minimum number of persons physically present to transact a legally binding business.

11.16 ANSWERS TO CHECK YOUR PROGRESS

A 7 i) False ii) True iii) True iv) False v) False vi) False vii) True viii) True

B 7 i) True ii) False iii) False iv) False v) True vi) False vii) True viii) False ix) True x) False

C 7 i) True ii) False iii) True iv) True v) False vi) True vii) False viii) False ix) True

11.17 TERMINAL QUESTIONS

1) Who are the directors of a company? How are they appointed?
2) Explain the rules regarding the number of directors and directorships.
3) Discuss the legal position of directors.
4) What restrictions have been imposed by the Companies Act in respect of appointment of directors?
5) Explain the qualifications and disqualification for the office of a director.
6) What is meant by qualification shares? Is it necessary to be a shareholder or to acquire qualification shares before acting as a director?
7) What are the circumstances when the office of a director shall become vacant?
8) How can a director be removed from office before the expiry of their term of office?
9) Discuss the powers and duties of directors.
10) Explain the liability of directors towards the company and third parties. Can a director be held liable for criminal liability?
11) Write an explanatory note on meetings of directors.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answer to the University. These are for your practice only.

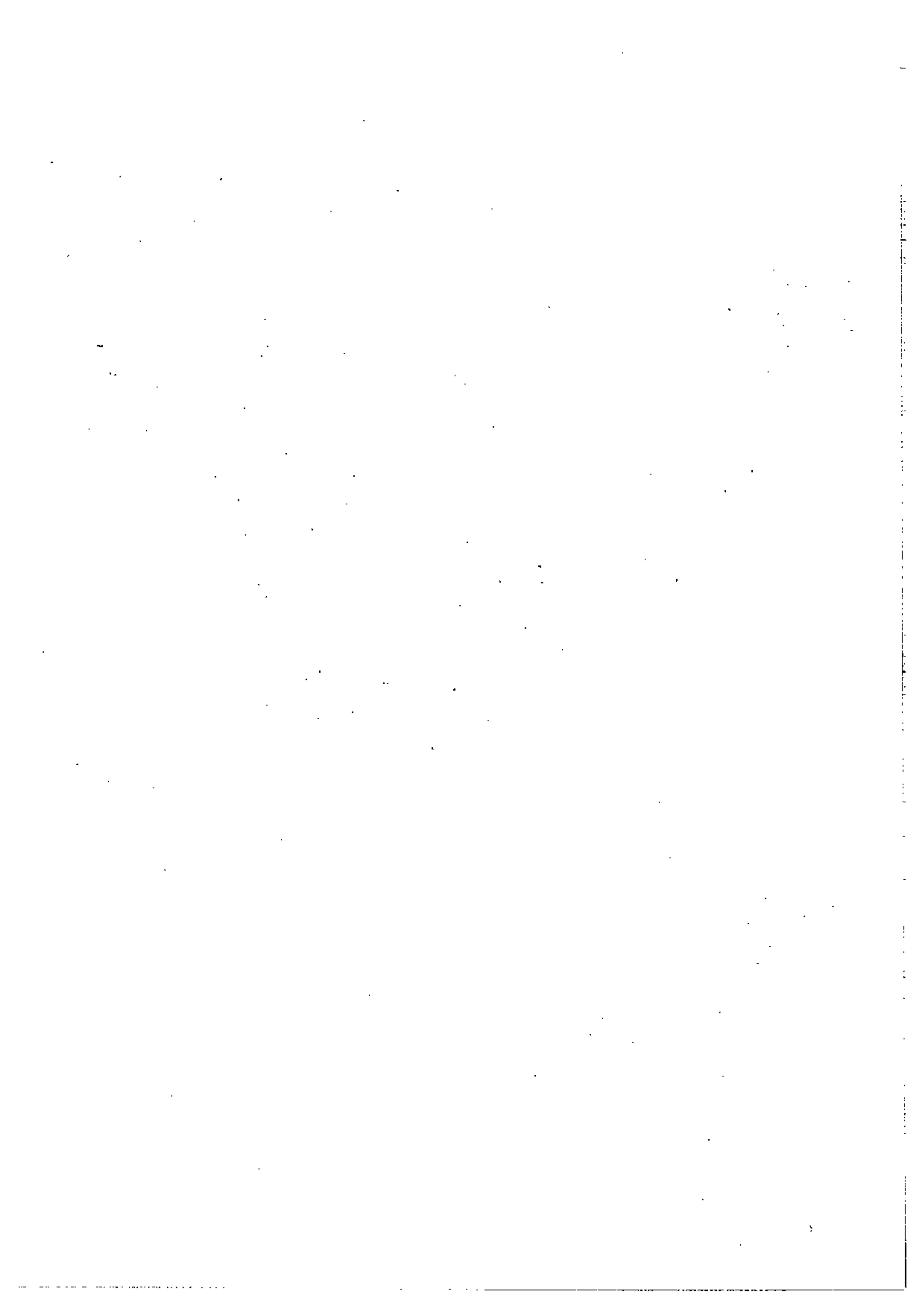
SOME USEFUL BOOKS

Bagarial, Ashok K. 1990 *Company Law.* Vikas Publishing House Pvt. Ltd., New Delhi (Chapter 7-9).

Chawla, R.C. and K.C. Garg, 1990. *Mercantile Law.* Kalyani Publishers, New Delhi (Chapter 7-9) of Section on Company Law.

Kapoor, N.D. 1990. *Elements of Company Law.* Sultan Chand and Sons, New Delhi (Chapter 6-8).

Kuchhal, M.C. 1990. *Modern Indian Company Law.* Shree Mahavir Block Depot, Delhif (Chapters 8-14).



Uttar Pradesh
Rajarshi Tandon Open University

BBA-1.4(E2)
Company Law

Block

4

MEETINGS AND WINDING UP

UNIT 12

Company Secretary 5

UNIT 13

Meetings and Resolutions 17

UNIT 14

Winding Up 35

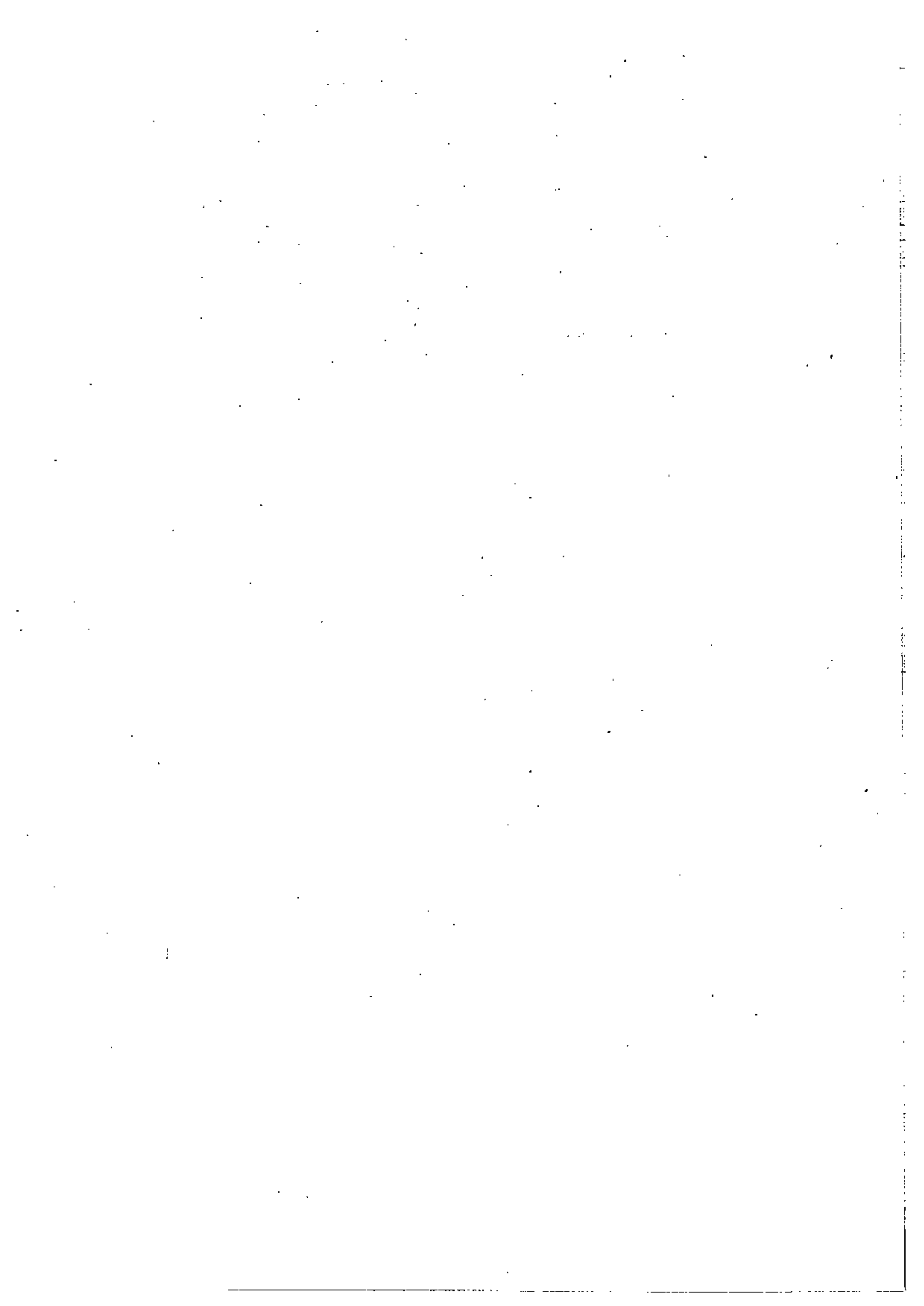
BLOCK 4 MEETINGS AND WINDING UP

You know that a company is an artificial person which cannot act on its own. It acts through its principal officers who take policy decisions in various types of meetings by passing the necessary resolutions. Hence, it is necessary to know the rules regarding the conduct of these meetings and the passing of various resolutions. You also know that a company is created by law and so it can be wound up only by following the procedure laid down by law. In this block, you will learn about the rules regarding various types of meetings and resolutions, the role of a company secretary and the procedure for winding up of a company. This block consists of three units (Unit 12, Unit 13 and Unit 14).

Unit 12 deals with the position of a company secretary and discusses the rules relating to his appointment, removal, duties, liabilities, rights, etc.

Unit 13 deals with the meaning and importance of meetings, and discusses the rules regarding the conduct of various types of meetings including notice, quorum, proxies and voting. It also explains the various types of resolutions that are passed from time to time in different meetings.

Unit 14 explains the various modes of winding up of a company and the procedure to be followed for the purpose.



UNIT 12 COMPANY SECRETARY

Structure

12.0 Objectives
12.1 Introduction
12.2 Meaning of a Company Secretary
12.3 Qualifications of a Company Secretary
12.4 Secretary in Whole-Time Practice
12.5 Appointment of Secretary
12.6 Removal of Secretary
12.7 Position of a Company Secretary
12.8 Duties of a Secretary
12.8.1 Statutory Duties
12.8.2 General Duties
12.9 Liabilities of a Secretary
12.10 Rights of a Secretary
12.11 Role of a Secretary
12.12 Let Us Sum Up
12.13 Key Words
12.14 Answers to Check Your Progress
12.15 Terminal Questions

12.0 OBJECTIVES

After studying this unit, you should be able to:

- define a company secretary.
- describe the qualifications and appointment of a company secretary
- explain the position of a company secretary
- describe the duties and liabilities of a company secretary.

12.1 INTRODUCTION

A company secretary plays an important role in the administration of a joint stock company. The provisions of the Companies Act have become so complicated that it needs constant attention for their compliance. It has become practically impossible for the top management to supervise the routine administration as well as ensure the compliance with the provisions of the Act. It is for relieving the top management from this responsibility that company secretary is appointed. In this unit, you will learn the meaning of company secretary, his qualifications and appointment and the role played by him. You will also learn the duties and liabilities of a company secretary.

12.2 MEANING OF A COMPANY SECRETARY

A secretary is an officer of the company who is appointed to perform the ministerial or administrative duties. You should remember that it is not his duty to manage the affairs of the company; he is primarily concerned to ensure that the affairs of the company are conducted in accordance with the provisions of the Companies Act and articles of association of the company.

The Indian Companies Act, 1956 (as amended by the Companies Amendment Act, 1974) in Section 2(45) defined a secretary as "any individual, possessing the prescribed qualifications, appointed to perform the duties which may be performed by a secretary under the Act and any other ministerial or administrative duties".

The Company Secretaries Act, 1980 defines a company secretary as 'a person who is a member of the Institute of Company Secretary of India' [Section 2(1) (c)]. The Companies Amendment Act of 1988 has incorporated this definition in Section 2(45) which now states, "a secretary means a company secretary within the meaning of clause (C) of sub-section(1) of section 2 of the Company Secretaries Act, 1980, and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties". You will note that with this amendment a statutory recognition has been given to the members of the Institute of Company Secretary of India.

From the above definition of a secretary, the following three points emerge:

i) Only an individual can be appointed as a company secretary. Thus a firm or a body corporate cannot be appointed as a company secretary.
ii) The company secretary should possess the qualifications prescribed by the Central Government.
iii) The duties of the company secretary are of a ministerial or administrative nature.

You should remember that a company secretary is not to act independently but he has to act under the full control of the Board of Directors. He has no authority, except that which is delegated by directors, to act or enter into a contract or make representations so as to bind the company.

12.3 QUALIFICATIONS OF A COMPANY SECRETARY

According to Section 2(45) of the Companies Act, a company secretary must possess the qualifications prescribed by the Central Government from time to time. Under Section 383-A of the Act every company having such paid up share capital as may be prescribed, must have a whole time secretary. As per the new rules framed in 1988, this ceiling is Rs. 25 lakhs. Now we have two sets of qualifications—one for such companies having a paid up share capital of Rs. 25 lakhs or more and—second for such companies having lesser paid up share capital.

Companies having a paid up share capital of Rs. 25 lakhs or more

i) Every Company having a paid up share capital of Rs. 25 lakhs or more should have a whole time secretary.
ii) No person can be appointed as whole-time secretary unless he is a member of the Institute of Company Secretary of India.

Companies having a paid up share capital of less than Rs. 25 lakhs

It may not be possible for small companies to have whole-time secretary. Therefore, companies having a paid up share capital of less than Rs. 25 lakhs may not appoint a whole-time secretary. Any person possessing one or more of the following qualification can be appointed as a secretary for small sized companies.

i) A member of the Institute of Company Secretaries of India;
ii) Any person who has passed the Intermediate examination conducted by the Institute of Company Secretaries of India;
iii) Post-graduate degree in Commerce or Corporate Secretaryship granted by any University in India;
iv) Law graduate from any University;
v) A member of the Institute of Chartered Accountants of India;
vi) A person holding post-graduate degree or diploma in Management science granted by any University or the Institutes of Management Ahmedabad, Calcutta, Bangalore, or Lucknow;

vii) A member of the Institute of Cost and Works Accountants of India;
viii) Post-graduate diploma in company secretaryship granted by the Institute of Commercial Practice, Delhi, under Delhi Administration or diploma in corporate laws and management granted by the Indian Law Institute, New Delhi;
ix) Post-graduate diploma in Company Law and Secretarial Practice granted by the University of Udaipur, or
x) A member of the Association of Secretaries and Managers, Calcutta.

You should note that non-profit companies registered under Section 25 are exempted from these rules regarding the qualification of secretary.

In addition to the statutory qualifications laid down above, a company secretary should also possess some other qualifications. He must have general knowledge including the knowledge of the industry and trade, then only he can render useful advice to directors. He must have a sound knowledge of different laws affecting the business. He should also have knowledge of economics, banking and finance. He should have a good personality because he has to get on well with everybody and to get full co-operation from the staff.

12.4 SECRETARY IN WHOLE-TIME PRACTICE

You have learnt that the term 'Company Secretary' here means a person who is a member of the Institute of Company Secretaries of India. A Company Secretary may accept full time employment as secretary of a company or he may choose to practice independently as a company secretary, either individually or in partnership with one or more practising company secretaries. According to section 6 of the Company Secretaries Act, 1980 only a member of the Institute whether in India or elsewhere shall be entitled to practice provided that he has obtained from the council a certificate of practice.

The Companies (Amendment) Act, 1988 introduced the concept of company secretary in whole-time practice. According to section 2 (45-A) of the Act, "secretary in whole-time practice" means a secretary who shall be deemed to be in practice within the meaning of sub-section (2) of section 2 of the Company Secretaries Act, 1980 and who is not in full-time employment. Thus, a member of the Institute in practice and not in full-time employment becomes a secretary in whole-time practice.

A member of the Institute may practise either individually or with one or more other members. The Company Secretaries Act, 1980 has specified the areas of practice for company secretaries. Section 2(2) of the Company Secretaries Act, 1980 has prescribed the following areas of practice for a company secretaries in practice:

a) to engage himself in the practice of the profession of company secretaries to, or in relation to, any company; or

b) to offer to perform or perform service in relation to the promotion, forming, incorporation, amalgamation, reconstruction, re-organisation or winding up of companies; or

c) to offer to perform or perform such services as may be performed by—

   i) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,
   ii) a share transfer agents;
   iii) an issue house,
   iv) a share and stock broker;
   v) a secretarial auditor or consultant;
   vi) an adviser to a company on management, including any legal or procedural matter falling under the Capital Issues (Control) Act, 1947; the Industries (Development and Regulation) Act, 1951; the Companies Act, 1956; the

Securities Contracts (Regulation) Act, 1956; any of these Rules or Bye laws made by a recognised stock exchange, the Monopolies and Restrictive Trade Practices Act, 1969, the Foreign Exchange (Regulation Act, 1973; or under any other law for the time being in force.

vii) issuing certificates on behalf of, or for the purposes of a company; or

d) to hold himself out to the public as a company secretary in practice; or
e) to render professional services or assistance with respect to matters of principle or details relating to the practice of the profession of company secretaries; or
f) to render such other services as, in the opinion of the Council, are or may be rendered by a company secretary in practice;

The amendment Act of 1988 has also specified certain areas wherein certifications by secretary in whole time practice have been recognised, namely:

a) Under section 33(2) of the Companies Act, a statutory declaration in Form No. I of the Companies (Central Government) General Rules & Forms, 1956 for compliance of legal formalities for incorporation of the company can now be given by a company secretary in whole time practice.

b) Under Section 149 of the Companies Act, a company having a share capital which has issued a prospectus inviting public to subscribe for its shares, the company cannot commence business unless a duly verified declaration by a secretary in whole-time practice has been filed with the Registrar that all the required formalities have been complied with.

c) Under Section 161, annual return of a company whose shares are listed on a recognised stock exchange, in addition to being signed by a director and the manager or the secretary is also required to be signed by a secretary in whole-time practice.

d) Under Section 269 read with Schedule XIII to the Companies Act the statutory certificates of compliance with the requirements for appointment of managing director or whole-time director or manager can given by secretary in whole-time practice.

12.5 APPOINTMENT OF SECRETARY

You have learnt that for a company having paid up share capital of Rs. 25 lakhs or more, it is obligatory to appoint a whole-time secretary. In the case of companies having paid up share capital of less the prescribed amount, it is not obligatory to appoint a whole-time secretary. However, in practice, every company usually appoints a secretary and the necessary provision is made in the articles of association for that purpose.

Just like the first directors of the company, the first secretary may be appointed by the promoters. Such a person helps the promoters in carrying out all the preliminary work in connection with the formation of the company. Such a secretary is often referred to as the 'pro tem secretary' (secretary for the time being). Sometimes, the first secretary may be named in the articles of the association, but this will not give the person the right to be appointed as the secretary. He cannot sue the company if he is not so appointed subsequently by the Board of directors. There should be an independent contract between the company and the secretary so named in the articles. Therefore, the first secretary appointed by promoters should enter into a fresh contract with the company after its incorporation.

Normally, the appointment of a company secretary is made by the Board of directors in their first meeting by passing a resolution. A service agreement is executed between the company and the secretary in which the terms and conditions of his appointment, remuneration etc. are stated. In large-sized companies, the managing director may be authorised by the Board to appoint a secretary.

A director, being an individual can be appointed as secretary, but it requires the approval of the company by special resolution. But where the Board of directors of

a company consists of only two directors, then neither of them can be appointed as secretary of the company.

Section 303 of the Companies Act requires that the particulars of appointment of a person as secretary must be recorded in the Register of Directors/Manager/Secretary and the requisite particulars relating to such appointment must be filed in duplicate in the prescribed form with the Registrar of companies within thirty days of appointment.

You should note that no individual can hold the office of secretary in more than one such company whose paid up capital is Rs. 25 lakhs or more. If the person appointed as secretary holds an appointment as such in any other company, he has to notify the other company within twenty days of his appointment. It should further be noted that if a relative of a director is to be appointed as the secretary, then a special resolution has to be passed in a general meeting for such appointment [Section 314].

Check Your Progress A

1) Define a company secretary.

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2) Who can be appointed as secretary of a company?

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3) Who appoints the company secretary?

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4) List four important qualifications of a company secretary.

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5) What do you mean by a secretary in whole-time practice?

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6) State whether the following statements are true or false.

   i) Persons possessing the qualifications prescribed by the Central Government can be appointed as secretary of a company.
   ii) A body corporate can be appointed as the secretary of a company.
   iii) Every company having the paid up share capital of Rs. 25 lakhs or more must appoint a whole-time secretary.
   iv) A person having a graduate degree in commerce can be appointed as a secretary.
   v) A company having two directors cannot appoint any one of them as secretary of the company.
   vi) The secretary appointed by the promoters is deemed to be the first regular secretary of the company.
   vii) The particulars of the appointment in the prescribed form are required to be filed with the Registrar within twenty-one days of the appointment.
   viii) If a relative of a director is to be appointed as secretary, a special resolution should be passed in the general meeting for such appointment.

12.6 REMOVAL OF SECRETARY

You know that the appointment of a company secretary is generally done by means of a resolution of the Board of directors, as such he can be removed by the Board of directors or by the managing director, if he is so authorised by the Board.

When a secretary is appointed, the terms and conditions of his service are stated in the service agreement. Usually, there is a clause in the service agreement which provides the manner in which he can be dismissed. The secretary, being an employee of the company is a servant of the company and his removal is governed by the common law governing the relationship of master and servant. However, the secretary must be given due notice of termination of his employment in accordance with the terms and conditions of his employment. In case no period of notice is mentioned in the service agreement, a reasonable notice should be given, otherwise the company shall be liable to pay compensation to him. Even if the company secretary is appointed for a fix term, the company can remove him before the expiry of the terms by giving him a reasonable notice.

The services of a secretary may, however, be terminated without notice for wilful disobedience, misconduct, negligence, incompetence or permanent disability. When the court orders for compulsory winding up of the company, the order of the court shall be deemed to be the notice of discharge of a secretary alongwith other employees of the company.

12.7 POSITION OF A COMPANY SECRETARY

The position of a company secretary has undergone a tremendous change during the last so many years. He has arisen from the position of a clerk to an indispensible figure in the corporate hierarchy. However, it is very difficult to explain precisely the position of a company secretary. The Companies Act does not define the exact position of a secretary. The position of a company secretary can be discussed under the following headings:

i) **As a Servant of the Company:** Lord Esher observed in the course of his judgment in **Barnett Hoares & Co. Vs. The South London Tramways Co. Ltd.** that secretary is a mere servant, his position is that he is to do what he is told. There is a service agreement between the secretary and the company and his employment is governed by the terms and conditions of this agreement, therefore he is an employee of the company. He is to work under the control of the Board of directors. He has to carry out the orders of the directors. It is for the secretary to ensure effective execution and implementation of the management policies laid out by the Board. He cannot exercise independent disertion in the work assigned to him.

ii) **As an Agent of the Company:** Since the secretary is concerned with the administration of the company, he acts on behalf of the company. The duties of a secretary are of ministerial and administrative in nature. The routine matters relating to the company are left to be looked after by the secretary. He has to deal with the staff, workers, trade unions, shareholders and the outsiders. So he has to use his discretion in dealing with such matters. He is an important link between the company and the outsiders. All policy decisions are conveyed by the secretary to the staff and outsiders.

iii) **As an Officer of the Company:** Strictly speaking the secretary is not a managerial personnel, but he is treated as principal officer of the company for the purposes of various sections of the Act. He is responsible for the compliance of various legal formalities under different Acts. The Companies (Amendment) Act, 1988 has particularly specified that a secretary is bracketed with the managerial personnel including directors and is liable to punishment by way of imprisonment, fine or otherwise for violation of the provisions of the Companies Act.

The secretary is required to sign the annual return filed with the Registrar [Section 161 (1)], make declaration regarding commencement of business (Section 149),

authenticate the Balance Sheet and Profit and Loss Account (Section 215), and to make declaration under Section 33(2) of the Act that all the formalities required by the Act and the Rules therein have been complied with in respect of registration of a company. The secretary is recognised as "principal officer" under the Indian Stamp Act, M.R.T.P. Act, Income Tax Act, Sales Tax Act etc.

iv) As an Advisor to the Board: The secretary plays an important role and enjoys a unique position in the management of the company. Though the policies of the company are formulated by the directors, but since the secretary has complete information about all internal matters and changes in the policies of the government, he is in a better position to supply the required information and advice to the directors. He advises the Board on various legal matters. He can be described as the real guiding spirit behind the Board of directors.

From the above it should be clear to you that the position of the secretary has changed over the years. Though he has no managerial functions to perform, because he is described as a responsible officer of the company, he is the principal administrative officer of the company. We can state that while the directors are the brains of the company, the secretary is its ears, eyes and hands.

12.8 DUTIES OF A SECRETARY

The duties of a company secretary vary from company to company depending upon its size, management structure and the personal qualifications of the secretary. In India, in private and in joint sectors, apart from the secretarial duties, the company secretary is normally entrusted with legal, administrative and management functions. In large sized companies, there are separate managers incharge of the functions relating to accounts, law and personnel etc. Even in such cases the role of the company secretary as the coordinator cannot be under estimated. It can be said that the company secretary acts in three fold capacity, namely, as an agent of the Board of directors, as a person incharge of secretarial work relating to the company and as chief administrative officer of the company.

The duties of a company secretary can broadly be divided into two categories—(a) statutory duties, and (b) general duties. The statutory duties can further be subdivided into two—duties under Companies Act and duties under other Acts.

12.8.1 Statutory Duties

Following are some of the statutory duties of the company secretary under the Companies Act:

- Signing of any document or proceedings requiring authentication by the company under Section 54.
- Filing of necessary documents and returns with the Registrar of Companies, e.g. return of allotment of shares, annual returns, annual accounts etc.
- Giving the notice of the increase in the share capital to the Registrar under Section 97.
- Delivering the share certificate within 3 months of allotment or within 2 months of registration of transfer under Section 113.
- Making entries in the Register of Members on the issue of share warrants under Section 115.
- Filing particulars of charges with the Registrar of Companies.
- Getting the name painted outside every office or the place of its business and to get is engraved on the seal of the company (Section 147).
- Making a statutory declaration for obtaining the certificate of commencement of business (Section 149).
- To make available for inspection and furnish copies of register of members (Section 163).
- Sending notice of general meetings to every member of the company (Section 171).
- Filing of certain agreements and resolutions with the Registrar (Section 192).
- Keeping minutes of the proceedings of general meetings and of Board of

directors and other meetings.

xiii) Maintaining the various registers and statutory books of the company, such as Register of Members, Register of Directors, Register of charges etc.

In many of the duties, the secretary shall be held responsible as an officer in default, if there is a default in complying with the provisions of the Act. According to Section 5, a secretary, among others has been defined as an officer in default.

Duties Under Other Acts: A company secretary has also to see to it that the requirements of other Acts are also complied with. Under the Income Tax Act, the secretary being the 'Principal officer' is responsible for the deduction of income tax from the salaries of its employees and its deposition in the Government treasury. Under the Indian Stamp Act, the secretary should ensure that various documents like share certificates, transfer forms etc. are properly stamped as per the requirements of the Indian Stamp Act.

The secretary is also required to comply with the provisions of various labour and industrial laws such as The Factories Act, The Industrial Disputes Act, Minimum Wages Act. etc.

12.8.2 General Duties

Apart from the statutory duties tested above, a secretary is required to perform several general duties as follows:

i) To carry out the orders of the Board of directors.
ii) To assist the Board in the formulation of policy decisions.
iii) Not to disclose confidential information relating to the affairs of the company.
iv) Not to make any secret profits on account of his position.
v) To act as a medium and link between the company and outsiders.
vi) To provide information to the shareholders.
vii) To organise, supervise and coordinate the office work.

12.9 LIABILITIES OF A SECRETARY

You have learnt that it is the duty and responsibility of a secretary to see that the affairs of the company are conducted in accordance with the provisions of the Companies Act and articles of association. If a default is made in complying with certain provisions of the Act, a secretary, being an officer of the company, shall be liable for fine and punishment.

The liability of a company secretary can be discussed under two headings, namely, statutory liabilities and contractual liabilities.

Statutory Liabilities

You know that a company secretary is an important officer of the company and he has to comply with not only the provisions of the Companies Act but also the requirements of the Income Tax Act, Indian Stamp Act, labour and industrial laws. The company secretary may be held for the following:

i) default in holding the statutory meeting and filing the statutory report with the Registrar (Section 165),
ii) default in holding the annual general meeting (Section 168),
iii) default in filing a return of allotment (Section 75),
iv) default in the preparation of share certificate within three months of allotment and two months after the application for registration of transfer (Section 113),
v) default in maintaining the register of members (Section 150),
vi) default in circulating members' resolutions of which they have given notice to the company (Section 188),
vii) default in getting the name of the company pointed or affixed outside the registered office and every office of place of business, and engraving it on the seal of the company (Section 147),
viii) default in filing the annual returns (Section 162),
ix) default in recording the minutes of the meetings of the shareholders and the Board (Section 193),

x) default in registering certain resolutions and agreements requiring registration (Section 192),
xi) default in maintaining the register of directors (Section 303),
xii) default in maintaining the statutory registers such as index of register of members, register of loans, register of charges etc.,
xiii) liability for making any false or misleading statement. A secretary can escape from the liability if he can prove that his liability was expressly excluded either by law or by the articles of the company or by any resolution of the company. He may also not be held liable if he can satisfy the court that he has acted honestly and to the best of his ability under the circumstances. Apart from the liability under the Companies Act, a secretary shall be liable for fine and punishment if he violates the provisions of the Income Tax Act, Indian Stamp Act, Sales Tax Act and other labour and industrial laws.

Contractual Liabilities

In addition to the various statutory liabilities, a company secretary has several contractual liabilities which arise out of his service agreement, they are as follows:

i) he shall be liable for any loss or damages caused to the company by wilful neglect or negligence in the discharge of his duties;
ii) he shall be personally liable if he acts beyond his authority;
iii) he shall be liable to account for the secret profits made by him by virtue of his position as a secretary;
iv) he shall be liable to indemnify the company for any loss suffered by the company as a result of disclosure of some secret information relating to the company;
v) he shall be liable for any fraud or wrong done to the company during the course of his employment.

12.10 RIGHTS OF A SECRETARY

Some rights are given to the secretary by the Act, Board of directors and the general meetings of shareholders. He also derives some rights out of the service agreement with the company. A secretary has the following rights:

i) right to control and supervise the working of his department;
ii) right to sign documents requiring authentication by the company;
iii) right to be indemnified for any loss suffered by him while discharging his duties;
iv) right to receive remuneration.

But a company secretary has no right to borrow money in the name of the company or to make allotment of shares or register transfer so shares without the express authority or consent of the Board of directors. He has not authority to call a meeting of the company.

From the above, it should be clear to you that secretary is responsible officer of the company and he has several statutory and contractual liabilities. But, he has to work according to the directions of the Board of directors.

12.11 ROLE OF A SECRETARY

The company secretary plays an important role in company administration. The scope of his role depends on the size and nature of the company. He is liable not only to the company, but also to its shareholders, creditors, employees and the society.

From the discussion given above, a three-fold role of the company secretary can be visualised, namely, as a statutory officer, as a coordinator and as an administrative officer.

i) **Statutory Officer:** As a principal officer of the company, the company secretary is

responsible for strict compliance with the various provisions of the Companies Act and the requirements of other Acts. He is responsible for proper maintenance of books of accounts and other registers. He has to sign several documents such as annual returns, return of allotment, declaration for commencement of business. He is responsible for authentication of the balance sheet and profit and loss account, for holding meetings of directors and shareholders and maintaining minutes of such meetings.

As a statutory officer, the company secretary is responsible to comply with the provisions of other Acts, such as Income Tax Act, Capital Issues (control) Act, Monopolies and Restrictive Trade Practices Act, Sales Tax Act, Factories Act, Industrial Disputes Acts etc.

ii) Coordinator: A company secretary is the link between the Board of directors and other executives of the company. The Board lays down the policy decisions, but it is the secretary who ensures their proper implementation. He acts as a link between the Board, managing director and the Chairman on the one hand and with the staff on the other hand. In a company where there are several independent departments such as sales, purchase, personnel etc., he acts as a coordinator with these functionaries for ensuring that the policy decisions are duly carried out and if there are some matters which require further consideration, the secretary shall place them before the Board and convey the decision of the Board to the concerned department.

The company secretary also acts as a coordinator with trade unionists, auditors, shareholders of the company, Government and the community at large. He is to ensure the compliance of the provisions of companies Act and various other Acts. He should see that the company functions in a manner as to achieve the declared objectives of the Government. It is now widely accepted that the company has some responsibility towards the society as well. The secretary can advise the Board regarding the matters where the company can contribute to the welfare of the society.

iii) Administrative Officer: As a general administrative officer, he is responsible for efficient administration of the company. He has to supervise, control and coordinate the functioning of different departments such as finance, personnel, organisation. He should develop a strong and efficient organisational structure. He has also to ensure the safety and proper maintenance of the assets and properties of the company. He has to ensure that they are not misused. The company secretary is responsible for ensuring that records are maintained properly. With the fast changes taking place, a secretary is expected to play a still more important role in the administration of the company. He is to assist the Board in laying down the policies and dealing with the Government and financial institutions.

Check Your Progress B

1) How can the secretary of a company be removed?

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2) Enumerate four important duties of a secretary.

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3) List three statutory duties of a company secretary.

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4) What do you mean by three-fold role of a secretary?

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5) State whether the following statements are true or false.

i) A secretary can be removed by giving him a due notice.
ii) No notice is necessary for removing a secretary for wilful misconduct, negligence or permanent disability.
iii) A secretary appointed for a fixed term cannot be removed before the expiry of the term.
iv) A secretary can convene a general meeting, make allotment of shares, register transfer of shares.
v) Company secretary is responsible for the compliance of the provisions of the Companies Act and other laws of the country.
vi) The company secretary is liable only to the directors and not to the shareholders.
vii) Some managerial powers can be delegated by the Board to the secretary.
viii) A company secretary can make profit by using his position.
ix) A company secretary has to ensure the safety of the assets of the company.

12.12 LET US SUM UP

The term company secretary means a person who is a member of the Institute of Company Secretaries of India. Every company having a paid-up share capital of Rs. 25 lakhs or more must have a whole-time secretary. Companies having less paid-up share capital can also appoint a secretary, who should possess one or more of the qualifications as prescribed by the rules for appointment and qualification of secretary.

The Companies Act also recognises the concept of company secretary in whole-time practice. A secretary who obtains the licence from the Institute can only practise.

A secretary is generally appointed by the Board of directors. He can be removed by a resolution of the Board or by the managing director, if he is so authorised by the Board. Before removing a secretary, a proper notice must be given to him. However, no notice is necessary for wilful misconduct, negligence or permanent disability.

The company secretary occupies an important position in the company administration. His position is that of a servant, agent and an officer of the company. He has several statutory and other duties. Being an officer of the company, he is liable to be fined or punished for not complying with the provisions of the Companies Act or other laws of the country. Because he is occupying a position of trust, he must not use his position to make secret profits. He must keep the matters of the company upto himself only.

A secretary plays a three-fold role—a statutory officer, a coordinator and an administrative officer of the company.

12.13 KEY WORDS

Secretary: A person who is a member of the Institute of Company Secretaries of India.

Practicing Secretary: An individual who is a member of the Institute of Company Secretaries of India and who has obtained from the council a certificate to practice.

Statutory Duties: Duties laid down in the Statute.

Breach of Duty: Non performance of a contractual or statutory duty.

Pro-tem: For the time being.

Contractual Duties: Duties arising out of the contract.

12.14 ANSWERS TO CHECK YOUR PROGRESS

A 6 i) True ii) False iii) True iv) False
v) True vi) False vii) False viii) True

B 5 i) True ii) True iii) False iv) False v) True
vi) False vii) True viii) False ix) True

12.15 TERMINAL QUESTIONS

1) Define the term 'Secretary' under the Companies Act. Who can be appointed as a secretary of a company?
2) How is the secretary of a company appointed? State how can he be dismissed?
3) State the qualifications which a company secretary should possess.
4) Discuss the legal position of a company secretary and state his main functions.
5) Enumerate the duties of a company secretary.
6) Discuss the statutory and contractual liabilities of a company secretary.
7) Discuss the role of a company secretary as (a) statutory officer, (b) co-ordinator and (c) administrative officer.
8) "The secretary is a link between the directors and shareholders of a company." Explain.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 13 MEETINGS AND RESOLUTIONS

Structure

13.0 Objectives
13.1 Introduction
13.2 Meaning of Meeting and its Importance
13.3 Kinds of Meetings and their Importance
13.4 Statutory Meeting
- 13.4.1 Purpose of Statutory Meeting
- 13.4.2 Notice of Statutory Meeting
- 13.4.3 Statutory Report

13.5 Annual General Meeting
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13.7 Requisites of a Valid Meeting
13.8 Notice of Meetings
13.9 Quorum for Meetings
13.10 Proxies
13.11 Voting
13.12 Chairman
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- 13.13.1 Ordinary Resolution
- 13.13.2 Special Resolution
- 13.13.3 Resolution Requiring Special Notice

13.14 Minutes
13.15 Let Us Sum UP
13.16 Key Words
13.17 Answers to Check Your Progress
13:18 Terminal Questions

13.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of a company meeting
- discuss the importance of company meeting
- explain the various types of meeting
- list the requisites of a valid meeting
- explain the rules regarding the notice and quorum
- explain the different types of resolutions and the purposes for which they can be passed.

13.1 INTRODUCTION

A company, being an artificial person, cannot act by itself like a human being. The business of the company is carried on by the elected representatives, called as

'directors'. The decisions are taken by the directors at the meetings of the Board. But they cannot take decision on all matters relating to the working of the company. There are certain matters which are to be decided by the general body of shareholders, who are the owners of the company. For this purpose, the meetings of the shareholders are held wherein decisions are taken by shareholders by means of passing resolutions. In this Unit, you will study the different types of meetings and the business transacted therein. The provisions of the Companies Act lays down the rules regarding the holding and conduct of such meetings. You will also study the various types of resolutions and the purposes for which they are required.

13.2 MEANING OF MEETING AND ITS IMPORTANCE

Meeting may generally defined as the gathering, assembly or coming together of two or more persons for transacting any lawful business. For proper working of the company, it is necessary that the shareholders meet as often as possible and discuss matters of mutual interest and take important decisions. Meetings provide a place for fruitful participation where free and frank discussion takes place. The decisions taken at the meetings generally become acceptable and are met with least resistance.

To constitute a valid meeting there must be at least two persons, because a meeting cannot be constituted by one person. But there are certain circumstances where one person can constitute a valid meeting, they are:

a) Where one person holds all the shares of a particular class, he alone can constitute a meeting of that class;
b) Where the meeting is called by an order of the Company Law Board, the Board may direct that one member of the company present in person or by proxy shall constitute a valid meeting.

Company meetings play a significant role in decision making process. They provide an opportunity to shareholders to review the working of the company and take policy decisions, thereby controlling the Board of directors. The directors are duty-bound to follow the decisions taken at the general meeting of shareholders. Meetings constitute a very important aspect in the management and administration in the company form of organisation.

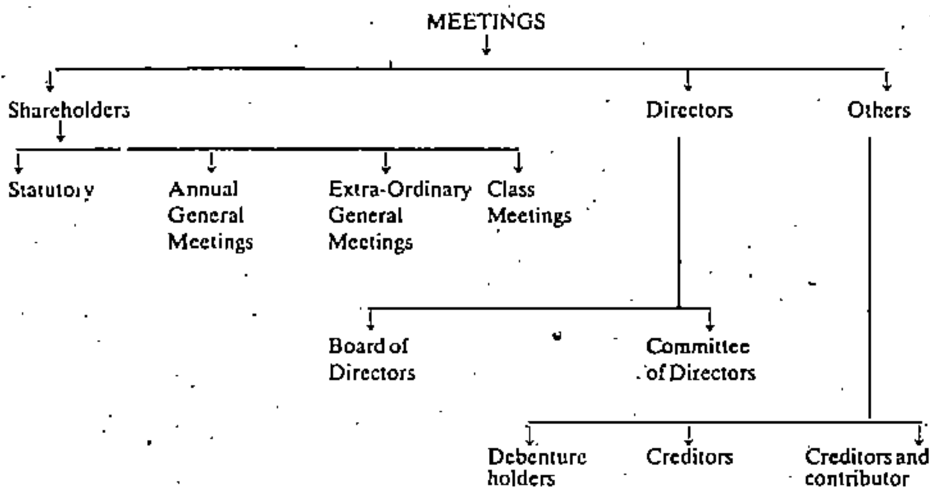
13.3 KINDS OF MEETINGS AND THEIR IMPORTANCE

Company meetings can broadly be classified as follows:

1) **Meetings of Shareholders:** Such meetings are also known as general meeting of the members which are held to exercise their collective rights. The meetings of the shareholders may again be of the following four types:
   a) Statutory Meeting;
   b) Annual General Meeting;
   c) Extraordinary General Meeting; and
   d) Class Meeting.
2) **Meetings of Directors:** The directors are to act collectively in the form of a board, and the decisions are taken at the meetings of the Board of directors. These meetings may again be of two types:
   a) Meetings of the Board of directors; and
   b) Meetings of the committee of directors.
3) **Other Meetings:** These meetings may be either of the following:
   a) Meetings of debenture-holders;
   b) Meetings of creditors;

c) Meetings of creditors and contributories on the winding up of the Company.

Figure 13.1 will help you in understanding the types of meetings:



13.4 STATUTORY MEETING

This is the first meeting of the shareholders of a public company and is held once in the lifetime of any public company. According to Section 165 of the Companies Act, every company limited by shares or limited by guarantee and having a share capital must hold a general meeting of members of the company within a period of not less than one month and not more than six months from the date on which the company becomes entitled to commence business. This meeting is called as the 'statutory meeting' and it must be specially stated so in the notice calling it. A private company is not required to hold a statutory meeting.

13.4.1 Purpose of Statutory Meeting

The primary objective of holding the statutory meeting is to inform the shareholders about the facts relating to the formation of the company, shares taken up, money received, contracts entered into, preliminary expenses etc. It gives an opportunity to the members to discuss matters relating to the formation of the company. This enables them to know the position and future prospects of the company. This meeting enables the members to meet the directors and they can satisfy themselves that the money subscribed by them is being properly used.

13.4.2 Notice of Statutory Meeting

Statutory meeting is treated as a general meeting and as such 21 days clear notice in writing must be given to all members of the company. In calculating 21 days, the date on which it is served and the date of the meeting are excluded. A shorter notice will be valid if consent is given by members holding at least 95 per cent of the paid-up capital carrying voting rights, or representing at least 95 per cent of the voting power (Section 171). The consent for a shorter notice may be given either at the meeting or before the meeting.

The notice must expressly state that the meeting is the statutory meeting of the company. A copy of the statutory report must also be sent alongwith the notice.

13.4.3 Statutory Report

The Board of Directors is required to prepare a report called the 'statutory report'.

You have learnt that alongwith the notice convening the meeting, this statutory report should also be sent to each Member. If the statutory report is sent later, it will still be treated as valid if all the members entitled to attend and vote at the meeting agree to it.

Contents of the Statutory Report: According to Section 165(3) of the Companies Act, the statutory report must give the following information:

i) The total number of shares allotted, distinguishing those allotted as fully or partly paid up otherwise than in cash, the extent to which they are partly paid up, the consideration for which they have been allotted and the total amount received in cash;

ii) An abstract of receipts and payments of the company upto a date within seven days of the date of the report and the balance of cash in hand;

iii) An account or the estimate of the preliminary expenses of the company (such as legal charges, charges in connection with the preparation of memorandum and articles of association, printing expenses, registration charges) showing separately any commission or discount paid or to be paid on the issue or sale of shares or debentures;

iv) Names, addresses and occupation of the directors, auditors, manager and secretary. Changes, if any, in these respects, since the incorporation, are also required to be given;

v) Particulars of any contract which are to be submitted to the statutory meeting for approval. If any modification or proposed modification of a contract is to be submitted for such approval, brief particulars of contracts and particulars of modifications or proposed modification should also be given;

vi) The extent to which underwriting contracts have not been carried out, and reasons therefor;

vii) The arrears, if any, due on calls from directors and from the manager; and

viii) The particulars of any commission or brokerage paid, or to be paid, in connection with the issue or sale of shares to any director or to the manager.

The report must be certified as correct by not less than two directors, including the managing director, where there is one. With regard to the shares allotted by the company and the cash received in respect of such shares and the receipts and payments is also required to be certified as correct by the auditors.

A certified copy of the statutory report must be sent to the Registrar after sending the report to the members. At the commencement of the statutory meeting, the Board of directors shall produce a list of members showing their names, addresses and occupations alongwith the number of shares held by them. This list shall remain open and accessible to any member of the company during the continuance of the meeting.

The members present at the meeting are free to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice of the matter has been given or not. But only such resolutions can be passed of which notice has been given in accordance with the provisions of the Act. If default is made in filing the statutory report, or in holding the statutory meeting, every director and other officers in default shall be punishable with fine which may extend upto Rs. 500. Further, the members have the right to file a petition to the court for compulsory winding up of the company, if the meeting is not held or the report is not filed with the registrar.

Check Your Progress A

1) Define a meeting.

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2) List the different types of members' meeting.

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3) What is a statutory meeting?

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4) When is a statutory meeting of a company required to be held?

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5) What are the statutory requirements as to the length of the notice for statutory meeting?

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6) State whether the following statements are true or false.
   i) A statutory meeting must be held by all companies.
   ii) The statutory meeting of a public company must be held within six months of the date of incorporation.
   iii) The notice of statutory meeting must be accompanied by a statutory report.
   iv) The statutory report must be certified as correct by not less than two directors of the company including the managing director if there is one.
   v) The members present at a statutory meeting are free to discuss any matter relating to the company.
   vi) A copy of the statutory report must be filed with the Registrar before copies thereof are sent to the members.
   vii) The auditors must certify the report in respect of the shares allotted, cash received on such shares and the receipts and payments of the company upto a date within seven days of the report.
   viii) If default is made in holding the statutory meeting, members have the right to file petition to the Court for compulsory winding up of the company.

13.5 ANNUAL GENERAL MEETING

The annual general meeting of the company is an important means through which the shareholders get the opportunity to exercise their power of control. It is at this meeting that the directors retire and seek re-election. The shareholders get an opportunity of reviewing and evaluating the overall performance of the company during a year. The shareholders can place their views before the management and can seek clarifications on matters about which they are not satisfied. Thus, you note that an annual general meeting is very important. Unlike the statutory meeting which is held only once in

the life-time of the company, the annual general meeting is held every year.

Every company, public or private, must in each calendar year, hold in addition to any other meeting a general meeting as its annual general meeting and the notice must specify that it is the annual general meeting.

The holding of an annual general meeting is a statutory requirement.

Following are the rules regarding annual general meetings:

i) The first annual general meeting of the company must be held within a period of 18 months from the date of its incorporation, and if such a general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year.. For example, a company is incorporated on 5th October, 1989 and holds its first annual general meeting 10th March, 1991 (i.e. within 18 months of incorporation), then it need not hold any other annual general meeting in 1990 and 1991. But from the year 1992 onwards, it must hold such a meeting in every calendar year.
ii) The gap between two annual general meetings must not exceed 15 months. The Registrar may, however, for any special reason extend the above time by a period not exceeding three months.
iii) At least 21 clear days' notice of the meeting in writing must be given to every shareholder, directors and auditors of the company. A shorter notice may also be given if it is agreed to by all the members entitled to vote at the meeting.
iv) The annual general meeting of the company must be called on a working day during business hours either at the registered office of the company or at some other place within the city in which the registered office of the company is situated. Thus, no meeting can be called on a public holiday, for example on 15th August, 2nd October and 26th January. If any day is declared by the Central Government to be a public holiday after the issue of notice convening the annual general meeting, it shall not be deemed to be a public holiday and the meeting could be held on that day as scheduled.
v) The Board of directors can cancel or postpone the holding of the meeting on the scheduled date, but this power should be exercised by the Board bonafide and for proper reasons. The better course for the Board will be to hold the meeting and then have the matter decided by the meeting.

Consequences of not holding Annual General Meeting

You learnt that holding of the annual general meeting is a statutory requirement. If a company makes a default in holding the annual general meeting in accordance with the provisions of Section 166 of the Companies Act, the following two consequences will follow:

i) Any member of the company can apply to the Company Law Board for calling the meeting. On such application, the Company Law Board may order the calling of the meeting, or it may issue directions for calling the meeting, which may even include a direction that one person present in person or proxy shall constitute the annual general meeting. A meeting called by the order of the Company Law Board shall be deemed to be annual general meeting of the company.
ii) The company and every officer of the company in default shall be punishable with fine upto Rs. 5,000 and if the default continues, with a further fine upto Rs. 250 for every day after the first day of default during which the default continues.

The Business to be Transacted: According to Section 173 of the Companies Act, at the annual general meeting ordinary business is to be transacted. Any other business can also be transacted at the annual general meeting, but that will be termed as 'special business'. Thus, the annual general meeting can transact both ordinary and special business. The following ordinary business is generally transacted at every annual general meeting:

i) the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors;
ii) the declaration of dividend;
iii) the appointment of directors in the places of those retiring; and
iv) the appointment of the auditors and fixing their remuneration.

If any other business (other than those mentioned above) is to be transacted at the annual general meeting, it shall be treated as special business. Special business can be transacted at an annual general meeting provided the articles of association do not prohibit it and the notice of the meeting mentions it as special business.

You should note that the ordinary business requires an ordinary resolution, while the special business may be passed by an ordinary resolution or special resolution as required by the Act.

You will study the details of ordinary and special resolutions later in 13.12 of this Unit.

13.6 EXTRAORDINARY GENERAL MEETING

All general meetings of a company other than the statutory and annual general meeting are called 'extraordinary meetings'. Extraordinary general meeting is a meeting which is held between two annual general meetings. These meetings are called in emergencies or on special occasions. This meeting is called to discuss some urgent special business which cannot be postponed till the next annual general meeting, for example, alteration in the memorandum or articles of association, reduction of capital, issue of debentures etc. All business transacted at such meeting is deemed to be special business.

An extraordinary general meeting may be called by

a) Board of directors on its own motion;
b) the Board of directors on the requisition of members; or
c) the requisitionists themselves; or
d) the Company Law Board.

a) **By the Board of Directors:** Clause 48 of Table A states that "the Board may, whenever it thinks fit, call an extraordinary general meeting." However, the Board has to pass the resolution for convening such meeting.

b) **By the Board on requisition:** According to Section 169 of the Act, the Board of directors must call an extraordinary general meeting of the company on the requisition of required number of members. The requisition letter for calling this meeting must be signed by members holding at least one-tenth of the paid-up capital and having a right to vote on the matter of requisition. In the case of a company having no share capital, it must be signed by those members who have at least one-tenth of the total voting power.

The requisition must state the purpose for which the meeting is requisitioned and it must be deposited at the registered office of the company. You should note that only such matter can be taken up at the meeting which is specified in the requisition.

On receipt of a valid requisition, the Board of directors should, within 21 days, move to call a meeting and the meeting must actually be held within 45 days of the date of deposit of the requisition. A notice of 21 clear days is necessary for calling the extraordinary general meeting. A duty has been imposed on the management to disclose, in an explanatory statement all material facts relating to every special business to enable the members to form a judgement on the business.

c) **By the Requisitionist:** If the Board of directors fails to call the meeting within 21 days and the meeting is not held within 45 days of the deposit of the requisition, the requisitionists may themselves proceed to call the meeting. But the requisitionists must hold the meeting within three months from the deposit of the requisition. Such meeting must, as nearly as possible, be held in the manner as called by the Board of directors. When the requisitionists themselves call a meeting, they may recover the reasonable expenses incurred from the company, and the company may deduct such amount from the amount of remuneration payable to the directors in default.

If the meeting is called by requisitionists, it can only transact the special business for which it has been expressly convened. The resolutions, which are properly passed at such requisitioned meeting, shall be binding upon the company.

d) **By the Company Law Board:** Under Section 186 of the Act, the Company Law

Board is empowered to call, hold or conduct such a meeting, if for any reason it is impracticable to call or conduct an extraordinary general meeting. The term 'impracticable' means not possible to call, hold or conduct the meeting in accordance with the provisions of the Act and Articles, for example, if the meeting cannot be called because of the rivalry of two groups.

The Company Law Board may order for the calling, holding and conducting such a meeting either on its own motion or on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting. The Company Law Board should use this power sparingly and on being convinced that it is in the larger interest of the company. While calling a meeting, the Company Law Board may give such directions as it thinks fit, including the direction, that one member present in person or by proxy would constitute the quorum.

Like any other general meeting, the notice of the extraordinary general meeting must also be given at least 21 days before the date of the meeting specifying the date, time and place of the meeting. The notice must also specify the special business to be transacted at the meeting. You should note that unlike an annual general meeting, extraordinary general meeting may be held on any day including a public holiday. The meeting may be held at a place other than the registered office of the company or even outside the city in which the registered office is situated.

Check Your Progress B

1) What is an annual general meeting?

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2) What is the purpose of holding annual general meeting?

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3) What business is usually transacted at the annual general meeting of a company?

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4) What is an extraordinary general meeting?

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5) Who can call an extraordinary general meeting?

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6) What is the minimum number of members who can requisition an extraordinary

general meeting?

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7) State whether the following statements are True or False.

   i) The time interval between two annual general meetings shall not exceed fifteen months.
   ii) The first annual general meeting must be held within fifteen months from the date of its incorporation.
   iii) An annual general meeting may be called by giving a notice shorter than 21 days if all members entitled to vote give their consent.
   iv) Declaration of dividend is an item of ordinary business.
   v) One hundred members of a company can requisition an extraordinary meeting.
   vi) In an extraordinary general meeting of a company all business transacted is deemed to be special business.
   vii) The requisitionists may themselves convene an extraordinary general meeting within six months of depositing the requisition.
   viii) An extraordinary general meeting can be called on a public holiday and at a place other than the registered office of the company.

13.7 REQUISITES OF A VALID MEETING

The decisions taken at the general meeting shall be valid and binding only if the meeting itself has been properly called and conducted. Any irregularity in calling or conducting the meeting shall invalidate the proceedings of the meeting. The company meetings must be conducted in accordance with the rules and regulations laid down in the Act (Section 171 to 186) and the articles of association. The following are the requisites of a valid meeting:

1) **Proper Authority:** The meeting shall be valid only when it is called by a proper authority. The proper authority to convene the meeting is the Board of directors. The Board of Directors should pass a resolution at its meeting to call the general meeting, otherwise the notice calling the meeting will become invalid and the proceedings of the company shall not be effective (Harban V. Phillips). Thus, a notice issued by the secretary without the authority of a resolution of the board is patently invalid.

   Though the Board of directors is the proper authority to convene a general meeting, but under certain circumstances the meeting may be called by requisitionists or by the Company Law Board.

2) **Proper Notice:** 'Notice' means an advance intimation of the meeting so as to enable the person concerned to prepare himself for it. A proper notice should be given to every member, auditors, directors of the company and to every such person who is entitled to attend the meeting. The notice must be clear and should state the purpose for which the meeting is called. The notice must be in writing and it must be given at least 21 clear days before the date of the meeting.

   You should note that deliberate omission to serve notice to one or more members will invalidate the meeting. But an accidental omission will not render the meeting invalid. Similarly, the non-receipt of the notice will not affect the validity of the meeting. The notice must state the date, time and place of meeting.

3) **Quorum:** Quorum means the minimum numbers of members whose presence is necessary at the meeting for transacting the business of the company. In the absence of a quorum, no meeting can be held. Any resolution passed at a meeting without quorum shall be invalid.

4) **Chairman:** Every general meeting of the company should be presided over by a chairman. The chairman has to be there to conduct the meeting in a proper and smooth manner. The articles usually provide the mode of appointment of the chairman of a meeting.

   If the articles do not provide otherwise, the members who are personally present at the meeting shall elect one of themselves to act as the chairman of the meeting. The chairman should act bonafide and in the interest of the company, he must act in an impartial manner.

5) **Properly Conducted:** It is essential that the business at the meeting must be conducted according to rules. Company meetings are held for discussing particular issues relating to the company's working and taking a decision on the same. The matter should be placed in the form of a resolution, it should be discussed thoroughly, amendments to it should be carefully considered and then it should be decided by voting by show of hands or poll.

6) **Proper Record:** A proper record of the proceedings should be kept in the Minutes Book. Every company is required to maintain minutes of the proceedings of every general meeting and meetings of the Board and its Committees. When the minutes are confirmed and signed by the chairman, they are acceptable in a court of law as evidence of the proceedings.

13.8 NOTICE OF MEETINGS

The normal rule for any meeting of shareholders of a public company is that the meeting should be called by giving a notice of not less than 21 clear days.

However, a private company may provide in its articles for a shorter notice. The essentials of a valid notice are:

a) It must clearly state the date, time and place of the meeting as also the purpose of the meeting.
b) The notice must be issued on the authority of a resolution of the Board of directors.
c) The notice should be signed by a person authorised by the Board. Usually, a director of the Board or the company secretary would sign the notice.
d) It must be sent to all persons who are entitled to receive the notice.

The words "clear days notice" indicate that the day of serving the notice and the day of meeting are excluded. Thus in normal practice, 21 clear days would mean 23 days. Further, if the notice is to be sent by post, another 48 hours are to be added to the 23 days. Thus the notice must be sent at least 25 days before the date of the meeting. A shorter notice can also be given. In the case of annual general meeting, all the members should consent to the shorter notice and in the case of any other meeting, members holding not less than 95% of the paid-up share capital or voting rights should consent to it. The consents can be given either before or at the meeting, and has to be given in the prescribed form.

Persons Entitled to Notice

The persons who should be sent the notice of any general meeting are:

a) Every member of the company;
b) Persons entitled to a share in consequence of the death or insolvency of the member;
c) Auditors of the company for the time being;
d) Public trustees in respect of holdings to which Section 153B is applicable.

Further, if the notice pertains to the meeting of a particular class of shareholders, then it should be sent only to the shareholders of that class.

13.9 QUORUM FOR MEETINGS

A quorum is the minimum number of persons who must be present in order to constitute a valid meeting. If there is no quorum, the meeting shall not be valid and the business

a valid meeting. If the quorum is not present, the meeting shall not be valid and th transacted at such meeting will be invalid. The main purpose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may not be acceptable to the vast majority of members.

Generally, the quorum is fixed by the articles of the company. According to Section 174 of the Companies Act, unless the articles provide for a larger number, five persons personally present (and not by proxy) in the case of a public company and two persons personally present in the case of any other company, shall constitute the quorum for a general meeting of the company.

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 dissolved (Section 174(3).

In any other case, if there is no quorum within half an hour from the time fixed for holding the meeting, the meeting shall stand adjourned to the same day in the next week, at the same time and place, or to such other day and at such other time and place as the Board may determine.

If at the adjourned meeting also, there is no quorum within half an hour from the time appointed for holding the meeting, then the members present shall form the quorum. But you must remember that there must be at least two persons to hold the meeting. These provisions are also applicable to private companies, if the articles do not provide otherwise.

According to Article 49 of Table A, the quorum must be present at the time when the meeting begins and proceeds to take up business. It means that the quorum must be present at the beginning of the meeting and it need not be present throughout or at the time of taking votes on any resolution. But as regards the meetings of the Board of directors, the quorum must be present throughout the meeting. You should note that a quorum is presumed unless it is questioned at the meeting.

13.10 PROXIES

The term 'proxy' is used both for the person who is authorised to act and vote for another at a meeting of the company and the instrument through which such a person is named and authorised to attend the meeting. Section 176 of the Companies Act, states that any member of a company who is entitled to attend and vote at a meeting of the company, is entitled to appoint another person as his proxy to attend and vote instead of himself. Thus, any person may be appointed as a proxy whether he is a member of the company or not.

Unless the articles provide otherwise: (a) a proxy cannot be appointed in the case of a company having no share capital and (b) a member of a private company cannot appoint more than one proxy to attend on the same occasion.

The instrument appointing a proxy must be in writing and signed by the appointer or his attorney duly authorised in writing and must be stamped. The instrument appointing a proxy should be deposited with the company forty eight hours before the commencement of the meeting. Any provision in the articles of the company requiring the proxy form to be deposited earlier than 48 hours will be invalid.

The proxy has no right to speak at the meeting, but he can put questions in writing and sending the same to the Chairman for answer. For each meeting a separate proxy is required. A proxy can demand a poll and unless the articles otherwise provide a proxy is not allowed to vote except on a poll.

Every notice of a meeting must clearly state that a member is entitled to appoint a proxy and that the proxy need not be a member. If default is made, every officer in default shall be punishable with fine upto Rs. 500. But no invitation to appoint any person as proxy be made at the expense of the company and in case any such invitation is issued, the officer in default will be liable to fine upto Rs. 1,000.

Every member entitled to vote at a meeting of the company is entitled to inspect the proxies deposited at any time during the business hours. You must remember that a

proxy is always revocable, but it can be revoked before the proxy has voted. For revoking the proxy, the company must be informed. Death or insanity of a member appointing the proxy revokes the proxy, but proper intimation to the company is necessary. If the member appointing the proxy personally attends and votes at the meeting, the proxy shall stand revoked.

13.11 VOTING

You have learnt that the business of the company is transacted at meeting. A motion becomes a resolution when it is duly passed at the meeting. The shareholders have the right to discuss every proposed resolution and propose amendments therein. After the motion is discussed, it is put to vote. The voting may be (a) by show of hands or (b) by taking a poll.

a) **By show of hands:** At any general meeting, a resolution put to vote is decided first by show of hands. On a show of hands, each member shall have one vote. Unless the articles otherwise provide, proxies are not entitled to vote in case of such voting. The chairman counts the hands 'for' and 'against' a resolution and declares the result and when it is recorded in the minutes it becomes a conclusive proof of the fact. However, the dissatisfied shareholders may challenge the validity of the passing of the resolution or they may demand a poll.

b) **By taking a poll:** If there is dissatisfaction about the result of voting by show of hands a poll can be demanded. The chairman on his own motion may demand for the poll. The poll may also be demanded even before the declaration of the result on a show of hands.

In the case of a public company having a share capital, a poll may be demanded by any member present personally or through proxy and holding shares having not less than one tenth of the total voting power or, on which not less than Rs. 50,000 has been paid-up. In the case of a private company having share capital, a poll may be demanded by one member personally present or by proxy if seven such members are personally present in the meeting or by two members if more than seven members are present. You should note that as soon as a demand for poll is made, all decisions taken by voting by show of hands stands cancelled.

In a poll, the voting rights of a member are in proportion to his share of the paid-up equity capital of the company. If the articles so provide, members holding shares on which calls are in arrear or in regard to which the company has right of lien, may not be allowed to vote in a poll.

The demand for poll may be withdrawn at any time by the person or persons who made the demand. When more than one resolution is put to vote, poll should be taken on each separately. A poll demanded on the question of adjournment of the meeting must be taken immediately and in all other cases, the chairman must take poll within 48 hours of the demand for poll.

The chairman of the meeting shall appoint two scrutineers to scrutinise the votes given on the poll, and to report thereon to him. Out of the two scrutineers, at least one shall be the member of the company but he should not be an officer or an employee of the company. The result of the poll shall be deemed to be a decision of the meeting on the resolution on which the poll was taken.

13.12 CHAIRMAN

Chairman is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. A chairman is necessary for conducting a meeting properly. He is the chief authority in the meeting, he is the umpire of debates and he regulates the meeting.

Articles usually provide the mode of appointment of the chairman of a meeting. But

if there is nothing in the articles, the members personally present at the meeting shall elect one of themselves to be the chairman of the meeting. If a poll is demanded on the election of the chairman, it must be taken forthwith and a chairman is elected for the purpose. You should note that these provisions as given in Section 175 of the Act are applicable only if there is no provision in the articles.

Regulations 50 to 52 of Table A state the rules regarding the appointment of chairman. The articles usually provide at the general meetings of the company. If there is no such chairman or if he is not present within fifteen minutes of the time fixed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one of their member to be chairman of the meeting. If at any meeting no director is willing to act as chairman or if no director is present within fifteen minutes of the time fixed for holding the meeting, the members present shall choose one of themselves as the chairman.

The chairman has prima facie authority to decide all questions which arise at a meeting and which require decision at the time. He has the power to give his ruling on points of order, to expel any unruly member, to adjourn the meeting if it becomes impossible to conduct the meeting smoothly, to regulate the taking of poll, to sign and date the proceedings of the meeting. If so authorised by the articles, the chairman may give his casting vote to decide the issue where the members are equally divided for and against the resolution.

The chairman must see to it that the preceedings of the meeting are conducted according to the rules, that proper order is maintained at the meeting, that proper opportunity is given to members to express their views. He should see that the voting is fair and the sense of the meeting is properly ascertained on each and every motion. He must act bonafide at all times and in the interest of the company.

13.13 RESOLUTIONS

Decisions of the members at a general meeting are expressed by way of resolutions. At the meetings a definite proposal in the form of a 'motion' is placed, it is discussed thoroughly and finally is put to vote. When the motion is passed by a majority, it is called a resolution. In simple words, resolution means the decision taken at the meeting.

The Companies Act provides for three types of resolutions that may be passed at the general meeting of a company—(i) Ordinary resolution; (ii) Special resolution; and (iii) Resolution requiring special notice.

13.13.1 Ordinary Resolution

An ordinary resolution is one which is passed by a simple majority, that is to say that the votes cast in favour of the resolution exceed the votes cast against the resolution. For example, if at a meeting where, say, 81 members cast their votes in a manner that 41 cast votes in favour and 40 against the motion, the ordinary resolution is said to be taken as passed. The voting may be either by show of hands or by poll. An ordinary resolution is required to pass the annual accounts, to declare dividend, to appoint auditors, to elect directors, to issue shares at a discount etc.

13.13.2 Special Resolution

A special resolution is one which is required for transacting special business and is required to be passed by a three-fourths majority. The voting may be either by show of hands or by polls. In determining the three-fourths majority, all the votes cast by members, whether personally or by proxy, are considered.

According to Section 189(2) of the Companies Act, a resolution shall be a special resolution when:

i) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meetings;
ii) the notice hass been duly given of the general meetings; and

iii) the votes cast by members in favour of the resolution are not less than three times the number of votes cast against the resolution.

The special resolution is necessary to transact important business. The articles of the company may specify purposes for which a special resolution is required. The Companies Act has also expressly required the passing of special resolution on certain matters. The following are some of the instances where special resolutions are necessary:

i) to alter the memorandum of association;
ii) to alter the articles of association;
iii) to create reserve capital;
iv) to reduce capital;
v) to pay interest out of capital;
vi) to allow a director to hold office of profit in the company;
vii) for voluntary winding up of the company.

13.13.3 Resolution Requiring Special Notice

A resolution requiring special notice is, in fact, not a type of resolution, but is a kind of ordinary resolution for which a prior notice of intention to move the resolution has to be given to the company. With regard to certain matters, a special notice is required to be given of a resolution to be moved at a meeting of the company. The object is to give members sufficient time to consider the proposed resolution. Where special notice of a resolution is required by the Act or the articles, the notice of the intention to move the resolution must be given to the company at least 14 full days before the date of the meeting. On receipt of such a notice the company must give notice of the resolution to the members at least seven days before the meeting either individually or through an advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles.

According to the Companies Act, a resolution requiring special notice is required to transact the following business:

i) to remove a director before the expiry of his term;
ii) to appoint an auditor in place of the retiring auditor;
iii) to appoint a new director in place of the removed director;
iv) to pass a resolution that retiring auditors shall not be reappointed.

13.14 MINUTES

The Companies Act, provides that every company must keep the minutes of the meetings containing a fair and correct summary of all proceedings of the meetings. The minutes of a meeting should be recorded within 30 days of the meeting in the books called the minute book, kept for the purpose. Each page of the minute book should be initialled and last page signed and dated by the chairman of the meeting. The minutes duly signed by the chairman are presumptive evidence that the meeting was duly called and held and all proceedings duly carried out. The minutes book should be kept in the safe custody so as to avoid any tempering of the same. The minutes of a general meeting should also be signed within 30 days of the meeting, by the chairman of the meeting or any other authorised person. The minutes book relating to the general meeting is open to inspection of any member of the company without charge during business hours at least for 2 hours.

Further, a member of the company is entitled to be furnished within seven days of his request with a copy of any minutes of the general meeting on payment of such sum as may be prescribed for every 100 words or part thereof.

Check Your Progress C

1) What is meant by 'notice' of a meeting?

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2) To whom the notice of meetings must be sent?

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3) Define 'Quorum'.

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4) What is the quorum for the general meeting of members?

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5) What do you understand by 'proxy'?

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6) When should a proxy be deposited with the company?

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7) What is 'poll'?

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8) What is a resolution?

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9) What is a special resolution?

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10) List three instances which require a special resolution?

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11) What is a resolution requiring special notice?

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12) Why is a chairman necessary for a meeting of a company?

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13) State whether the following statements are True or False.

i) The quorum at a general meeting of a public company is the personal presence of three members and in case of a private company the personal presence of two members.
ii) For the purposes of quorum, only members present in person and not by proxies, are to be counted.
iii) One person cannot constitute quorum under any circumstances.
iv) The proxy must be a member of the company.
v) A proxy can speak at a general meeting and cast his vote on a show of hands.
vi) A resolution put to vote at a general meeting shall be decided on a show of hands in the first instance.
vii) A poll can be demanded by any ten members of the company.
viii) An ordinary resolution is passed by a simple majority.
ix) A special resolution is passed by a two-thirds majority.
x) A special resolution is required to be passed for changing the name of a company.
xi) An ordinary resolution is necessary for issuing shares at a discount.
xii) For appointing another director in place of the removed director, a resolution requiring special notice is necessary.

13.15 LET US SUM UP

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 three types: (a) statutory meetings (b) annual general meeting (c) extraordinary general meeting.

Statutory meeting is the first meeting of the shareholders of a public company and is held only once in the life-time of the company. This meeting must be held not earlier than one month and not more than six months after the date on which it became entitled to commence business. At least twenty one days clear notice must be given and the notice must be accompanied by a statutory report. This report contains all the necessary information in regard to the formation of the company. The main purpose of holding this meeting is to inform the shareholders about the progress of allotting the shares and the position of the company.

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 the statutory and 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 or by the Company Law Board.

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 the 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. There are three types of resolutions: (i) ordinary, (ii) special, and (iii) resolution requiring special notice.

Ordinary resolution is one which is passed by simple majority of votes of members present in the meeting. An ordinary resolution is needed to transact ordinary business, for example, to pass annual accounts, declare dividend etc.

Special resolution is one where it is specifically mentioned in the notice calling the meeting. Such a resolution can be passed only by three-fourths majority. Special resolution is necessary for altering the memorandum, for reducing share capital, for creating reserve capital, for paying interest out of capital etc.

A resolution requiring a special notice is one where the mover of the resolution is required to give notice to the company at least 14 days before the date of the meeting about his intention to move the resolution. A special notice is required before moving a resolution for removing a director before the expiry of his term, for appointing another person as a director in place of the removed director, for providing that the retiring auditors shall not be reappointed etc.

13.16 KEY WORDS

Meeting: An assembly of two or more persons for transacting some lawful business.

Statutory Report: A report containing vital information about the information of the company.

Notice: An 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.

Motion: A proposal put before the meeting for consideration.

Resolution: When a motion is duly passed, it becomes a resolution or decision.

Proxy: A authority to represent and vote for another person at a meeting.

Poll: A method of voting where a member records the number of votes in proportion to equity shares held by him.

Minutes: Written record of the proceedings of a meeting.

13.17 ANSWERS TO CHECK YOUR PROGRESS

A	6	i) False	ii) False	iii) True
		iv) True	v) False	vi) False
		vii) True	viii) True	
B	7	i) True	ii) False	iii) True
		iv) True	v) False	vi) True
		vii) False	viii) True	

C. 13

i) False	ii) True	iii) False
iv) False	v) False	vi) True
vii) False	viii) True	ix) False
x) True	xi) True	xii) True

13.18 TERMINAL QUESTIONS

1) What are the different types of meetings of a company? Explain the purpose of holding such meetings.
2) What are the requisites of a valid meeting?
3) What is a statutory meeting? When is it held? What business is transacted at such meeting?
4) What is a statutory report? What it must contain?
5) What is 'notice' of a meeting? Explain briefly the rules regarding the notice of general meeting.
6) What is the significance of annual general meeting? What business is generally transacted at such meetings?
7) How an extraordinary general meeting be convened?
8) What is a 'special resolution'? For what purposes are such resolutions necessary?
9) Is a special resolution and a resolution requiring special notice something? Indicate four instances where special notice is necessary.
10) What do you mean by 'quorum'? What happens if there is no quorum at a meeting?
11) Write an explanatory note on proxies.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 14 WINDING UP

Structure

14.0 Objectives
14.1 Introduction
14.2 Meaning of Winding Up
14.3 Winding Up and Dissolution
14.4 Modes of Winding Up
14.5 Compulsory Winding Up

14.5.1 Grounds for Compulsory Winding Up
14.5.2 Who can File a Petition?
14.5.3 Commencement of Winding Up
14.5.4 Consequences of the Winding Up Order
14.5.5 Conduct of Winding Up

14.6 Voluntary Winding Up

14.6.1 Members' Voluntary Winding Up
14.6.2 Creditors' Voluntary Winding Up
14.6.3 Consequences of Voluntary Winding Up

14.7 Distinction Between Members' and Creditors' Voluntary Winding Up
14.8 Winding Up Under Supervision of the Court
14.9 Let Us Sum Up
14.10 Key Words
14.11 Answers To Check Your Progress
14.12 Terminal Questions

14.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of winding up.
- distinguish between winding up and dissolution
- describe the different types of winding up
- list the grounds for compulsory winding up
- describe the consequences of winding up
- explain the rules regarding voluntary winding up
- distinguish between members' and creditors' voluntary winding up.

14.1 INTRODUCTION

You have learnt that a company is an artificial person created by law and as such its life can be ended only by a legal procedure. Winding up is a means by which a company is dissolved. A company shall cease to exist only when it is dissolved. There are three ways in which a company may cease to exist in the eyes of law, they are:

a) Under a scheme of reconstruction and amalgamation, a company may be dissolved by order of the court without being wound up (Section 394);
b) When the company becomes a defunct company, the Registrar may remove the name from the Register of Companies (Sec. 560);
c) Through winding up process.

In this Unit you will study the different types of winding up, the grounds for winding

up and the consequences of winding up.

14.2 MEANING OF WINDING UP

The winding up is the process of putting an end to the life of the company. During this process the company ceases to carry on its normal business, the assets of the company are sold and the proceeds are utilised in paying off the debts and liabilities. If any surplus is left, it is paid back to the members in proportion to their contribution to the capital of the company. An administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and distributes the surplus, if any, among the members. Thus, with the winding up, a company ceases to be a going concern, all its operations come to a halt. You should note that the process of winding up begins only after the court passes the order for winding up and till such an order is passed there is no winding up.

Further, a company may be unable to pay its debts but it cannot be adjudicated insolvent as the law of insolvency does not apply to companies. Only individuals can be declared insolvent, not a body corporate. In such a case, a company can only be wound up.

14.3 WINDING UP AND DISSOLUTION

Winding up and dissolution of the company are not the same thing. A company is not dissolved immediately, on the commencement of winding up proceedings. Winding up is the prior stage and dissolution is the next. On dissolution, the name of the company is struck off by the Registrar from the Register of Companies i.e. it ceases to exist. While on winding up, the Companies' name is not struck off from the register. The legal entity of a company remains even after the commencement of winding up and it can be sued in a court of law. Dissolution is the final stage of the Company's winding up process. But a company can be dissolved without winding up under certain circumstances such as when it merges with another company.

The main points of difference between winding up and dissolution are as follows:

i) In winding up the assets of the company are sold and the proceeds are utilised in paying off the debts and other liabilities of the company. It is the first stage of terminating the life of a company. While the dissolution is the next stage and after this the company ceases to exist.
ii) The winding up proceedings are carried out by a liquidator of the company while in case of dissolution no such proceedings are carried out.
iii) Creditors can prove their debts in the winding up but not in the dissolution of the company.
iv) In the cases of winding up it is not always necessary to obtain an order of the court because voluntary winding up may take place, but for dissolution of the company, the order of the court is essential.

From the above discussion it should be clear to your that winding up and dissolution of a company is not the same thing.

14.4 MODES OF WINDING UP

Under Section 425 of the Companies Act, a company may be wound up in any of the following ways:

1) Compulsory winding up by the Court.
2) Voluntary winding up. It may further be:
   a) Members' Voluntary winding up; or
   b) Creditors' Voluntary winding up.
3) Voluntary winding up under the supervision of the court.

Let us now discuss these modes one by one in detail.

14.5 COMPULSORY WINDING UP

The winding up of a company by an order of the court is known as compulsory winding up. Section 433 of the Act contains the cases where the Court may order for the winding up of a company on a petition submitted to it.

14.5.1 Grounds for Compulsory Winding Up

The company may be wound up by the Court under the following circumstances:

i) **Special Resolution by the Company:** If the company has passed a special resolution to the effect that the company be wound up by the court. The resolution may be passed for any reason whatsoever. In such cases, the court may order the winding up of the company on a petition submitted to it. But the Court's power is discretionary, that is, it may not pass an order for winding up even if the company has so resolved if such winding up would be detrimental to the interests of the company or public.

   This mode of winding up is not very popular as members' voluntary winding up is preferable because there the interference of the court is least.

ii) **Default in holding statutory meeting:** You know that a public company must hold the statutory meeting within six months of obtaining the certificate to commence business and file the statutory report with the registrar. If the company makes any default in holding the statutory meeting or in filing the report with the registrar, the court may order the winding up on a petition of the registrar or of a contributory. If a petition is filed by any other person, e.g. a creditor, it must then be presented before the expiry of fourteen days after the last day on which the statutory meeting ought to have been held (Sec. 439(7). However, the court is not bound to order for winding up on this ground. It may instead order the company to file the statutory report or hold the statutory meeting.

iii) **Failure to commence business:** If the company fails to commence business within one year of its incorporation, or suspends its business for a whole year, the court may order the winding up of the company only when it is satisfied that the company has no intention of carrying on business or is unable to carry on its business. Where the delay in commencing the business or suspension of business is due to temporary reasons and there are reasonable prospects of the company starting business within a reasonable time, the court shall not pass the winding up order.

   Sometimes, a company may have a number of business units. In such a case an interesting question may arise as to whether the suspension of any one business unit is a valid ground for winding up of the company? The matter is to be decided by the Court. Even if the business in all the units has been suspended, the court may not order winding up if it is satisfied that there are chances of the company resuming its business.

iv) **Reduction in membership:** If the number of members is reduced, in the case of a public company, below seven and in the case of a private company, below two, the court may order the winding up of the company.

v) **Inability to pay debts:** Inability to pay debts means that the company is not in a position to honour its monetary commitments i.e. its existing assets are not sufficient to discharge its existing liabilities. In such a situation, the court may order the winding up of the company.

According to Section 434 of the Companies Act, a company shall be deemed to be unable to pay its debts in the following circumstances:

a) If a creditor to whom the company is indebted for a sum exceeding Rs. 500 has served a demand notice on the company requiring the company to pay the sum

due and the company has for three weeks thereafter neglected to pay or otherwise satisfy him. For calculating the period of three weeks the days on which the demand notice is despatched and served should be excluded; or

b) If a creditor has obtained a decree from the court for the payment of his debts by the company, and the company fails to satisfy in full this decree in favour of a creditor; or

c) If the court is satisfied that the company is unable to pay its debts taking into account the company's contingent and prospective liabilities. This means the commercial insolvency of the company, a situation where the company is unable to meet its current liabilities. The mere fact that the company is incurring losses or running in continuous losses does not mean that it is unable to pay its debts. Also the excess of liabilities over assets alone does not mean that the company is unable to pay its debts.

The court may order winding up on this ground only when:

i) the debt owned by the company is undisputed, for a definite sum and is payable immediately;
ii) the creditors' right to the debt is clear and undisputed, and
iii) the company has neglected to pay without sufficient cause or excuse.

Where the sole purpose of the petition is to put pressure on the company for the repayment of a debt, the court shall not pass an order for winding up.

vi) **Just and equitable:** Where the court is satisfied, on the facts and circumstances of the case, that it is just and equitable for the company to be wound up, it may pass an order for the winding up of the company. Under this clause, the court has very wide discretionary powers. What is 'just and equitable' depends upon the facts and circumstances of each case.
Some of the instances under which the court has ordered winding up on the ground of being 'just and equitable' are as under:

i) When the main object of the company has failed or has become substantially impossible to be carried out.
ii) When there is a complete deadlock in the management of the company, for example, where two directors holding equal voting rights become so hostile that they would not talk with each other, it amounts to deadlock in the management.
iii) When shareholders holding majority voting power adopt an oppressive attitude towards minority shareholders.
iv) When the object for which the company was formed is fraudulent or illegal or it becomes illegal subsequently.
v) When the business cannot be carried on except at a loss, i.e. where there is no reasonable hope of running business at profit.
vi) When it is only a 'bubble' company and it has no property or business to carry on.
vii) When there has been gross mismanagement and misuse of funds by the directors of a private company or complete lack of confidence in the management.

You should, however, note that relief under just and equitable clause is in the nature of last resort when other remedies are not effective enough to protect the general interest by the company.

14.5.2 Who can File a Petition?

According to Section 439 of the Companies Act, a petition for compulsory winding up may be filed by anyone of the following:

i) **By the Company:** A petition can be filed by the company itself for winding up when a special resolution to this effect has been passed in the general meeting of the company. Therefore, the directors or the managing director cannot file such a petition of their own.

ii) **By the creditors:** A creditor can file a petition to the court, if he can prove that the company could not pay his debt of Rs. 500 or more within three weeks of making the demand. The term creditor includes a secured creditor, a

debentureholder, a prospective creditor and any Central or State Government or local authority to whom any tax etc. is due. A secured creditor holding ample security will fail to obtain the winding up order, if the petition is not supported by other creditors. The creditors' petition will not be taken up if the claim of the creditors has become time barred under the Limitation Act.

iii) **By contributories:** The term 'contributory' means a person who is liable to contribute to the assets of the company in the event of its being wound up. A contributory is entitled to present a petition for winding up even though he may be the holder of fully paid-up shares or that the company may have no assets at all, or may have no surplus assets left for distribution among the members after paying off the liabilities.

Any contributory may present a petition for winding up where the ground for winding up is that the number of members is reduced below the statutory limit. But a petition on any other ground can be presented only by the a) original allottee or who has acquired shares through transmission or b) by the person who has been the registered holder of the shares for atleast six months during the eighteen months immediately preceding the petition.

iv) **By the Registrar:** After obtaining the previous sanction of the Central Government, the Registrar can file the petition for winding up of the company on the following grounds:

a) if default is made in holding the statutory meeting or filing the statutory report;

b) if the company fails to commence business within one year of its incorporation or suspends the business for a whole year;
c) if the number of members falls below the statutory limit;
d) if the company is unable to pay its debts;
e) if the court considers it just and equitable.

The registrar can present the petition on the ground that the company is unable to pay its debts, only if it appears to him from the balance sheet of the company or from a special auditors' or inspectors' report that the company is unable to pay its debts.

v) **By any person authorised by the Central Government:** If the business of the company is being conducted to defraud its creditors, or members or any other person, as disclosed by the report of inspectors appointed to investigate the affairs of the company, the Central Government may authorise any person to file a petition for winding up of the company. Usually, the registrar is authorised to present the petition.

14.5.3 Commencement of Winding Up

When a winding up order is issued by the court against a company, the winding up does not commence from the date of the order but it commences from an earlier date. According to Section 441 of the Companies Act, the winding up of a company by court shall be deemed to commence at the time when the petition for winding up is presented. But where before the presentation of a petition for winding up, if a company has passed a special resolution for winding up, then the winding up shall be deemed to have commenced at the time of passing of the resolution.

If a winding up order has been made on more than one petition, the winding up shall commence from the date of the presentation of the earliest petition.

Sometimes, legal proceedings might be pending against the company. Before passing the winding up order, the court may, on an application made by the company or any creditor or any contributory, issue orders staying further proceedings on such terms as it thinks fit. In case a suit or proceeding is pending in the Supreme Court or in any High Court, the application for stay is to be made in the concerned court in which the suit or proceeding is pending.

Power of Court on hearing petition: According to Section 443 of the Companies Act, on hearing up a winding up petition, the Court may:

a) dismiss it, with or without costs; or
b) adjourn the hearing conditionally or unconditionally; or
c) make any interim order that it thinks fit; or
d) make an order for winding-up the company with or without costs, or any other that it thinks fit.

14.5.4 Consequences of the Winding Up Order

i) After the court has made the winding up order, it must immediately sent information to the official liquidator and the Registrar.
ii) The petitioner and the company is required to file with the Registrar a certified copy of the order within thirty days of the making of the order. The Registrar will then notify in the Official Gazettee that such an order has been made.
iii) The winding up order shall be deemed to be a notice of discharge to the officers and employees of the company, except when the business of the company is continued.
iv) No suit or other legal proceeding against the company could be commenced or proceeded with after the making of a winding up order, except with the leave of the court and subject to such terms and conditions as the court may impose.
v) The winding up order operates in favour of all the creditors and all the contributors, as if it had been made on a joint petition of creditors and contributories.
vi) The powers of the Board of Directors will terminate and the same will now vest in the official liquidator. The official liquidator, shall by virtue of his office, become the liquidator of the company.
vii) All debts, including those payable at some future date, become payable immediately.
viii) The Court issuing up the winding order shall have the right to dispose off any new or pending suit against the company. Any suit or proceeding lying pending in another court shall also be transferred to the court which has issued the winding up orders.
ix) All the property of the company shall be under the custody and control of the liquidator.

14.5.5 Conduct of Winding Up

The winding up proceedings are conducted by the official liquidator and his powers are subject to the control of the Court. He may also apply to the court for directions in any particular matter in winding up.

The company is required to submit within 21 days of the order of winding up or within such time not exceeding 3 months as extended by the court, a Statement of Affairs containing particulars regarding the assets of the company, its debts and liabilities, particulars of creditors along with details of security, if any, and particulars of debts due to the company. This statement is required to be verified by an affidavit of one or more directors of the company and also by the Manager, Secretary or Chief Officer of the company.

The official liquidator shall submit a preliminary report to the court based on the Statement of Affairs.

Once assets of the company are realised and contributions from the contributories have been received the liabilities of the company are to be discharged. According to the provisions of the Act, overriding preferential payments are to be made first, then the preferential payments and then the other creditors. Any surplus after discharging all debts and liabilities will be distributed amongst the contributories pro rata.

A 'contributory' means every person liable to contribute to the assets of the company in the event of it being wound up and includes holders of fully paid shares, though the liability of a contributory extends only upto the amount remaining unpaid on the shares held by him.

The liquidator is required to present an account of his receipts and payments to the court twice a year and also file with the Court a duly audited statement with respect to the proceedings and position of the liquidation every year.

When the affairs of the company have been completely wound up or when the court is of the opinion that the liquidator cannot proceed with the winding up for want of funds and assets or for any other reason, the court shall make an order of dissolution of the company.

The dissolution puts an end to the existence of the company, and the Registrar strikes off the name of the company from the Registrar of Companies. The company stands dissolved from the date on which the order is made by the court.

Check Your Progress A

1) What do you mean by 'winding up' of a company?

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2) What is meant by dissolution of a company?

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3) List the different modes of winding up a public company.

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4) List the four grounds when a company could be wound up on the ground of 'just and equitable'.

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5) When does compulsory winding up commence?

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6) What is the effect of the winding up order on the officers and employees of the company?

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7) Who is a contributory?

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8) State whether the following statements are True or False:
   i) A company may be wound up if the members pass an ordinary resolution to this effect.
   ii) If a company makes a default in holding the statutory meeting the court must order for its winding up.
   iii) The court may order for the winding up of a company if it is unable to pay its debts.
   iv) If a company does not commence business within one year from its incorporation, the court must order its winding up.
   v) The court may order for winding up of a company if the number of its members falls below the statutory limit.
   vi) The employees of the company can also file a petition to the court for winding up of the company.
   vii) A company is deemed to be unable to pay its debts if it fails to pay a creditor to whom it owes a sum exceeding Rs. 500 within three weeks of the demand for payment.
   viii) A secured creditor cannot file a petition for winding up of the company.
   ix) Winding up commences from the date of the winding up order.
   x) When a winding up order has been made, no suit or legal proceeding can be commenced against the company without the leave of the court.

14.6 VOLUNTARY WINDING UP

You have learnt about the winding up of a company by an order of the court. The company can also be wound up without the intervention of the court, and this is termed as 'voluntary winding up'. The voluntary winding up means winding up, without the intervention of the court, by members or creditors themselves. In voluntary winding up, the members and creditors are left free to settle their affairs without going to the court, although they may apply to the court for directions or orders, if and when necessary.

Section 484 of the Companies Act specifies the circumstances in which the company may be wound up voluntarily.

These are:

1) By passing an ordinary resolution in the following cases:
   a) where the period, if any, fixed for the duration of the company by the articles has expired; or
   b) where the articles provide that the company is to be dissolved on the occurrence of any event and if that event has occurred.
2) By passing a special resolution that the company be wound up voluntarily. When a special resolution is passed by the members to wind up the company, it is not necessary to give any reasons for doing so. When a company passes a special resolution for voluntary winding up, it must within 14 days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette, and also in some newspaper circulating in the district where the registered office of the company is situated.

You should note that a voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed (Section 486).

Voluntary winding up of the company is of two types, namely:

a) Members' voluntary winding up, and
b) Creditors' voluntary winding up.

Let us now discuss them one by one in detail.

14.6.1 Members' Voluntary Winding Up

The members' voluntary winding up is possible only in case when the company is

solvent and is in a position to pay all its debts in full. Members' voluntary winding up is possible in cases where a declaration of solvency is made by the company and is delivered to the Registrar for registration.

Declaration of Solvency: Where it is proposed to wind up a company voluntarily, the Declaration of solvency is to be made by all the directors (if there are only two directors) or by the majority of the directors (if there are more than two directors). The declaration must be made at the meeting of the Board and must be verified by an affidavit.

The declaration must state that the directors have made a full inquiry into the affairs of the company and that they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of winding it.

The declaration shall be effective only if it is made within five weaks immediately before the date of the passing of the resolution for winding up the company and is delivered to the Registrar for registration before that date.. The declaration must be accompanied by a copy of the report of the auditors of the company on the profit and loss account and the balance sheet of the company and also a statement of the assets and liabilities as at the latest practicable date immediately before the making of the declaration.

Conduct of Winding Up

The company in a general meeting, shall appoint one or more liquidators and fix his remuneration and liquidator so appointed will take charge only after his remuneration is fixed. The company is required to give notice to the Registrar of the appointment of the liquidator within 10 days of such appointment.

The powers of the Board of Directors shall cease on the appointment of a liquidator except when the company or the liquidator sanctions their continuance.

If the company is unable to pay or in the opinion of the liquidator will not be able to pay its debts in full within the period stated in the declaration of solvency, the liquidator should immediately call a meeting of the creditors and place before them a statement of the assets and liabilities of the company. In such cases, the winding up will proceed in the manner of creditors' winding up.

If the liquidation continues for more than one year, the liquidator should call a meeting of the shareholders at the end of each year and place before them an account of his acts and dealings and the progress of winding up during the year. Where the company in liquidation proposes to sell its business or property to another company, the liquidator may receive shares or other interest in the other company (transferee) as consideration for distribution among the members of the company (transferor company) but he can do so only on the authority of a special resolution of the company. If any member of the transferor company does not agree to the special resolution, he may require the liquidator either to abstain from carrying the resolution or to purchase his interest at an agreed price.

Final Meeting and Dissolution

When the affairs of the company are fully wound up i.e. when all the assets have been disposed off and realised and all debts and liabilities have been discharged, the liquidator shall call a general meeting of the company and lay before it the accounts of winding up to show how the winding up has been conducted and the property of the company dealt with. This is the final meeting of the company.

A copy of these accounts is to be sent to the official liquidator and the Registrar within one week after the meeting. The official liquidator would then scrutinise the books and papers of the company and shall report to the court. If the report of the official liquidator shows that the affairs of the company were conducted properly, then the company shall be deemed to be dissolved from the date of submission of report to the court.

If the report reveals that the winding up affairs were conducted in a manner prejudicial to the members' interest or public interest, the court shall direct the official liquidator

to make further investigations, after which, the court may either dissolve the company or make any other order, as it deems fit.

14.6.2 Creditors' Voluntary Winding Up

This type of winding up takes place when the company is not in a position to pay its debts in full and where a declaration of solvency has not been made. In this type of winding up, since the interest of the creditors is involved, they are given the powers to control and supervise the winding up of the company.

The various statutory provisions governing such a winding up may be discussed under the following heads:

Meeting of Creditors

The company must call a meeting of the creditors to be held either on the same day on which the meeting of the company is to be held or on the day following the day when the members meeting is held to pass a resolution for voluntary winding up. The Board of Directors shall lay before the creditors a full statement of the position of the affairs of the company together with a list of the creditors of the company and the estimated amount of their claims.

Appointment of Liquidator

The creditors and the members, at their respective meetings, may nominate a person to be the liquidator. Where the members have not nominated any person, the nominee of the creditors, shall be the liquidator. Where different persons have been nominated by the creditors and members, the creditors' nominee shall be the liquidator.

Committee of Inspection (COI)

The creditors at the meeting may appoint a committee of inspection consisting of not more than five persons to which the company may also appoint five members. In case of any difference of opinion as to the nominees to the Committee of Inspection, the court shall settle the matter.

The remuneration of the liquidator shall be fixed by the COI or the Creditors, failing which, it shall be determined by the court.

The Boards' powers shall cease on the appointment of the liquidator. However, the COI, or if there is no such committee, the creditors in general meeting may sanction the continuance of the Board's powers.

The liquidation would proceed in the same manner as in the case of members' voluntary winding up. In addition to the final meeting of the members, a meeting of the creditors shall also be called before the company is dissolved.

General Provisions with respect to Member's Voluntary Winding up and Creditors' Voluntary Winding up

Statement of Affairs

The Board of Directors is required to submit a statement as to the affairs of the company, to the liquidator which should state the following particulars and is to be verified by one or more directors and manager, or secretary or other Chief Officer of the company:

i) assets of the company—cash and bank balances and negotiable securities to be stated separately.
ii) debts and liabilities of the company.
iii) names and addresses of creditors indicating the amount of secured and unsecured debts.
iv) debts due to the company, persons from whom they are due and the amount likely to be realised.
v) Such other information as may be required.

Liquidator's Power

The liquidator has the same powers as that of the official liquidator in compulsory winding up. Whereas the official liquidator requires the sanction of the court in certain cases, the liquidator in case of members' voluntary winding up would require the sanction of the members/company and in case of creditors' voluntary winding up, of the court of the committee of inspection or the creditors.

In addition, the liquidator would also have the power of the court to settle the list of contributories, making calls and calling general meetings of the company. You should, however, note that the exercise of powers by the liquidator shall be subject to the control of the court.

Conduct of Winding Up

The Court has the power to remove a liquidator and appoint the official liquidator or any other person as the liquidator in place of the removed liquidator. You should note, that a body corporate is not qualified for appointment as a liquidator of a company in a voluntary winding up.

The liquidator shall within 30 days after his appointment, publish in the Official Gazette and deliver to the Registrar for registration a notice of his appointment in the form prescribed.

The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of the company.

In a voluntary winding up, the liquidator is an agent of the company and not a trustee for shareholders or creditors. He is the custodian of the property of the company.

His functions include taking into custody the property of the company, selling the same, instituting and defending suits in the name and on behalf of the company, keeping proper books and recording proceedings at meetings and to have them audited, calling meetings of the committee of inspection, members and creditors. As an agent of the company, an individual shareholder or creditor cannot sue him for delaying payments etc. except in cases of deliberate misconduct. In any case, the suitable remedy is to seek a court order in reference to his conduct.

14.6.3 Consequences of Voluntary Winding Up

You know that the voluntary winding up commences from the date of the passing of the resolution to that effect. This date is important because it helps in determining the liability of past members. The consequences of voluntary winding up can be summarised as following:

i) From the commencement of voluntary winding up, the company ceases to carry on its business, except so far as may be required for the beneficial winding up thereof. It means that the corporate entity of the company shall continue until the dissolution of the company.
ii) With the appointment of liquidator, all the powers of the Board of Directors, managing or whole-time director shall come to an end. But with the approval of the general meeting, or the liquidator or the creditors or the committee of inspection, the directors etc. may continue to exercise their powers.
iii) Voluntary winding up does not always mean a notice of discharge to its employees, e.g., if it is done to effect amalgamation. But winding up on grounds of insolvency will mean discharge of its employees.
iv) After the order has been made, no suit or other legal proceeding can be commenced or if pending at the date of the winding up order can be proceeded with against the company except with the leave of the court.
v) Any transfer of shares in the company and any alteration in the status of the members of the company made after the commencement of the winding up shall be void unless it is done with the sanction of the liquidator.
vi) Every notice, invoice, order, business letter issued by or on behalf of the company or liquidator of the company bearing the name of the company shall contain a statement that the company is being wound up.

14.7 DISTINCTION BETWEEN MEMBERS' AND CREDITORS' VOLUNTARY WINDING UP

From the following table, you can very well understand the main points of difference between members' and creditors' voluntary winding up:

MEMBERS' VOLUNTARY WINDING UP	CREDITORS' VOLUNTARY WINDING UP
1) This takes place only when the company is in a position to pay its debts.	1) This takes place only in cases when the company is not in a position to pay its debts.
2) The directors must file a 'declaration of solvency' with the registrar.	2) The directors are not required to file any such declaration
3) Only the general meeting of members is called.	3) A meeting of creditors must be called immediately after the meeting of the members.
4) The liquidator is appointed by the members.	4) If the creditors and the company nominate different persons as liquidator, the person nominated by creditors shall be the liquidator.
5) There is no committee of inspection.	5) A committee of inspection is usually appointed to assist the liquidator.
6) The liquidator can exercise powers with the sanction of special resolution of the company.	6) The liquidator can exercise powers with the sanction of the court, or committee of inspection or of a meeting of creditors.
7) Winding up proceedings are controlled by members.	7) Winding up proceedings are controlled by creditors.
8) Meeting of members is called on the completion of winding up proceedings.	8) Meeting of members and creditors is called on the completion of winding up proceedings.

14.8 WINDING UP UNDER SUPERVISION OF THE COURT

You have learnt that a company can be wound up without the intervention of the court, but voluntary winding up, may be under the supervision of the court. At any time after the company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up shall continue but subject to the supervision of the court. When the voluntary winding up is in progress and if any creditor or contributory or the liquidator is not satisfied, they may apply to the court for winding up under the supervision of the court. Such an order is passed by the Court on any of the following grounds:

a) the liquidator is partial or negligent in collecting the assets; or
b) the majority is playing fraud with the minority; or
c) the rules regarding winding up of a company have not been fully complied with.

In such cases, the court may make an order that the winding up of the company shall continue subject to the supervision of the court and on such terms and conditions as it thinks fit. The most important effect of the supervision order is that is gives the court the necessary jurisdiction over suits and legal proceedings as in the case of compulsory winding up under order of the court.

Generally, the liquidator appointed in voluntary winding up is allowed to continue. but the court may appoint one or more additional liquidators. The court may remove any liquidator so appointed and fill any vacancy occasioned by the removal or by death, or resignation. The court may also appoint or remove a liquidator on an application made the Registrar in this behalf. The liquidator so appointed shall have the same powers and duties as in the case of appointment of liquidators in a voluntary winding up.

The court will have all the powers as it has in the case of compulsory winding up such as, staying of suits and other legal proceedings, making calls etc.; though the winding up remains a voluntary winding up.

Section 527 of the Companies Act empowers the court to pass an order for compulsory

winding up, in case of need, superseding the order of winding up under its supervision. In case of winding up under the supervision of the court, when the affairs of the company have been completely wound up and the liquidator has submitted his report to the court recommending dissolution, the court shall pass an order dissolving the company. The company is treated as having been dissolved from the date of the order of the court.

Check Your Progress B

1) What is meant by voluntary winding up?

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2) List the two circumstances when a company may be wound up voluntarily.

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3) What is meant by 'declaration of solvency'?

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4) When does the voluntary winding up commences?

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5) What is meant by Creditors' voluntary winding up?

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6) Give two important points of distinction between members' and creditors' voluntary winding up.

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7) What is winding up under the supervision of the court?

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8) State whether the following statements are True or False:

   i) A company may be wound up voluntarily by passing a resolution at the meeting of Board of Directors.
   ii) A company may, at any time resolve by passing a special resolution to be wound up voluntarily.
   iii) If the articles have fixed the duration of the company, the company shall stand dissolved automatically on the expiry of the said period.
   iv) A copy of the resolution passed for voluntary winding up at the creditor's meeting, must be filed with the Registrar within fourteen days of the passing thereof.
   v) Voluntary winding up commences from the date of the passing of the resolution to that effect.
   vi) The remuneration fixed for the liquidators in voluntary winding up cannot be increased in any circumstances.
   vii) The creditors may, if they think fit, appoint a committee of inspection consisting of not more than five members.
   viii) Winding up of a company under supervision of the court presupposes a voluntary winding up of the company.

14.9 LET US SUM UP

A company being a creation of law, can come to an end by the process of law. This process is known as winding up. A company may be wound up in one of the following ways:

i) Winding up by court;
ii) Voluntary winding up; and
iii) Voluntary winding up under the supervision of the court.

The voluntary winding up may be either (a) members' voluntary winding up or (b) creditors' voluntary winding up.

A company may be wound up compulsorily by court (i) if a special resolution to this effect is passed; (ii) if default is made in holding the statutory meeting or filing the statutory report; (iii) failure to commence business within one year of its incorporation; (iv) the number of members falling below the statutory minimum limit; (v) if the company is unable to pay its debts; (vi) any other ground which is just and equitable.

A petition for winding up can be presented (a) by the company; or (b) by creditors; or (c) by contributories; or (d) by the Registrar; or (e) by any person authorised by the Central Government.

In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the court, although they may apply to the court for directions or orders if and when necessary.

A company may be wound up voluntarily (a) by passing an ordinary resolution; (b) by passing a special resolution.

In the case of members' voluntary winding up, the majority of the directors make a declaration of solvency duly verified by an affidavit, that the company has no debts or that it will be able to pay its debts in full within three years from the commencement of winding up.

In the case of Creditors' voluntary winding up, there is no need of declaration of solvency and the resolution for winding up is moved by creditors. It is generally done when the company is unable to pay its debts.

When voluntary winding up is in progress and if any creditor or contributory or liquidator is not satisfied with the winding up proceedings, he may apply to the court requesting for winding up under the supervision of the court.

14.10 KEY WORDS

Winding up: A process by which the life of the company comes to an end.

Dissolution: The company ceases to exist.

Just and Equitable: Any ground, which in the opinion of the court, is reasonable and in the interest of the concerned parties.

Statement of Affairs: A statement containing particulars regarding the assets of the company, its creditors, debtors etc.

Liquidator: A person who helps the court to complete the liquidation proceedings.

Committee of Inspection: A committee appointed to act with the liquidator.

Declaration of solvency: A declaration made by majority of directors at a meeting of the board, declaring that the company has no debts or that it will be able to pay them in full within three years from the commencement of winding up.

14.11 ANSWERS TO CHECK YOUR PROGRESS

A	8	i)	False	ii)	False	iii)	True
		iv)	False	v)	True	vi)	False
		vii)	True	viii)	False	ix)	False
		x)	True				
B	8	i)	False	ii)	True	iii)	False
		iv)	False	v)	True	vi)	True
		vii)	True	viii)	True		

14.12 TERMINAL QUESTIONS

1) What do you understand by winding up of a company? How is it different from dissolution of a company?
2) What is compulsory winding up? Under what circumstances can a company be compulsorily wound up by the court?
3) Who may present a petition for winding up?
4) What are the consequences of a winding up order by court?
5) What is meant by 'declaration of solvency'?
6) When and how can a company be voluntarily wound up? State briefly the consequences of such winding up.
7) Explain the circumstances when the court will consider winding up of the company to be just and equitable.
8) Explain briefly the provisions of the Companies Act as applicable to Creditors' Voluntary winding up.
9) What are the consequences of a winding up order?
10) Distinguish between members' voluntary winding up and creditors' voluntary winding up.
11) Write a note on committee of inspection.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

Bagarial, Ashok K. 1990. *Company Law*. Vikas Publishing House Pvt. Ltd., New Delhi (Chapters 1-4)

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