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COMPANY LAW

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Subject: COMPANY LAW **Credits: 4**

SYLLABUS

Company and its Formation

Public and Private Companies, Formation of a Company, Promoters, Nature and Types of Companies

Principal Documents

Prospectus, Memorandum of Association, Articles of Association

Capital and Management

Directors, Allotment of Shares, Share and Loan Capital

Meetings and Winding Up

Meetings and Resolutions**,** Company Secretary

Suggested Readings:

1. Ramaih, A Guide to Companieis Act, Wadhwa Publications
2. Avatar Singh: Company Law, Eastern Book company, Lucknkow
3. Anantha Raman, Lectures on Company Law, Wadhwa and Company
4. Tadon M.P. ,Company Law, Allahabad Law Agency, Allahabad

PART 1. COMPANY AND ITS FORMATION

CHAPTER 1

Nature and Types of Companies

STRUCTURE

- Learning objectives
- Definition of company
- Main characteristics of a company
- One-man company
- Lifting the corporate veil
- Distinction flanked by a company and a partnership
- Types of companies
- Association not for profit
- Illegal associations
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Describe a company,
- Describe the features of a company,
- Explain the concept of corporate veil,
- Distinguish flanked by a company and a partnership
- Describe the several types of companies, and
- Describe an illegal association

DEFINITION OF COMPANY

The term 'company' implies an association of a number of persons for some general objector objects. In information, 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'. Though this does not create the firm a company in the legal sense of the word, they at 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(l) (i) of the Companies Act, 1956 states that a Company means a company shaped and registered under the Act or an existing Company. An existing Company means a Company shaped and registered under any of the previous Companies Acts. This definition, though, is not exhaustive because it does not reveal the c features of a Company.

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

A company has been defined through Lord Justice Lindley as follows: Esy a company is meant an association of several persons who contribute money or company's worth to a general stock and employs it in some trade or business, and who are the profit and loss (as the case may be) arising there from. The general stock s c contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are described members. The proportion of capital to which each member is entitled is his share. Shares are always transferable a through the right to transfer them is often more or less restricted."

Another good definition has been given through Chief Justice Marsh all. 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 subsistence."

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

From the 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 a self-governing legal entity, a general seal, and perpetual succession.

MAIN CHARACTERISTICS OF A COMPANY

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

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 substance of carrying on a lawful business for profit. It comes into subsistence when it is registered under the Companies Act.

Separate Legal Entity

In the eyes of law, a company shaped and registered under the Companies Act has a separate 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 subsistence. 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 through 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 separate from those of its members; it can sure and is sued exclusively for its own purpose".

Even though the company lacks a physical subsistence, for purposes of law it is regarded as a self-governing legal person who has a personality of its own and is dissimilar from the members constituting the company. So, 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 whole share capital. No member can either individually or jointly claim any ownership rights in the assets of the company throughout its subsistence or on its winding up. Likewise, 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 through referring to the case of Salomon vs. Salomon and Company Ltd. Mr. Salomon was running a shoe business in England. We shaped a company recognized as 'Soioman 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 accepted a floating charge in excess of the assets of the company. One share off 1 each was subscribed for in cash through each member of Saloman's family. Saloman was the managing director of the company. Throughout 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 realized £6,000. The company owed £10,000 to Mr. Saloman and £7,000 to unsecured creditors. Therefore, after paying off the debenture holder (Mr. Saloman), nothing was left for unsecured creditors. The creditors claimed priority in excess of the debentures contending that Mr. Saloman and Saloman and Co. Ltd. were one and the similar person, the company was only a facade to defraud the innocent creditors. Mr. Saloman should not so, be treated as a secured creditor. The Mouse of Lords held that the company had been validly constituted and it had an self-governing subsistence separate from its members. So, 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 information 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 separate entity, and although all the shares may be practically controlled through one person, in law a company is a separate entity. Likewise 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. Therefore, a shareholder can be the creditor of the company.

Limited Liability

A major advantage enjoyed through a company is that the liability of its members is limited. You will later on revise that on the foundation of liability, companies may be classified as

- Companies limited through shares; and

- Companies limited through guarantee.

In the case of former the liability of every member of the company is limited to the amount of shares subscribed through him. If the member has paid full amount of the face value of the shares subscribed through him, his liability shall be nil and he cannot be asked to contribute anything more. Likewise, in the case of a company limited through guarantee, the liability of the members is limited upto the amount guaranteed through a member.

Company and its Formation 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 through the procedure of law.

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 sure 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. Though, a private limited company is required to put sure restrictions on transferability of its shares.

General Seal

In view of the information 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 general 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 necessity has a general seal with its name engraved on the similar. The seal acts as a substitute for the signature of the company. Any document which does not bear the general seal of the company is not binding on the company.

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 subsistence. A company may enter into contracts and can enforce the contractual rights against others and it can be sued through others if it commits a breach of contract.

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 in excess of 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 whole illustrate in such a company, yet such kind of companies are legal.

LIFTING THE CORPORATE VEIL

You learnt that a company has a separate legal entity self-governing and dissimilar from its members. The principle of separate legal entity was well recognized in the well-known case of Saloman v. Saloman and Co. Ltd. On incorporation a row of demarcation or a veil is drawn flanked by the company and its members. In information, 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 shaped a company and given to their association the status of a legal entity.

As a consequence of this separate legal entity, the company enjoys many advantages which you have studied in foregoing paras. But when the company starts by 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 treats the company and its members as similar 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 recognized as lifting the veil of corporate personality."

You should, though, note that the powers of the court to lift the corporate veil are 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:

- Under express statutory provisions, and

- Under judicial interpretations

Under Express Statutory Provisions

The Companies Act, 1956 itself gives for sure 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 beside with the company. These cases are as follows:

- ***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 throughout the time when it accepted on business after those six months and who was aware of this information, shall be severally liable for all debts of the company contracted throughout 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 separate personality but loses the significant characteristic 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.
- ***Non disclosure of representative capability:*** As a rule when an officer of a company or any person on its behalf signs or authorizes to be signed, on behalf of the company, any bill of swap, 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 authorized person fails to disclose his representative capability, such officer, or person shall be personally liable for the amount due if the

company refuses to pay it. For instance, a bill of swap drawn upon a company is accepted through a director in his personal capability 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.

- ***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 described the holding company and the latter as subsidiary company. In common, a subsidiary company is altogether treated as a parate 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 he accounts of its subsidiaries. It requires that the copies of balance sheet, profit and loss account, director's statement, and auditor's statement of each subsidiary company be attached to the balance sheet of the holding company. Therefore, companies under the similar group are treated as one entity disregarding the rule that each subsidiary company has a separate legal entity.
- ***For investigation into affairs of related companies:*** Section 239 of the Act gives that if an inspector is appointed through 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 similar management. The power to do so may therefore lift the veil of incorporation.
- ***For investigation of ownership of a company:*** When the Central Government feels it necessary to know in relation to the membership of any company and also some other matters relating to the company with the substance 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 statement on these matters (Section 247). This will be done through lifting the corporate veil so as to discover out the true persons controlling it.

- ***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 accepted 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 create the fraudulent persons personally liable for the debts of the company

Under Judicial Interpretations

Besides the 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 revise some of the cases where the corporate veil was lifted.

- ***For determination of the character of the company:*** Sometimes, particularly throughout war flanked by countries it becomes necessary to ascertain the character of sure companies. At such times the courts are justified in lifting the corporate veil of a company which is controlled through alien enemy. In this method a company registered in India may be declared alien enemy if it is establish that the persons controlling such a company are citizens of an enemy country. For instance 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 substance of this company was to sell tyres in United Kingdom, which were, manufactured in Germany through a German company. Majority of the shares of this company were held through 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, through by the corporate veil.

- ***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 absent the customers of the company, so extensive as he was in the employment of the company and afterwards. After leaving the company, Horne shaped another company which was to carry on the similar business. This new company of Horne solicited the customers of Gilford Motor Co. Ltd. In a suit filed through 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. Likewise, where a dummy company was shaped to avoid a legal obligation, the court lifts the corporate veil. (Jones v Lipman) Therefore, where a company is shaped to defraud, the court will lift the corporate veil and look into the true ownership of the company.
- ***For protecting the revenue:*** The court will allow piercing of corporate veil if it is of the opinion that the company has been shaped 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 fulfill the revenue obligations. In Re Sir Dinshaw Manekjee Fetit’s case the assesses, Sir Dinshaw who was a very rich man, was earning vast dividend and interest income. He shaped 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 method 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 assesses himself. Sir Dinshaw was held the owner of total income and liable to pay tax.

- ***Where company is shaped to act as an agent of its members:*** As a common rule, a company is not an agent of its shareholders or of another company. But, under sure 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 through 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 through 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 through 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.
- ***Avoidance of Welfare Laws:*** The courts have disregarded of the separate legal personality of the company when the company's self-governing status was being used as a device to reduce the amount payable through 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 shaped with no assets of its own except those transferred to it through the principal Company and its Formation company. The new company had no business of its own, it received dividend on shares transferred to it through the principal company. Therefore, 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 self-governing 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.

DISTINCTION FLANKED BY A COMPANY AND A PARTNERSHIP

You learnt that a company is an artificial person created through law, with limited liability and perpetual succession as its main characteristics. Let us now revise the distinction flanked by a company and partnership; the main points of variation flanked by the two are as follows:

- ***Formation:*** A company comes into subsistence 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 shaped through an agreement flanked by the partners. Registration of a partnership firm is not compulsory under the Indian Partnership Act, 1932.
- ***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 occupied in banking business and twenty in the case of a non-banking business.
- ***Legal status:*** After incorporation, in the eyes of law, a company is recognized as a separate legal personality dissimilar from the members who constitute it, whereas the partnership does not acquire any juristic

status and continues to be only an association of persons even after registration. In easy words, the partners and the firm are one and the similar.

- ***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 through them or upto the amount of guarantee given through them. A creditor of a company cannot proceed against the private properties of a member. Though, in case of a partnership, the liability of partner is unlimited as well as joint and many. 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.
- ***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.
- ***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.
- ***Management:*** The affairs of the company are supervised through 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.
- ***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 through their acts done in the ordinary course of business.
- ***Property:*** In the case of a company, the property of the company is in the name of the company and is owned through it. It does not belong to the individual shareholders of the company. Throughout 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.

- ***Statutory necessities:*** A company is required to comply with several statutory formalities, such as convening the statutory meeting and delivery of statutory statement to the Registrar of Companies, whereas a partnership is not required to perform any such statutory obligations.
- ***Dissolution:*** The corporate subsistence 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 through an agreement.
- ***Governing legislation:*** A company is governed through the Companies Act, 1956, while a partnership is governed through the Indian Partnership Act, 1932.

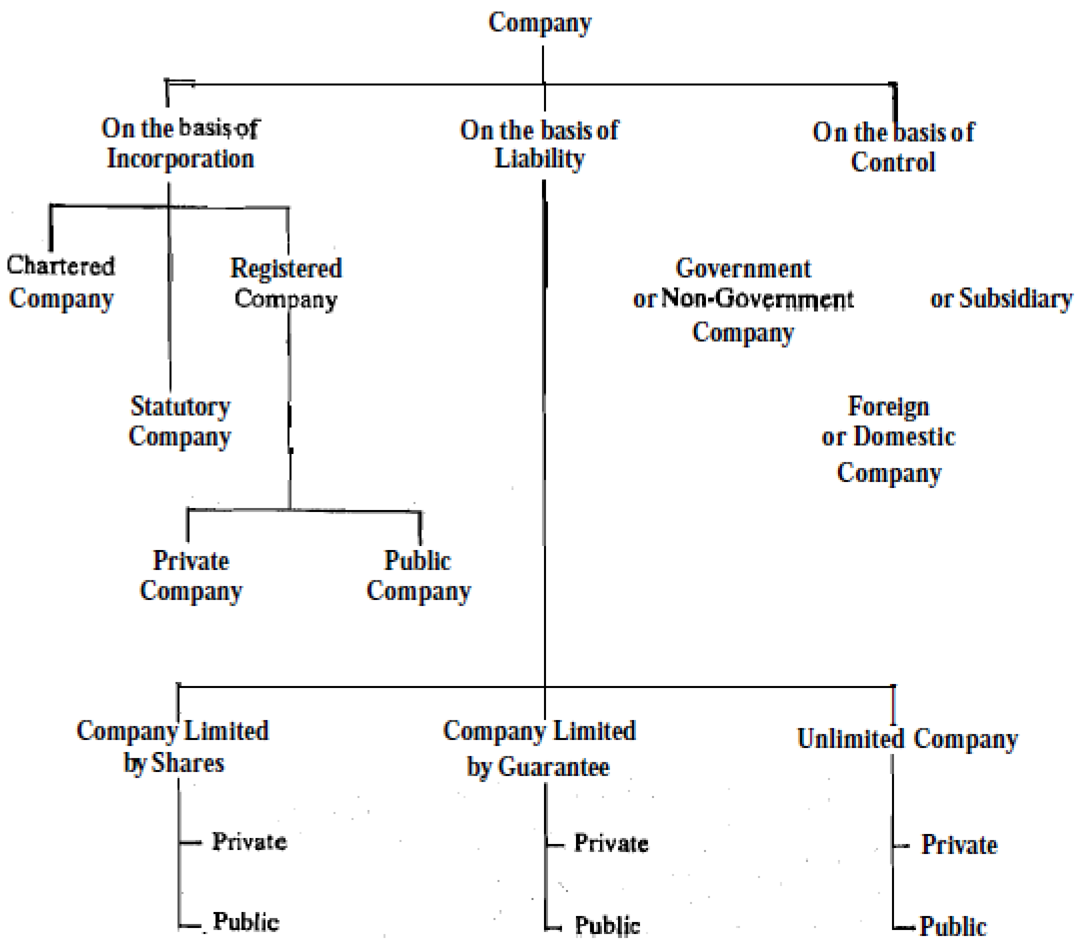
TYPES OF COMPANIES

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

- On the foundation of incorporation
- On the foundation of liability
- On the foundation of control

Look at Figure 1.1 cautiously to have an overall view of the dissimilar types of companies.

Figure 1.1: Kinds of Companies



On the Foundation of Incorporation

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

- ***Chartered company:*** A company incorporated under a special charter granted through the King or Queen of England is described 'chartered company'. A chartered company is regulated through 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 well-known examples of chartered company are the East India Company and the' Bank of England. This kind of company cannot now be shaped in India.

- ***Statutory company:*** A statutory company is one which is created through a special Act of Parliament or a State Legislature. Such companies are usually shaped 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. Though, the provisions of the Companies Act are also applicable to them in so .distant as they are constant 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 mannered under the control and supervision of the Auditor Common of India and the annual statement of working are required to be placed before the Parliament or State legislature, as the case may be. Well-known instance 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.
- ***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 comprises the existing companies. Through existing company we mean a company shaped and registered under any of the previous Acts. A registered company comes into subsistence only when it receives the certificate of incorporation. Registered companies are governed through 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 through 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.

On the Foundation of Liability

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

- ***Company limited through shares:*** A company in which the liability of its members is determined on the foundation of the amount, if any, remaining unpaid on the shares held through them is termed as a company limited through shares'. Such companies are popularly recognized as limited liability companies. The liability of the members is limited to the extent of nominal value of shares held through them. If a member has paid the full amount of shares, then his liability shall be nil. Let us create th]is clear through taking an instance. 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 described through 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 whole 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 throughout the subsistence of the company or throughout the winding up of the company.
- ***Company limited through. guarantee:*** Section 12(12) (b) of the Act gives that a company having the liability of its members limited through 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 through guarantee'. Such companies are usually shaped for the promotion of art, science, culture, sports, etc. It is motivating to note that in a company limited through guarantee, a member is required to pay the amount guaranteed through him only if the company is wound up while he is a member or within one year after he ceases to be a member. Therefore, the members cannot be asked to pay the guaranteed amount throughout the life time of the company. The

memorandum of association of a company limited through 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, though, keep in mind 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 through a guarantee is shaped 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 through guarantee is shaped will share capital, then the members are also liable to pay the unpaid amount on their Mares. Bul the guaranteed amount can be described up only at the time of winding up of the company.

- ***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 through 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 necessity specify the amount of share capital with which the company is to be registered. Such a company necessity has its memorandum and articles of association. The articles of association necessity specify the number of members with which the company is to be registered.

On the Foundation of Control

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

- ***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 through the Central Government or through any State Government or Governments or partly through the Central Government and partly through one or more State Governments and comprises a company which is a subsidiary of a government company as therefore defined". Indian Telephone Industry, Hindustan Aeronautics Ltd. is 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 through the provisions of the Companies Act. Section 620 of the Act, though, gives that the Central Government may through notification in the official Gazette direct that any of the provisions of this Act specified in the notification
- Shall not apply to any government company, or
- 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.

- ***Foreign company:*** A foreign company means a company which is incorporated in a country outside India under the law of that country but has recognized a lay 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 necessity be filed with the Registrar of companies within thirty days from the date of establishment:

- 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,
- The full address of the registered office of the company,
- A list of directors and secretary of the company,
- The names and address of any person resident in India who is authorized to accept, on behalf of the company, service of legal procedure and any notice served on the company; and
- The full address of the company's principal lay of business in India. A foreign company is obliged to state the name of the country in which the Nature and Types of company is incorporated in every prospectus inviting subscription in India for its Companies shares or debentures. The company will also conspicuously exhibit on the outside of every office or lay, 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 common use in the locality in which the office or lay is situated. The name, of the company and of the country where the company has been incorporated should also be staled in legible English; 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 stay at their principal lay 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 Ace relating to the filing of the annual return with the Registrar of companies are also applicable to a foreign company.
- ***Holding and Subsidiary company:*** Usually 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 (Bet us call it Company S) is deemed to be a subsidiary of another company (let us call it Company HI) only in the following cases:

- When the company (Company H) controls the composition of Board of Directors of other Company (Company S),
- When the Company H holds more than half of the equity share capital of Company S in conditions of nominal value. You necessity 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. 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 oases, would the Company S be deemed a subsidiary of Company H,

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 flanked by 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.

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 though, one exception which is provided through Section 25.

This section gives that the Central Government may through license grant that an association may be registered as a company with limited liability, without by the words 'limited' or 'private limited' as part of its name. The license will be granted only in the case of 'association not for profit'. In other words the Central Government will grant the license only if it is satisfied that:

- The association in relation to the to be shaped as a limited company aims at the promotion of commerce, art, science, religion, charity or any other useful substance;
- It intends to apply its profits, if any, for promoting its objects; and
- It prohibits the payment of dividend to its members.

Such companies may ha public or private companies and May or may not have share capital, The Central Government may impose any conditions and circumstances that it deems fit for the grant of the license which shall be binding on the association. The Government Company and its Formation can at any time, after giving notice of its intention, revoke the license given to the association, It would, though, allow the association to present its case against revocation of the license.

ILLEGAL ASSOCIATIONS

Meaning

The law desires to prevent the mischief arising from big trading undertakings being accepted on as unregistered bodies because if business is accepted on through 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 gives 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 shaped unless it is registered as a company under this Act, or is shaped in pursuance of some other Indian law.

It is, therefore, clear from the account that if an association is shaped 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 necessity be registered under the Companies Act or should be shaped in pursuance of some other Indian laws. Likewise, any association shaped 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. If it is not registered, the association will be regarded as an 'illegal association' even if none of the objects for which the association has been shaped is illegal.

Now imagine the situation where an unregistered association is shaped 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 shaped flanked by 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 account 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 shaped for non-commercial purposes such as associations shaped for promoting religion, science, art, or charity etc.

Exceptions

Section 11 does not apply in the following cases:

- ***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 through 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. Though, for computing the number of members of such an association, the minor members of such families shall not be incorporated.
- ***Stock swap:*** A stock swap is not sheltered through Section 11 as it is not shaped for the purpose of carrying on any business.
- ***Non-profit earning associations:*** All religious, charitable, literary, social, sports and other associations whose substance is not to create profit are also not sheltered through Section 11.

Consequences

The consequences of an illegal association are as follows:

- Every member shall be personally liable for all liabilities incurred in such business.
- 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. Though, 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.

- Every person who is a member of such an association shall be punishable with fine which may extend to one thousand rupees.
- An illegal association cannot be wound up under the Companies Act.
- No suit can be filed through any member for partition, dissolution or for taking account of an illegal association.
- Since an illegal association has no legal subsistence, it cannot enter into a contract.
- The illegality of an illegal association cannot be cured through subsequent reduction in the number of its members.

REVIEW QUESTIONS

- "Company is an artificial person created through law with a perpetual succession and is dissimilar from the personality of the member constituting it'. Comment.
- Talk about the concept of corporate veil. Under what circumstances can this veil are lifted?
- Distinguish flanked by a company and a partnership.
- Describe the features of a company.
- Talk about the circumstances in which lifting of corporate veil is justified

CHAPTER 2

Public and Private Companies

STRUCTURE

- Learning objectives
- Meaning of a private limited company
- Meaning of public limited company
- Distinction flanked by a private company and a public company
- Privileges of a private limited company
- Exemptions accessible to an self-governing private company
- Restrictions on a private company
- Conversion of a private company into a public company
- Conversion of a public company into a private company
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Describe a private and a public limited company,
- Distinguish flanked by private and public companies,
- Describe the privileges' enjoyed through 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 circumstances under which a private company is deemed to be a public company.

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, through 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 talk about the implications of each of these restrictions.

- ***Restriction on the right of members to transfer their shares:*** The articles of association of a private company necessity 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 usually give that whenever a member of a private company desires to transfer his shares, he necessity offer them to the existing members at a price to be determined through 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 described a 'closed corporation. The Act, though, 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.
- ***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 flanked by 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 incorporated:
- Persons who are in the employment of the company and through virtue of their employment happen to be members of the company, and
- Persons, who, having been in the employment of the company, were members of the company while in that employment and have sustained 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.

- ***<u>Prohibition on invitation to public:</u>*** This restriction implies that a private limited company necessity not issue a prospectus or any other public invitation, directly or indirectly to the common public so as to invite them to invest in its shares or debentures. The question arises as to how one would ascertain whether an invitation made through the company is in the nature of public invitation or not. The public may contain 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 creation the invitation and those getting it.

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

You should note that since the mentioned three restrictions necessity 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 necessity add the words 'Private Limited' at the end of its name. A private company may be a company limited through shares or (b) a company limited through 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.

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. Therefore, 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 common public to subscribe for its shares. Therefore, 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 swap. It should be noted that the minimum number of members in a public company necessity be seven.

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

DISTINCTION FLANKED BY 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 flanked by the two. The following are the main points of variation flanked by a private company and a public company:

- ***Minimum number:*** For the formation of a public company you require at least seven members, while the minimum number of members required for forming a private company is only two.
- ***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 necessity not exceed fifty.
- ***Name:*** The name of a public company limited through shares of guarantee necessity end with the word 'Limited' whereas the name of a private company limited through shares or guarantee necessity end with the words 'Private limited'.
- ***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 through the articles of association.
- ***Invitation to the public:*** A public company, after issuing a prospectus or a statement in lieu of prospectus, invites the common 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.
- ***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.
- ***Documents:*** The memorandum of association and articles of association of a public company should be signed through seven

members, while in case of a private company; they are required to be signed through 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 through this document alone that the company spaces some statutory restrictions,

- ***Allotment of Shares:*** No public company can allot shares until the amount of minimum subscription has been received through the company. No such restriction is applicable in case of a private company. A private company can allot shares immediately after incorporation.
- ***Share Warrant:*** A public company can issue bearer share warrants. But a private company cannot issue share warrants.
- ***Statutory meeting:*** A public company necessity holds a statutory meeting and files a statutory statement with the Registrar of companies. A private company is neither required to hold the statutory meeting nor file a statutory statement with the Registrar.
- ***Directors:*** A public company necessity has at least three directors whereas a private company necessity has at least two directors. The director of a public company necessity files 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 necessity retires through rotation, while the directors of a private company are not liable to retire through 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.

- ***Special privileges:*** A private company enjoys some special privileges, but a public company enjoys no such privileges.
- ***Quorum:*** In the case of a public company, there necessity is at least five members personally present for holding the company meeting, but in a private company, this number is two.
- ***Managerial remurteration:*** 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.

PRIVILEGES OF A PRIVATE LIMITED COMPANY

You know that in a public company a big amount of public money is invested. So, there is greater need to protect their interests through 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 considerably interested in such companies. So, several of the provisions of the Companies Act are not applicable to a private company. Therefore, a private company is granted a number of exemptions or privileges. These are as follows:

- ***Number of members:*** A private company can be shaped with only two members.
- ***Commencement of business:*** A private company can start its business immediately after its incorporation.
- ***Minimum subscription:*** A private company can allot shares without waiting for the minimum subscription to be received.
- ***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.
- ***Assistance for purchase of shares:*** A private company can help its prospective member or members financially for the purchase of its own shares.

- ***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.
- ***Statutory meeting and statement:*** A private company need not hold a statutory meeting or file a statutory statement with the Registrar of companies.
- ***Provisions concerning 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.
- ***Quorum:*** Only two members who are personally present at the common meeting of shareholders shall form the quorum, unless otherwise provided in the articles.
- ***Demand for Poll:*** If a resolution is being discussed in a meeting and the number of members are seven or less than seven a poll may be demanded through only one member. If more than seven members are present, such a poll may be demanded through only two members.
- ***Managerial remuneration:*** The restriction on the managerial remuneration i.e. per cent of net profit is not applicable to a private company.

EXEMPTIONS ACCESSIBLE TO AN SELF-GOVERNING PRIVATE COMPANY

The several privileges are accessible to every private company whether it is a subsidiary of a public company or a private company 'deemed to be a public company'. But such companies do not enjoy several of the privileges which are enjoyed through an self-governing private company. An self-governing private company has the following additional privileges.

- ***Type of Shares:*** An self-governing private company can issue any class of shares in such shapes and with such voting rights as it deems appropriate. Even shares with disproportionate voting rights can be issued.
- ***Common meetings:*** A private company, if it so desires, can exclude the provisions of Companies Act in respect of common meetings. Through its articles, it can formulate its own provisions to regulate its

common meetings. These provisions may relate to the notice of the meetings, quorum, chairman, proxy, voting and demand for poll. ,

- ***Exemption concerning managerial remuneration:*** The restrictions imposed through the Companies Act concerning the remuneration of directors are not applicable to an self-governing private company. It is also not necessary for such companies to obtain sanction of the Central Government to augment the remuneration of directors. .
- ***Appointment of a firm or body corporate to any office of profit:*** The restrictions concerning the appointment of a firm or a body corporate to a lay of profit under the company do not apply to an self-governing private company.
- ***Augment 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 rising the number of its directors beyond the maximum number mentioned in the articles. No such approval is required in case of an self-governing private company.
- ***Filling of casual vacancies:*** The regulations in respect of filling the casual vacancies in the Board of Directors do not apply to an self-governing private company.
- ***Disqualification of directors:*** The self-governing private company may, through its articles, give special grounds for disqualifications for appointment of directors.
- ***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 does not apply in case of an self-governing private company.
- ***Number of companies:*** A person can be the director of any number of self-governing private companies. The provisions of the Act limiting the number of companies to be supervised through a director to twenty, do not apply to it.

- ***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 self-governing private company.
- ***Inter company loans:*** An self-governing private company can lend money to other companies under the similar management.
- ***Intercorporate purchase of shares:*** The provisions prohibiting the purchases of shares arid debentures of other companies in the similar group do not apply to such a company.
- ***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 affect the interests of the company. Self-governing private companies are exempt from such provisions.

You should though, note that the above privileges and exemptions can be enjoyed through an self-governing private company as extensive as it remnants 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.

RESTRICTIONS ON A PRIVATE COMPANY

Along with the privileges accessible to a private company, some restrictions have also been placed. You have learnt in relation to the three restriction placed on a private company through its articles viz., (a) restriction on the right to transfer shares, restriction on the maximum number of the members exceeding fifty, and 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:

- A private company cannot issue share warrants payable to bearer.
- Under Section 159 private companies are required to send an annual list of their members and a summary of sure 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 incorporated in counting the number of fifty.

- A private company is an annually required to certify to the Registrar that since the last annual common 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 throughout the preceding three years did not exceed ten crores rupees, and (d) the company did not accept or renew deposits from the public.
- 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.

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 lay upon itself or the privileges it wants to enjoy. A private company, after incorporation, may get itself converted into a public company either through its own choice or through a default in meeting the provisions of Section 3 (i) (iii).

In addition, there are sure 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 through operation of law. Let us now talk about the ways in which a private company, through choice or through default, gets converted into a public company.

Conversion through 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:

- The company necessity calls a meeting of its Board of Directors to consider and approve the proposal to convert the company into a public company.
- In accordance with the decision of the Board, the company necessity convenes a common meeting at which the company necessity passes a

special resolution altering its articles of association. The articles necessity is altered in such a method that they no longer contain the restrictions of Section 3(1) (iii); as well as all the provisions which may be inconsistent with the necessities of a public company. The name of the company would also be altered through deleting the word 'private' from the name of the company.

- Within thirty days of the common meeting at which the special resolution is passed, the company necessity files the following documents with the Registrar of companies.
- A copy of the special resolution concerning alteration of the articles,
- A copy of the altered articles, and
- 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.

- If the number of members in the private company is less than seven, the company necessity augments the number of members to seven. Likewise the number of director's necessity is increased to at least three.
- After filing the copy of resolution and the prospectus or statement in lieu of prospers the company necessity applies to the Registrar for a fresh certificate of incorporation. The company usually enters into fresh agreements with its managerial personnel presently before conversion.

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

Conversion through Default

You have learnt that a private company is one which spaces sure restrictions on itself through its articles of association. If it creates 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 accessible to the company. All the provisions of a public company shall become applicable to it as if it was a public company. It necessity though, 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 sure 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 give 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, though, happen that, in excess of a era of time, private companies may, through their enterprise and investments, engage in extensive business and may actually be in a location to control several public companies. At times, other private and public companies may invest their funds in such a private company. In an indirect method, so, public money gets invested in the private companies. There is no cause why such companies should still be allowed the privileges given to private companies.

The Companies Act has provided for such contingencies through creation specific provisions. These provisions are mainly contained in Section 43-A of the Act. Section 43-A gives that if a private company operates on a big level or in some method takes advantage of or utilizes 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. Though, 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 circumstarices described in Section 43-A under which a private company is deemed to be a public company are:

- When twenty-five per cent or more of its paid up share capital is held through one or more bodies corporate, a private company shall automatically became 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 through a bank in the capability 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 through virtue of this section.
- Where the average annual turnover of a private company is rupees ten crores or more throughout the era of three consecutive financial years, the company will be deemed to be a public company on the expiry of a era of three months from the last day of the third financial year throughout 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 realization made from the supply of sharing of goods or on account of services rendered, or both, through the company throughout a financial year".

- 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 through the private company.
- 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. Through the inclusion of a new sub-section (1-C) from 1988, Section 43-A gives that if a private company, after an invitation is made through 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 through virtue of Section 43-A is termed as a 'deemed public company'. Again such a company may carry on with presently 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 gives 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 create 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 makes a special kind of public company (a deemed public company). The special characteristics 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 tiling a statement in lieu of prospectus with the Registrar, does not apply. In all other compliments a deemed public company is treated as a public company.

CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY

You have learnt that under sure circumstances a private company gets converted into a public company. Likewise, 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 through 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 through passing a special resolution in the common meaning of the company. Such a resolution would also be needed to alter the name of the company. Likewise, some alterations would also be necessary in the articles of association to create them relevant to a private company.

Section 31 of the Act specifically gives 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 through the Central Government. When the special resolution in respect of the alteration has been approved through 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.

REVIEW QUESTIONS

- Describe a private company. Distinguish flanked by a private company and a public company.
- Talk about several privileges enjoyed through a private company. Why does law grant these privileges to a private company?
- Enumerate the several restrictions imposed through law on a private company.
- Describe the procedure for converting a private company into a public company.
- Describe a public company. Describe the procedure for converting a public company into a private company.

CHAPTER 3

Promoters

STRUCTURE

- Learning objectives
- Promoter : meaning and importance
- Functions of a promoter
- Legal location of promoters
- Duties of promoters
- Liabilities of promoters
- Remuneration of promoters
- Location of preliminary contracts
- Review questions

LEARNING OBJECTIVES

After learning this chapter, 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 location of preliminary contracts.

PROMOTER: MEANING AND IMPORTANCE

You learnt that a company is an artificial person created through law. A company is born only when it is duly incorporated. For incorporating a company several documents are to be prepared and other formalities are to be complied with. All this work is done through promoters. Gerstenberg has defined promotion as the detection of business opportunities and the subsequent, organisation of funds, property and managerial skill into a business concern for the purpose of creation profits there from. After the thought is conceived, the promoters create detailed investigations to discover out the weaknesses and strong points of the thought, determine the amount of capital required, and estimate the operating expenses and probable income. On being satisfied in relation to the economic viability of the thought, the promoters take all the necessary steps for incorporating the company.

The Companies Act does not describe 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 well-known to the commercial word through which a company is usually brought into subsistence.

Another definition given through Lord Blackburn states that"the term promoter is a short and convenient method of designating those who set in motion the machinery through which the Act enables them to make an incorporated company".

Justice C. Cockburn described a promrer 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 maybe an individual, firm, an association of persons, or a body corporate. Even if a person has taken a very minor part in the promotion behaviors, 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, though, significant for you to keep in mind that everyone who is associated with the procedure of the formation of a company cannot be described a promoter. For instance, a solicitor who draws up the documents of the proposed company in his professional capability is not a promoter in the eyes of law. Likewise, an engineer who advises on the selection of location or a valuer who helps with drawing the estimates would not be regarded a promoter. Section 62 (6) creates it clear that persons assisting the promoters through acting in a professional capability e.g., solicitors, accountants and other experts are not promoters.

It should be clear to you that a promoter is one who performs the preliminary duties necessary to bring a company into subsistence. Therefore, 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 provide it a concrete form.

The promoters, in information, render very useful services in the formation of a company. They render a very useful service to society and they play an significant 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 thought sometimes goes wrong then the time and money spent through them will be a waste.

FUNCTIONS OF A PROMOTER

You learnt that a promoter plays a very significant 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 capability of promoters; they perform the following functions in order to incorporate a company and to set it going.

- ***To originate the scheme for formation of the company:*** Promoters are usually the first persons who conceive the thought of business. They carry out the necessary investigation to discover out whether the formation of a company is possible and profitable. Thereafter, they organize the possessions to convert the thought into a reality through forming a company. In this sense, the promoters are the originators of the plan for the formation of a company.
- ***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 pr a public company, attempt to secure the co-operation of persons needed to form the company. You learnt that the minimum number of members requited to form a public company is seven and that for a private company the minimum number is two. Depending upon the farm chosen, the promoters may decide upon the number of primary members.
- ***To settle in relation to 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 provide 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.
- ***To get the documents of the proposed company prepared:*** As the company itself does not exist before incorporation, this work of preparation of these documents has to be undertaken through 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 promoter's necessity also arrange to get the prospectus prepared and printed.

- ***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 many of these matters. They, so, appoint solicitors to assist them in the procedure of formation of the company. The company is shaped for the purposes of carrying on business and as such deals with funds and their management. The promoters necessity, so, also appoint bankers for the company who will receive share application moneys. If the proposed company is a public limited company, the promoters necessity also ensure the success of the first capital issue made through the company through appointing underwriters and brokers.
- ***To settle preliminary agreements for acquisition of assets:*** The promoters may be required to acquire a appropriate location for the factory, create arrangements for plant and machinery, and may even create tentative arrangements for key personnel. Sometimes in order to run the business the company may be required to take in excess of property of a running business. Promoters fulfill the function of seeing that such property and business is acquired through the proposed company on justifiable conditions.
- ***To enter into preliminary contracts with the vendors:*** In respect of all the properties and assets, the promoters would need to settle the conditions of contracts with the third parties from whom these properties are to be bought. These contracts are described preliminary contracts.
- ***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 several legal formalities for incorporating the company are complied with.

LEGAL LOCATION OF PROMOTERS

You learnt that promoters are responsible for the formation of a company. As such, they inhabit significant location, and have very wide powers relating to the formation of the company. It will, though, be motivating to note that there are no specific statutory provisions in this regard.

The legal location of a promotes is somewhat peculiar. The promoter’s legal location 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 subsistence. 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 necessity be in subsistence. For the similar cause, he also cannot be described the trustee of the company.

Though, it does hot mean that the promoters do not have any legal connection with the proposed company. The legal location of a promoter can be correctly described through saying that he stands in a fiduciary location (connection of trust and confidence) in relation to the company he promotes,

Lord Cairns has rightly stated the location of promoter in Erlanger V. New Sam brers Phosphate Co. "The promoters of a company stand undoubtedly in a fiduciary location. They have in their hands the creation and molding of the company. They have the power of defining bow and when and in what form, and under whose supervision, It shall come into subsistence and begin to act as a trading corporation," In information, the promoters inhabit a fiduciary location 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 connection means a connection of utmost trust and confidence and implies disclosure of all material facts. Being in a fiduciary location, the promoter necessity not create, either directly or indirectly, any profits at the expense of the company that he promotes, without the knowledge and consent of the company.

DUTIES OF PROMOTERS

In the section you have presently learnt that the promoter occupies a location of total confidence and trust in relation to the company promoted through him. The promoter in this fiduciary capability has the following significant duties.

- ***Not to create any secret profit:*** A promoter cannot create any direct or indirect profits out of the promotion of the company, since he occupies a location of a trust, it is his duty to be honest and uphold the trust of his location. You necessity clearly understand that the law does not forbid the promoter from creation a profit. The law prohibits only the creation 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 create a profit provided they disclose information to an self-governing Board of directors. If there is no self-governing Board of Directors, then he necessity disclose the profits to the planned shareholders.

- Recording the contract — The Company may on learning of the secret profit, rescind the contract entered into through the promoter to create the said profit.
- Order for refund — The Company may require the promoter to refund the amount of secret profit.
- Suit for breach of duty — The Company may sue the promoter for misfeasance, as the promoter, through creation the secret profit, has defaulted in his duty towards the company.
- ***To create full disclosure to the company of all relevant facts:*** In keeping with his fiduciary capability, 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 creation a disclosure the promoter necessity create the full and complete disclosure. If he contracts to sell his own property to the company without creation a full disclosure, the company may either repudiate the contract or affirm the contract and recover the profits made through the promoter. Let us explain these fiduciary duties of the promoter with the help of an instance. He 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 shaped, the purchase agreement of land was approved at the meeting of the shareholders but the information of A's ownership and the profit made through 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 through him in the sale of land. You would

observe that in this case A' had defaulted in his duty to create full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure through the promoters of the profits they were creation the company is entitled to rescind the contract. A' could have retained the profits trade through 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.

- ***To provide the benefit of negotiations to the company:*** The promoter necessity pass on to the company, the benefit of any negotiation or agreement that he has accepted on in his capability of a promoter. For instance, when he has negotiated a sure price for some land for the company, he necessity 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 cause, 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 through promoters. Though, 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 necessity act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.
- ***Duty of promoters towards future allottees:*** The promoters stand in a fiduciary location towards the company. It does not mean that they stand in such relation only to the company but they also stand in this location to the future allottees of shares. The promoters necessity ensure that the prospectus issued at his instance contains all material facts and particulars and does not contain any mis-statements.

LIABILITIES OF PROMOTERS

You have presently gone through the duties of a promoter in his fiduciary capability and learnt that in the event of any breach the promoter can be made liable to hand in excess of to the company, any secret profit made through him. The company can also file a suit for recession of the contract of sale made through 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:

- ***Set out in the prospectus:*** If this provision is not compiled with, the promoter may be held liable through the shareholders.
- ***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, through 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 through him on account of the untrue statements made in the prospectus. Under Section 62 specific provisions have also been made of the ground on which the promoted can avoid his liability. These remedies are general persons who can be held liable for mis-statement in the prospectus.
- ***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 through 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 Wars immaterial or that he was justified in believing, because of reasonable grounds, that the statement was true at the time of issue of prospectus.
- 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 statement alleges a fraud in the promotion or formation of the

company, the promoter can also be held liable for public examination through the Court, like any other director or officer of the company.

- Section 543 of the Act gives for the liability for misfeasance or breach of trust through misapplication of funds throughout 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 establish guilty of breach of trust or misfeasance in relation to the company,
- Section 203 gives that the court may suspend a promoter from taking part in the management of the company distant a era of five years if he is convicted of any offence in connection with the promotion, formation or management of a company.
- The promoters are personally liable for pre-incorporation contracts. Even the death of the promater does not relieve him from this liability.

REMUNERATION OF PROMOTERS

Before the company is brought into subsistence he has to complete all the formalities, spend considerable ability and effort, and organize necessary possessions so that the company can be shaped. He has to incur preliminary expenses as well. For all these significant behaviors and his considerable effort he should be suitably remunerated. Though, he is also in a peculiar location for doing all these behaviors for a company that is not yet in subsistence. The promoters cannot claim as a matter of right any remuneration from the company. He, so, is not entitled to recover any remuneration for his services unless the company after getting shaped enters into a specific contract with the promoter for this purpose. You necessity 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 subsistence. There are also cases where the articles of a company may specifically give that a specified sum may be paid to the promoters as remuneration for their services. While this provision provides the director an authority to create such payment, it does not provide the promoters a right to claim remuneration or to sue the company, for the similar. In actual practice, so, the company, once it is registered, usually agrees to pay some remuneration for the valuable services rendered through the promoters. This remuneration may be paid to the promoters in any of the following ways:

- 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 in relation to the valuation and the profit earned to an self-governing Board of directors.

- If the promoter has purchased some business or some other property to be sold to the company, he may sell the similar to the company at a higher price after creation a full disclosure of the price paid' and the profit earned.
- The company may allot to the promoters fully paid up shares of the company.
- He may be paid a sure lump-sum through the company as a remuneration for services rendered.
- He may be given a commission at a fixed rate on the shares sold.
- The company may provide him an option to subscribe for a sure number of the company's unmissed shares at par. This option is usually limited to a sure era which means that the promoter necessity subscribe to the shares within a sure 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 necessity be disclosed in the prospectus, if the remuneration is paid within two years preceding the date of the prospectus.

LOCATION OF PRELIMINARY CONTRACTS

In order to fulfill the necessary formalities and organize the required possessions 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 usually entered into through the promoters in order to acquire some property or some rights for the company that they are interested in promoting. All such contracts entered into through the promoters with the third parties for the proposed company (before incorporation) are described ‘‘preliminary contracts'.

You necessity note that such preliminary or pre-incorporation contracts are not legally binding on the company even after its incorporation. The cause 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 necessity have been in subsistence 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 location of these contracts can be explained as follows.

- On registration, the company is not bound through the preliminary contracts — a company is not bound through the preliminary contracts even if the company has taken the benefit of the work on its behalf under the contract. For instance, a solicitor was appointed through the promoters of the company and was instructed through them to prepare the articles and the memorandum of the company. The solicitor also 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 through him. It was held that since the company was not in subsistence when these expenses were incurred, the company is not bound to pay.
- The company cannot enforce preliminary contracts — you necessity note that presently as the company cannot be held liable for the preliminary contracts, it also cannot enforce such contracts made before incorporation, through the promoters. This means that on account of a preliminary contract the company does not get a right to sue the third party for fulfillment of the contract. For instance, 'X' the owner of a piece of land in Assam agreed to lease it to a company to be shaped through promoters A, B, and C. The promoters later on shaped a company described M.Pvt. Ltd. On some prospecting of the land, it was exposed 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 subsistence when the lease was signed. In relation to the above two principles, significant provisions have been made in our country in the Specific Relief Act, 1963. These provisions give an significant 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 through conditions of incorporation, specific performance may be obtained through or against the company, if the

company has accepted the contract after the incorporation and has communicated such acceptance to the other party". The term "contracts for the purposes of the company" means contracts which are necessary for the incorporation and working of the company. For instance, contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the manufacture 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.

- The company cannot ratify the preliminary contracts — after incorporation the Company cannot ratify the contracts shaped before its subsistence. You will recall from your revise of the Unit on agency that for valid ratification of a contract, it is essential that the principal necessity 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 subsistence when the preliminary contracts were made; it could not be bound through any purported ratification. What the company can' do is to enter into a new contract with the vendors after incorporation to provide effect to the conditions of the contract made before incorporation.
- Liability of the promoter for preliminary contracts — the promoters are personally liable for contracts made for a company which is not yet in subsistence. You have already learnt that the company is neither bound nor entitled on account of a preliminary contract. So, it is the promoters alone who remain personally liable for the preliminary contracts. The cause for this is that the preliminary contract is made for a company which, as recognized to both the contracting parties, is as yet non—existent. The contract, so, is deemed to be personally entered into through the promoters and they will be held personally liable for

the performance of these contracts. The preliminary contracts made through the promoters usually 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 era either party may rescind the contract in such a case liability of the promoter will cease on the expiry of the specified era.

REVIEW QUESTIONS

- Describe the term 'promoter' and explain the functions performed through him.
- Talk about the legal location of a promoter.
- What are the fiduciary duties of a promoter towards a company promoted through him?
- Talk about the liabilities of a promoter.
- What do you understand through preliminary contracts? Talk about (a) the location of the company in relation to the preliminary contracts, and (b) the liability of the promoter for a preliminary contract.

CHAPTER 4

Formation of Company

STRUCTURE

- Learning objectives
- Stages in the formation of a company
- Promotion
- Documents to be filed with the registrar
- Incorporation
- Commencement of business
- Review questions

LEARNING OBJECTIVES

After learning this chapter, 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.

STAGES IN THE FORMATION OF A COMPANY

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

- Promotion
- Registration or incorporation, and
- Commencement of business

Each of the above stages comprises specific behaviors to be undertaken. Figure 4.1 provides you an overview of the behaviors involved in the several 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 registration fee • Application for suitable name • Preliminary 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.

PROMOTION

After detection of the business thought and judging its soundness, the promoters organize the necessary possessions for giving form to their business thought. They negotiate for, and obtain the required property, the necessary plant, and machinery 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 shaped only for a lawful purpose. The purpose of the company may be unlawful if it is:

- Against any provisions of the company law, or
- Against the provisions of any other law applicable in India.

In case of a company with limited liability, the liability of members may be limited either through shares or through 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 appropriate names in order of preference and would then apply on prescribed form to the Registrar for registration.

Section 20 of the Act gives that no company shall be registered through a name, which in the opinion of the Central Government, is undesirable i.e., the name should not be identical with, or too almost resemble, a name through which a company is already in subsistence.

Before an application for registration is filed with the Registrar of Companies, the promoters shall take the necessary steps for preparing the significant 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. Though, a public company limited through 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 through each subscriber who should provide his address, account and job, if any, in the attendance of at least one witness who shall attest the signature, and the witness is also required to provide his address and account of his job, if any. The articles of association should also be signed separately through subscribers. Though, it is not necessary that the promoters themselves should sign the memorandum and articles. These documents may be signed through' an agent provided he is authorized through 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 provide a written undertaking to take up and pay for their qualification shares.

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 necessities of the Act and the rules there under 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 sure other necessities of the Companies Act with respect to registration. They may contain (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 through issue of shares or debentures, and (iv) preparing prospectus or a statement in lieu of prospectus, as the case may be.

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:

- ***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 shaped. The memorandum through its clauses, describes the whole character of the company. This comprises its objectives, its name, the nature of its liability, the address of its registered office, the capital which the company is authorized 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 dealings 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.
- ***Articles of Association:*** The articles of association contain the rules and regulations for managing the internal affairs of the company and, so, govern the connection flanked by the company and its members. A private company necessity 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. It is not necessary for a public company limited through shares to file the articles of association. If a public company does not file its articles and chooses to remain silent in relation to the similar, 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 through subscribers and they should also be attested through a witness.
- ***Copy of the proposed agreement:*** According to the Companies Amendment Act, 1988 a clause has been inserted in the Act which gives 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 beside with the other documents.

- ***Statement of nominal Capital:*** In case of a company limited through shares or through guarantee, and having a share capital, the promoters necessity also file a statement declaring the amount of nominal capital with which the company is proposed to be registered. Normal capital is also described the 'authorized capital It means the amount of capital which a company is authorized to issue. The nominal capital is divided into shares of a uniform fixed value. The authorized capital necessity 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 crores 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.
- ***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, through 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. 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 provide a written undertaking to take up and 'pay for their qualification shares.
- ***Statutory declaration:*** Lastly, the promoters necessity file a statutory declaration in the prescribed form stating that all necessities of the Companies Act and its rules relating to registration have been complied with. This declaration may be signed through any of the following,
- An advocate of the Supreme Court or of a High Court; or
- An attorney or a pleader entitled to appear before a High Court; or
- A secretary, or a chartered accountant practicing in India and who has been occupied in the formation of the company; or

- Through a person named in the articles as a director, manager or secretary of the company.

INCORPORATION

When the necessary documents have been delivered to the Registrar and the requisite fees paid, the Registrar shall scrutinize these documents and if he is satisfied that (a) all the documents are in order, (b) all the necessities of the Companies Act in respect of registration have been complied with, and (c) the objects for which the company is to be shaped are lawful; he shall enter the name of the company in the Register of Companies maintained through his office. He would then issue a certificate, under his signature, certifying that the Company is incorporated. This certificate is described 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 general seal. The company comes into subsistence 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. Though, in case of a private company, the necessary documents viz. , the memorandum of association and the articles of association should be signed through 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. Though, the articles of a private company necessity be registered with the Registrar and it necessity incorporate the restrictions imposed through Section 3(l) (iii) of the Companies Act.

Conclusiveness of Certificate of Incorporation

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

In this case, the memorandum was establish 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 mainly 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 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 ground whatsoever. In Moosa Goolam Arif v Ebrahim Goolam Arif, the memorandum of association of a public limited company was signed through 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 information that the company came into subsistence 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 proof of all that it contains. Hence, the company shall be deemed to have been shaped on 6th January and allotment of shares was valid.

It should, though, 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 accessible is to wind up the company.

Effects of Registration

You have presently learnt that the certificate issued through the Registrar of Companies is described the 'certificate of incorporation'. This certificate is a very significant 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 separate from its members. Section 34 clause 2 describes the effects of registration which are as follows:

- 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 through the name contained in the memorandum of association. It becomes a legal person. The company's life starts from the date of its incorporation.
- The company acquires a perpetual succession. The consequence of it may be understood better through an instance. If a company had ten shareholders and all of them die at the similar time in a train accident, the company's subsistence will not be affected. 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.
- The company will have a general seal.
- The company can sue and be sued in its own name.
- A private company is entitled to commence business immediately after obtaining the certificate of incorporation.
- Liability and debts of the company are not the liability of the shareholders 1 members. They are, though, 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.

- The company will hold its property in its own name. The property of the ' company is not the property of the shareholders.
- The memorandum and articles of association become binding on the members and the company. This articles are deemed to be a contract flanked by the company and its members and would, after incorporation, govern the rights
- Of members against the company
- Of company against the members, and
- Flanked by members inter se.

COMMENCEMENT OF BUSINESS

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

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

- 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,
- every director has paid to the company, in cash, the application and allotment money on the shares taken or contracted to be taken through him:
- 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 recognized stock swap:

- where the shares of the company are to be quoted on the stock swap, requisite application necessity have been submitted to the stock swap and approval obtained within the stipulated time;
- the prescribed stamp duty as prescribed through the Indian Stamp Act and as prevalent in that State in which the company is registered is paid;
- a treasury challan showing payment of prescribed fee is attached; and
- 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 through one of the directors or the Secretary of the Company. Where the Company has not appointed a Secretary, the declaration may be verified through a practicing 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

- The company files with the Registrar, a statement in lieu of prospectus, beside with the statement specified in Part II of Schedule III. The statement should be filed with the Registrar at least three days before the first allotment.
- 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 through him
- 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 circumstances have been complied with and should be verified through one of the directors or the Secretary of the Company. In case the company has not appointed a Secretary, the declaration may be verified through a Secretary in whole time practice (Section 149).

When the necessities are duly fulfilled, the Registrar shall issue a certificate recognized as 'certificate of commencement of business'. This document certifies that the company is entitled to commence business and is also a conclusive proof of the information 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 throughout which the default continues [Sec... 149(6)]. It should be noted that the company necessity commence business within one year of its incorporation or otherwise it is liable to be wound up through the Court [Sec.433(c)].

You should, though, 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 motivating question arises as to the location of contracts entered into through 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. So, if a company enters into contract after its incorporation but never gets the certificate to commence business, contracts of entered shall not be binding upon the company. Though, on the issue of the commencement certificate, such contracts become automatically binding on the company and need no ratification. Let us explain this point through taking an instance. AJ 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.

REVIEW QUESTIONS

- Describe the term 'promoter' and explain the functions performed through him.
- Talk about the legal location of a promoter.
- What are the fiduciary duties of a promoter towards a company promoted through him?
- Talk about the liabilities of a promoter.
- Is a promoter entitled to remuneration for the services rendered through him throughout the formation of the company? List the ways in which a promoter might be given remuneration.

PART 2. PRINCIPAL DOCUMENTS

CHAPTER 5

Memorandum of Association

STRUCTURE

- Learning objectives
- Meaning and purpose of memorandum
- Form of memorandum
- Contents of memorandum
- Alteration of dissimilar clauses in the memorandum
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain the meaning and purpose of Memorandum of Association
- Describe the dissimilar shapes of Memorandum of Association
- List the dissimilar clauses of the Memorandum of Association
- Explain the doctrine of ultra vires
- Explain the procedure for alteration of dissimilar clauses of Memorandum of Association.

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 well-known 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 circumstances upon which alone the company can be brought into subsistence. It tells us what the company can do as specified in its objects clause. The objects clause is an significant clause in the Memorandum, as it tells us the scope of behaviors of the company. The company's actions cannot go beyond this clause. Therefore, it defines as well as confines the sphere of behaviors 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 through law to be void.

The Memorandum of Association is a public document open for inspection through any member of the public, so, 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 behaviors. Therefore the intending shareholder can discover out the field in, or the purpose for which his money is going to be used through the company and what risk he is taking in creation 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 create with the company is within the objects of the company or not. In case, he discovers 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 planned contract.

FORM OF MEMORANDUM

Section 14 of the Companies Act, 1956, requires that the Memorandum of a company necessity be in one of the Shapes given in Schedule 1 to the Companies Act, 1956 as may be applicable to the case of the company, or in a Form as close to thereto as circumstances admit. The dissimilar shapes are applicable to dissimilar kinds of companies.

The following model Shapes of Memorandum are given in the aforementioned schedule:

- Table B : A Company limited through shares.
- Table C: A Company limited through guarantee and not having a share capital.
- Table D: A Company limited through guarantee 'and having a share capital.
- Table E : A Company having unlimited liability.

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

CONTENTS OF MEMORANDUM

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

- 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.
- The name of the state, in which the Registered Office of the company is to be situated, the objects of the company, stating separately as (i) "Main objects" and (ii) "Other objects" not incorporated in (i).
- The declaration in the case of a company limited through shares or through guarantee that the liability of the members is limited.
- In the case of a company having a share capital,
- 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),
- 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 provisions of Section 13, we may list the following main clauses of the Memorandum of Association:

- Name Clause
- Situation Clause (Registered office clause)
- Objects Clause
- Liability Clause
- Capital Clause
- Association Clause (Subscription clause)

Name Clause

The Memorandum of every company necessity 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 necessity have its name through which it will be recognized.

A company may choose any name but it necessity not be undesirable in the opinion of the Central Government (Section 20), The Department of Company Affairs (the Government of India) has formulated sure guidelines for deciding cases of creation a name accessible 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 sure 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. Therefore 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 necessity be painted or affixed on the outside of every office or lay of business in a conspicuous location, in letters easily legible, in the language in common use in the locality. It necessity 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).

Registered Office Clause

This clause states the name of the State in which the Registered Office of the company will be situated. Every company necessity have a registered office, which establishes its domicile. In information, it is also the address where company's statutory books necessity 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).

Objects Clause

This clause defines the objects of the company and therefore designates the sphere of its behaviors. 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 through the: assent of the whole body of shareholders;

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

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

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

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

You should note that the objects of the company necessity not be illegal, immoral, or opposed to public policy or in contravention of the Companies Act, 1956, For instance, Section '77 prohibits a company from purchasing its own shares, Section 209 prohibits payment of dividend out of capital. Therefore 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 necessity be cautiously drafted but it necessity 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.

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. So, this clause shall not be incorporated in the case of an unlimited company. As you know that a company may be limited through shares, or through guarantee. In case the company is limited through shares, the liability clause necessity state that the liability of the members shall be limited through shares. It means that the liability of a member is limited to the nominal value of shares held through him. In case the shares are partly paid, then no member can be described upon to pay more than the amount that remnants unpaid on his shares. Therefore, a member is liable to pay only the unpaid amount on his shares and no further. For instance: A shareholder holds a Rs. 10 share and has paid Rs. 7.50 on it so distant. He can be described upon to pay Rs, 2.50 and nothing more.

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

In case of a company limited through 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 through 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 described upon to pay and he is also liable upto the amount of guarantee, whatever it may be, but only if he is described upon to contribute to the assets of the company at the time of winding up.

Capital Clause

This clause necessity indicate the amount of capital with which the company is registered, and is recognized as Registered or Authorized 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. Therefore 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 sure fixed value or amount. This fixed value is recognized as the "Par" or "nominal" value of a share. Therefore 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 arc authorized through the Memorandum.

Association Clause or Subscription Clause

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

- "We the many persons whose names and addresses are subscribed, are desirous of being shaped 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 through 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 attendance of at least One witness who necessity attest the signature. Each subscriber necessity take at least one share and write opposite his name in the memorandum the number of shares he is subscribing for.

Doctrine of Ultra Vires

The term 'Ultra' means 'beyond' and the term arise means the 'powers. Therefore, 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, so, any act which is beyond the stated purposes is ultra vires the company and, so, null and void. The company shall not be bound through 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:

- The members of the company know the purposes for which their money can be used through the company.
- The third parties dealing with the company know the purposes for which the company has been brought into subsistence and, so, restrict their transactions with the company to those purposes only. Likewise, the creditors are assured that the assets of the company shall not be risked in unauthorized business.

Therefore in order to protect the interests of the shareholders and the third parties who enter into contracts with the company, the company's behaviors 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 measured ultra vires (beyond capability) and void ab-initio.

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

- Ultra vires the Companies Act,
- Ultra vires the Memorandum of Association, and
- Ultra vires the Articles of Association.

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 through a unanimous resolution of all the shareholders. A few examples of such acts are as follows:

- Payment of dividend out of capital
- Free sharing of bonus shares
- Purchasing its own shares
- Reducing the share capital without complying with legal formalities.

Ultra vires the Memorandum

The Memorandum defines and confines the powers of the company. The substance of the company is determined through the Memorandum. A company cannot do anything which is beyond the purview of the objects clause. Any act done in contravention of the substance clause shall be ultra vires the Memorandum and shall be void and it cannot be ratified even through an unanimous resolution of all the shareholders. The doctrine of ultra vires was first applied in the well-known case of Ashbury Railway carriage and Iron Co. v. Riche. In this case the company was incorporated to create, and bell, or lend on hire, railway carriages, and wagons and to carry on the business of mechanical engineers and common contractors. The directors of the company entered into a contract with Riche, a firm of railway contractors to finance the construction of a railway row in Belgium. The contract was ratified through the company through passing a special resolution at a common meeting. Later, the contract was repudiated through 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 so void. It could not be ratified through the shareholders, as the contract was ultra vires the objects clause. The doctrine of ultra vires has been recognized in India as well. The doctrine has been affirmed through the Supreme Court in A. L. Mudaliar v. LIC of India.

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 instance, payment of interest on 'advance calls' at a rate higher than allowed through the articles. Such act shall also be void, but the company in Common Meeting may alter the articles through a special resolution and ratify unauthorized acts.

Effects of Ultra vires transactions:

- All act which is ultra vires the company shall be null and void and it cannot be enforced against the company.
- An ultra vires the company transaction cannot be ratified even through the whole body of shareholders.
- Not only the outsiders cannot enforce ultra vires transactions against the company, the company can also not enforce such transactions against third parties.
- Whenever an ultra vires act has been or is in relation to the 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.
- The directors of the company can be held personally liable for any loss caused through an ultra vires transaction.

It should be clear to you that if an act is ultra vires the company, then such act shall be null and void. Therefore, 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 directors, but it is with in the powers of the company then such an act is not altogether void. It can be ratified through the shareholders in their common meeting and when it is so ratified, the company becomes liable for such acts. Now, if the company has power to borrow, but it restricts the authority of the directors to borrow upto a sure sum. If the directors exceed their authority and borrow more than what they are authorized 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 lay.

ALTERATION OF DISSIMILAR CLAUSES IN THE MEMORANDUM

You have learnt that the Memorandum of Association is a document of prime importance, and so, it cannot be altered through the sweet will of the members of the company. The Companies Act, 1956 has laid down the procedure for altering the several clauses of the memorandum and the similar has to be followed strictly. Let us now talk about the procedure for creation alterations in the dissimilar clauses of the memorandum.

Change of Name

The name of a company may be changed at any time through (i) passing a special resolution at a common meeting of the company and with (ii) the written approval of the Central Government. Though, 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 measured through the Central Government as undesirable, it may change its name through passing an ordinary resolution and obtaining the approval of the Central Government.

The change of name-necessity 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.

Change of Registered Office

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

The Registered Office of a company may be shifted from one state to another through passing a special resolution at its Genera) Meeting. Further this special resolution is required to he confirmed through the Company Law Board. The Company Law Board, before confirming the special resolution, will satisfy itself that enough notice has been given to every credit and all other persons whose interests are likely to he affected through 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 provide an opportunity, to members and creditors of the company, the Registrar of companies and other persons interested in the company. The Company Law Board has authority to confirm the special resolution of the company subject to such conditions and circumstances as it thinks fit.

The company in 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, with 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, then the alternation shall at the expiry of such era, become void and inoperative. Once the Company has shifted its Registered Office to the new state, then it necessity send to the Registrar of that state, the address of the Kegistered 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 sure purposes only. These are mentioned below under the heading "change of objects clause."

Change in Objects Clause

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

- To carry on its business more economically and more efficiently,
- To attain its main purpose through new or improved means,
- To enlarge or change the local area of its operation,

- To carry on some business which under the existing circumstance may be conveniently or advantageously combined with the business of the company,
- To sell or dispose of the whole, or any part of the undertaking of the company,
- To restrict or abandon any of the objects specified in the memorandum or
- To amalgamate' with any other company or body of persons.

The company is under an obligation to file a printed or a kind 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 common 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 through the alteration. Also the notice necessity have been served on the Registrar of companies and the State Government. The Company Law Board will provide an opportunity, to all those to whom notice has been given, to be heard, There upon, on being satisfied the Company Law Board may confine the alteration either wholly or in part or subject to such circumstances as it thinks fit.

The company is under an obligation to send a certified copy of the order of the Company Law Board jointly 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 will register them and issue, within one month, a certificate which will be conclusive proof 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 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 era, become void and inoperative.

Change in Liability Clause

You know that one of the main characteristics of a company is the limited liability of members. Ordinarily, the liability clause cannot be altered so as to create the liability of the members Memorandum of Association unlimited.

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

Change in Capital Clause

The nominal or registered or authorized capital of a company may be increased as provided in section 94 of the Companies Act, 1956. A company limited through shares, if so authorized through its articles, may alter that condition of its Memorandum so as to augment its share capital through such amount as it thinks expedient through issuing new shares. This power to augment the authorized capital can be exercised through a company from time to time. Usually, this power is exercised when the company has issued all its authorized capital and requires more funds. Therefore , the share capital may be increased from Rs. 20,000 in 2000 equity shares of Rs. 10 each, through 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 necessity be made through the company in Common Meeting. An ordinary resolution is enough to create the alteration. The notice convening the meeting should specify the proposed augment or dissimilar kind of capital.

Where the capital has been increased, notice thereof necessity be filed with the Registrar of Companies. Also a copy of the resolution authorizing the augment necessity be submitted to the Registrar of Companies within 30 days of the passing thereof. Thereupon the Registrar of Companies shall record the augment and also create 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 throughout which the default continues.

REVIEW QUESTIONS

- What do you understand through Memorandum of Association?
- What is the purpose of Memorandum of Association?

- Enumerate the dissimilar clauses which are incorporated in the Memorandum of Association.
- Illustrate the Doctrine of ultra vires with appropriate examples.
- Describe the procedure for alteration of the objects clause of a company.

CHAPTER 6

Articles of Association

STRUCTURE

- Meaning and purpose of articles
- Registration of articles
- Contents of articles
- Alteration of articles
- Connection flanked by memorandum and articles
- Distinction flanked by memorandum and articles
- Effect of memorandum and articles
- Constructive notice of memorandum and articles
- Doctrine of indoor management
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain the meaning and the purpose of articles of association
- Describe the contents of articles of association
- Explain the connection of and distinction flanked by 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.

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 enough to explain its meaning.

The Articles of Association of a company are the rules and regulations relating to the 16 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.

Therefore ‘Articles’ is subordinate to, and controlled through 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 accepted 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-à-vis the members are incorporated 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 through whatever is contained in the Articles. In information, the Articles bind the company and the members as if they had been signed through each one of them.

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

Further, Articles of Association of a company constitute a contract not only flanked by members and the company; but members inter se also.

REGISTRATION OF ARTICLES

Section 26 of the Act requires that every private company, an unlimited company, and a company limited through guarantee necessity have their own articles and it should be registered beside with the memorandum. But a public company limited through shares need not necessarily have its own articles. A public company limited through 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 customized. In other words, there are three possible alternatives in which a public company limited through shares may adopt Articles of Association. These are:

- It may adopt Table A in full; or
- It may wholly exclude Table A and set out its own Articles in full; or
- 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 necessity contain die 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 through guarantee, the articles should state the number of members with which the company is to be registered [Section 27 (2)]. The Articles of Association necessity be printed, divided into paragraphs, numbered consecutively and signed through each subscriber of the Memorandum of Association in the attendance of at least one witness who shall attest the signature and shall likewise add his address, account and job, if any [Section 30].

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:

- The exclusion, wholly or in part, of Table A, in the case of a public company limited through shares. But other companies may, if they so desire, contain the relevant provisions from Table A in their Articles of Association.
- Share capital—shares and their value and its division into equity and preference shares, if any.
- Rights of each class of shareholders and the procedure for difference of their rights. Procedure relating to the allotment of shares, creation of calls and forfeiture of shares. Augment, alteration and reduction of share capital.
- Transfer and transmission of shares.
- Lien of the company on shares allotted to the members for the amount unpaid in respect of such shares.
- Appointment, remuneration, power, duties etc. of the directors and officers of the company.

- Conversion of shares into stock.
- Notice of the meetings, voting rights of members, quorum, poll, proxy, etc.
- Audit of Accounts, transfer of amount to the Reserves, declaration of dividend, etc. Borrowing Powers of the company and the mode of borrowing.
- Adoption of preliminary contracts, if any.
- Issue of share certificates.
- Issue of share warrants.
- Keeping of dissimilar Registers
- Concerning winding up of the company.

The Articles of Association necessity be prepared cautiously and it necessity 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 necessity keep in mind that the articles necessity not contain anything which is against the provisions of the Companies Act or the Memorandum of Association. For instance, the Articles necessity 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.

ALTERATION OF ARTICLES

You know that the Articles contain the rales 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 through following the procedure laid down in the Act.

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

Though, 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 through 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 provides wide powers to the members of the company to alter its Articles. Though, 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 method as to be contrary to whatever is given in the Company's Act, or the company'; Memorandum of Association. For instance, the Companies Act, 1956 prohibits a company from purchasing its own shares. Now, the company cannot alter its Articles in such a method as to empower itself to purchase its own shares. Therefore, there are sure limits within which the alteration of Articles can be accepted out.

Limitations on Power to Alter Articles

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

- The alteration in the Articles proposed to be made necessity not be in disagreement with whatever is contained in Memorandum of Association.
- The alteration in the Articles necessity not be inconsistent with any provisions of the Companies Act, 1956. For instance, Sections 106-107 deal with the procedure for difference of shareholder's rights. The Articles cannot be altered so as to contain rules which are contrary to the provisions in Sections 106-107 of the Companies Act, 1956.
- The alteration in the Articles cannot be made in such a method as to contain anything which is illegal either under the Companies Act, 1956 or any other law.
- The alteration necessity 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 through 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.

- An alteration which has the effect of compelling a member to take or subscribe for more shares, or in any method raising 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).
- A company may pass a special resolution and convert the uncalled capital into a reserve liability to be described 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.
- 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).
- No alteration to the Articles can be made which would discriminate flanked by the majority shareholders and the minority shareholders so as to provide the former an advantage of which the latter have been deprived.
- 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.
- The alteration necessity not be inconsistent with an order of the court. Such alterations can be made through the company only with the leave of the court,

A copy of the special resolution authorizing the alteration necessity be filed with the Registrar 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.

CONNECTION FLANKED BY MEMORANDUM AND ARTICLES

The Memorandum of Association is a fundamental document of a company presently like a constitution of a country. It is the main document as placed beside with Articles which is subordinate to and is controlled through the Memorandum of Association.

The Articles cannot confer powers on the company other than those given in the Memorandum of Association of the company. So, at the time of framing the Articles or creation alteration in the Articles, it necessity be ensured that the original regulations or die altered ones do not exceed powers of the company given through the Memorandum, nor provide validity to any provision which is contrary to the Companies Act, 1956. For instance, 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 create a provision in the Articles empowering the company to start business in the other objects clause beside 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.

DISTINCTION FLANKED BY MEMORANDUM AND ARTICLES

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

- Memorandum of Association is the charter of the company. It lays down the scope and powers of the company. In information, Memorandum defines the area beyond which the Articles of Association actions of the company cannot go. Inside that area the shareholders may create such regulations for the governance of the company as they think fit.
- Memorandum of Association is a fundamental document. Articles of Association are subordinate, to and are controlled through the Memorandum of Association.

- The purpose of Memorandum is two fold:
- To tell the intending purchaser of shares the scope of the behaviors of the company and the. objects on which his money will be invested,
- 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 give rules and regulations for the internal management of the company. Therefore, a company is not bound to an outsider, but it is bound to a member through whatever is contained in its Articles of Association.
- Articles of Association is the foundation of a contract flanked by the company and its members, Memorandum of Association usually defines the relation flanked by the company and outsiders.
- A public company limited through shares need not frame its own Articles of Association. It may adopt Table A as its Articles. But every company, without exception, necessity prepare its own Memorandum of Association.
- The clauses of the Memorandum cannot, be easily altered. The company has to follow the striker 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 through passing a special resolution.
- Any act which is beyond the powers given in the Memorandum is ultra vires and void and it cannot be ratified even through the whole body of shareholders. But any act which is ultra vires the Articles may be ratified through shareholders through passing a special resolution.

EFFECT OF MEMORANDUM AND ARTICLES

Section 36 gives that the Memorandum and Articles shall, when registered, bind the company and the members thereof to the similar extent as if they respectively had been signed through the company and through each member, and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles. Therefore, the Memorandum and Articles constitute a binding contract flanked by the company and each of its member. The legal effects can be studied under the following headings:

- ***Members bound to Company:*** The memorandum and Articles constitute a contract binding the members to the company. Each member is bound through whatever is contained in them as if both these documents were signed through him. In Boreland's Trustee v. Steel Brothers and Co. Etd. 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 through the directors. B, a shareholder became bankrupt and his trustee in bankruptcy claimed that he was not bound through the articles and could so, sell those shares at their true value. But it was held, that the trustee in bankruptcy was bound through the Articles as it constituted a binding contract flanked by the members and the company. Likewise 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 through 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 in excess of the shares. 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.
- ***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 through whatever is contained in them. For instance, it necessity confine its behaviors 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. Likewise, the company is bound to individual members in respect of their ordinary rights as members. For instance, 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 the Articles.

- ***Member bound to Member:*** The Memorandum and Articles do not constitute express contract flanked by the members of the company. Yet each member is bound through these documents on the foundation of an implied contract to the other members. The Articles regulate their rights inter se. As flanked by members inter se, each member is bound through the Articles and Memorandum to the other members. Though, this right can be exercised through the company only except in some exceptional cases. For instance, 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. Though, if a member holds a majority of the shares of the company and does not allow ah action to be taken in the name of the company, the complaining members are entitled to uphold 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.
- ***The company is not bound to outsiders:*** The Articles of Association do not constitute any contract flanked by the company and the outsiders so, 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 through the articles. Even if the name of an outsider is mentioned in the Articles for any proposed business, the company is not bound through it. The fallowing 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 solicitor to the company and also became a member of the company. The company, though, terminated his services. Thereupon, he sued the company for damages for breach of contract, Held, the Articles cannot be the foundation of a contract flanked by 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 similar time may be a creditor or employee of the company. In the case, he was trying to exercise his right as an employee of the company. There was no self-governing contract flanked by the company and Eley separately from whatever was contained in the Articles. So, his suit was dismissed.

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 accessible 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 kind of presumed knowledge of these documents is termed the 'Constructive Notice' of Memorandum and Articles of Association.

So, any person dealing with the company cannot argue that he has not read the documents, such as Memorandum, of the company. For instance, 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 defense, take the plea that he did not know the provisions of the Memorandum of Association of the company.

Therefore if a person deals with a company which is not sheltered through 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 then according to their proper meaning. It is immaterial if he has not even seen then

The doctrine of Constructive Notice is, though, customized through the doctrine of Indoor Management.

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 significant 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 through the company. This doctrine seeks to protect the outsiders against the company.

So, if a transaction appears to be within the powers of the company, then the company cannot escape liability through 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 lay within the doors that are closed to him. This doctrine is recognized 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 authorized through the articles to borrow on bond such sums of money, as authorized from time to time, through a resolution of the company, in Common 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 Common Meeting authorizing the directors to borrow money on the foundation of bond had been passed. He was not duty-bound to inquire whether the resolution had been actually passed or not. Though, he necessity have establish out whether the company had the power to borrow or not, as that was the burden imposed upon him through the doctrine of Constructive Notice.

Exceptions

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

- ***Knowledge of Irregularity:*** A person who has knowledge of an irregularity concerning the internal management of the company cannot claim protection provided through 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 so the company was liable to them only for £ 1,000.

- ***Negligence:*** If a person, who deals with the company, does not take the trouble of reading these documents to discover 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.
- ***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 necessity create proper inquiries and satisfy himself as to the officer's authority. If he fails to create proper inquiry in spite of suspicious circumstances, he cannot claim any protection under the doctrine of indoor management. In Anand Bihari Lai v. Dinshaw & Co.'s, case the accountant of the company transferred some property of the company to the plaintiff. The transfer was held through the Court to be void, because the power to transfer property could not be measured within the apparent authority of the accountant. The plaintiff were put to suspicion as they should have enquired thoroughly before entering into the transaction.
- ***Forgery:*** The rule is not applicable when the document relied upon through the outsiders turns out to be a forged one. A company is not liable for forgeries committed through its Officer. In the case of Ruben v. Great Fingal Consolidated Company, a share certificate was issued through the Secretary of the company under the two forged signatures of the directors as required through 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 discover out the geniuses of the signatures, so, he should he protected. But it was held that the doctrine of indoor management is not applicable to cases of forgeries.

REVIEW QUESTIONS

- What are Articles of Associations? How can they be altered?
- "The power of altering Articles of Association is wide, yet it is subject to a big number of limitations." Explain.
- What are the usual contents of the Articles?
- Explain the legal effect of the Articles of Association. How distant they are binding on outsiders?
- Explain briefly the relation flanked by Memorandum and Articles of Association.

CHAPTER 7

Prospectus

STRUCTURE

- Learning Objectives
- Meaning and Importance
- Contents of Prospectus
- Statement in lieu of Prospectus
- Minimum Subscription
- Misrepresentation in the Prospectus and its Consequences
- Review Questions

LEARNING OBJECTIVES

After learning this chapter, 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 accessible.

MEANING AND IMPORTANCE

Section 2(36) of the Companies Act, 1956 defines a prospectus as any document described or issued as a prospectus and comprises 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 easy 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 necessity keep in mind that a prospectus is: An offer through the company but it is only an invitation to offer. A company, through issuing a prospectus to the public at big, 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 shapes and submit the similar along with the share application money, This act of applicants amounts to creation offers to the company to buy as several shares in the company as are mentioned in the share application form. The Board of directors of the company will then create 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. Therefore, a contract flanked by the applicant and the company is made with all the contractual rights and obligations.

The definition of prospectus comprises any notice, circular, advertisement or other document inviting deposits from the public. Therefore, the invitation of public deposits through the companies is also regulated through the prospectus.

Meaning of Prospectus Issued to the Public

From the definition of prospectus, it necessity be clear to you that the invitation necessity be made to the public. In Section 67 of the Act the term 'public' has been explained as follows: It comprises 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. Therefore, 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 scrupulous 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 scrupulous case has to be measured. 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 through the case of Nash v. Lynde.

A managing director of a company sent to his co-director many copies of a document marked "strictly private and confidential” and containing particulars of a proposed issue of shares, accompanied through share application shapes. One of the copies was sent through the codirector 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 through him through cause 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 through 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.

CONTENTS OF PROSPECTUS

Section 55 gives that a prospectus issued through or- on behalf of a company, or in relation to an planned company shall be dated, and that date necessity, unless contrary is proved, be taken as the date of the publication of the prospectus.

Section 56 gives that a prospectus necessity (i) contain the matters specified in Part I of Schedule Hand 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.

Matters to be Specified in the Prospectus

Part I of Schedule II enumerates the following matters to be specified in the Prospectus:

- The main objects of the company.
- The names, occupations, and addresses of the signatories to the Memorandum of Association and the number of shares subscribed for through them.
- The number and classes of shares, if any.
- The number redeemable preference shares planned to be issued, with the date of redemption or, where no date is fixed, the era of notice required for redeeming the shares; and the proposed method of redemption.
- The number of shares, if any, fixed through the articles, as the qualification shares of a director.
- The names, addresses, and occupations of the directors, the managing director, or manager jointly with any provision in the articles or a contract concerning their appointment, remuneration, or compensation for loss of office.
- 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; 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.

- 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; jointly with the amounts payable and the era throughout which option is to be exercised through such persons, whose names, occupations and addresses necessity also be given.
- 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.
- The amount payable as premium on each share to be issued, stating the proposed date of issue; and where some shares of the similar class are to be issued at dissimilar premiums or at par, or at a discount and others at a premium, the reasons for the differentiation.
- Where the issue of shares or debentures is underwritten, the names of the underwriters, if any, arid the opinion of the directors that possessions of underwriters are enough to discharge their underwriting obligations.
- 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.
- 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 jointly with the amount paid and the rate of underwriting commission as well as any benefit paid or payable to the promoter or officer.

- The amount or estimated amount of preliminary expenses and. the names of persons through whom any of those expenses have been paid or are payable.
- Any amount or benefit paid or given within the two preceding years or planned to be paid or given to any promoter or officer and the consideration for the payment of the given benefit.
- The dates of, parties to, and common nature of every contract appointing or fixing the remuneration of a managing director, or manager whenever entered into.
- The names and addresses of the auditors, if any, of the company.
- 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 through the company within two years of the issue of the prospectus.
- If the share capital of the company is divided into dissimilar classes of shares, voting rights and rights to dividend and the right as to capital attached to the many classes of
- 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.
- In the case of an existing company, the length of time throughout which the company has accepted on the business. If the company proposes to acquire a business, which has been accepted on for less than three years, the length of time throughout which the business has been accepted on.
- If any reserves or profits of the company or any of its subsidiaries have been capitalized, particulars of the capitalization and particulars of any surplus arising from revaluation of assets throughout the preceding two years and the manner such surplus has been dealt with.
- In case the company had been in business, the statement of the auditors concerning profits and losses, and assets and liabilities, jointly 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.

- A reasonable time and lay at which copies of all balance sheets and profit and loss accounts, if any on which the statement of auditors is based, may be inspected.
- The name(s) of the stock swap 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 necessity contain a blank application form whereby it necessity be printed prominently that no application should be made in the name of a fictitious person. It should also be stated that applications necessity be made in single name only and not in joint names.

Reports to be Set Out in the Prospectus

In addition to the matters, Part II of the Schedule requires the following statement to be set out in the prospectus:

- An auditor's statement 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 through the company in respect of each class of shares throughout the preceding five financial years, and similar details with regard to subsidiary companies, if any.
- If the company proposes to acquire any business, a statement should be made through 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
- 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 statement similar to the one in (2) above is required to be set up.

Registration of Prospectus with Registrar of Companies

Section 60 requires that a copy of the prospectus duly signed through every director or proposed director necessity be delivered to the Registrar of Companies before the date of its publication. Every copy of the prospectus, on its face, necessity state that a copy of the prospectus has been delivered to the Registrar of Companies. The prospectus necessity be issued within ninety days after the date on which a copy of the similar 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 necessity have endorsed on, or attached to it the following documents; the consent of the expert to the issue of the prospectus, if his statement has been incorporated therein and such expert necessity not be linked or interested in the formation, promotion or management of the company.

- A copy of every contract appointing or fixing the remuneration of a managing director or manager.
- 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.
- When the persons creation 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 through them stating the adjustments and the reasons for the similar.
- 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 capability.
- Consent of director or directors, named in the articles or prospectus, to act as such directors of the company.
- A copy of the underwriting agreement, if any.

STATEMENT IN LIEU OF PROSPECTUS

A public company may not invite the public to subscribe to its share capital. Instead, it may arrange capital masterly. In such a situation, it is required through Section 70 to submit statement in lieu of prospectus with the Registrar of Companies, at least three days before it can create 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.

Likewise, 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. Though, 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 discovers that the contents thereof are approximately similar to the ones in the prospectus.

If allotment of shares or debentures is made through a company without filing the statement in lieu of prospectus with the Registrar of Companies, the allotted 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.

MINIMUM SUBSCRIPTION

Minimum subscription is the minimum amount equivalent to which the share applications necessity be received through 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 necessity be subscribed or applied for within 120 days of the issue of the prospectus before the lust 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, necessity be raised through the issue of shares to give in respect of each of the following heads and distinguishing the amount required under each head:

- 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;

- Any preliminary expenses payable through the company including any commission, underwriting or otherwise for subscription of shares in the company;
- The repayment of any moneys borrowed through the company in respect of any of the foregoing matters;
- The working capital; and
- 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 necessity forthwith refund within after that 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.

MISREPRESENTATION IN THE PROSPECTUS AND ITS CONSEQUENCES

You have learnt that the investors apply for shares or debentures of a company an the foundation of information given in the prospectus. The prospective buyer of shares is entitled to all true disclosures in the prospectus. A prospectus necessity, so, tell the truth, the whole truth and nothing but the truth. The prospectus necessity provide a true picture of the company. So, if there are untrue statements in the prospectus. The allottees have sure remedies against the company and the persons issuing the prospectus. Though, these remedies are not accessible 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 realized capital profits. This information was not disclosed in the prospectus, Held, that the nondisclosure of the information that dividends were not distributed out of trading profits but out of realized capital profits is a very significant statement the omission of which provides a right to the allottees of shares to avoid allotment and resort to other remedies accessible under the Companies Act.

If there is any omission in the prospectus calculated to mislead the public, it shall be Prospectus measured to be untrue. In Peek v. Gurney case the prospectus issued did not mention in relation to the sure liabilities. This created a false impression in relation to the company being very wealthy. The prospectus was held to be untrue.

An allottee of shares, who had applied for shares, on the faith of a prospectus i) containing nature statements or ii) omitting material facts, has remedies against the company, its promoters and directors and experts.

It should be noted cautiously that the right to claim compensation for any loss or damage is accessible only to a person who has 'subscribed' for shares or debentures on the faith of the prospectus containing untrue statements. Therefore, a subsequent buyer of shares in the open market has no remedy against the company or the directors or promoters.

Remedies against the Company

Person who has bought shares from the company relying on the statements in the prospectus, map (i) avoid the contract to purchase shares, and (ii) claim damages if he can illustrate that there is a misstatement in, or omission of material information from, the prospectus. Further he has to illustrate that the misstatement or omission was i) one of information and not of law nor a mere expression of opinion; ii) material and iii) actually relied upon through him.

- ***Rescission of contract:*** In case he wants to avoid the contract to purchase shares, he necessity do so i) within a reasonable time after the allotment of shares; ii) before proceeding's to wind up the company have commenced and iii) before he does anything which is incenses tent with the right to avoid the contract e.g. he tries to sell the shares or attends a common meeting of the company or accepts dividends.
- ***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 through

the company or through some one authorized through the company. In order to succeed, the allottee necessity, in addition to the three circumstances given in (a) above, prove that those acting on behalf of the company acted fraudulently, ii) that those purporting to act on behalf of the company were authorized 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.

Remedies against Promoters and Directors of the Company

Section 62 gives 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 through them through, cause of any untrue and misleading statement incorporated in the prospectus.

- Every person who is a director of the Company at the time of the issue of the prospectus;
- Every person who has authorized 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;
- Every promoter of the company; and
- Every person (including an expert) who has authorized the issue of the prospectus. But an expert is liable only in respect of his own untrue statements incorporated in the statement made through him and incorporated in the prospectus.

An allottee of shares may also bring an action for fraud i.e., for fraudulent mis-representations incorporated in the prospectus either against the company or the directors. If he decides to sue directors he need not receive the contract.

- ***Defenses Accessible:*** 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:

- 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
- That the prospectus was issued without his knowledge or consent, and on becoming aware of its issue, he gave reasonable public notice of that information; or
- That he withdrew his consent after the issue of the prospectus but before allotment and gave a reasonable public notice of the withdrawal; or
- That he had reasonable ground to consider that the statements made were true and he honestly whispered them to be true; or
- The statement was correct and a fair summary or a copy of an expert's statement; or
- The statement was made through an official or is an official document.

Remedies Against Experts

You have noted that several a times statements of experts are incorporated in a prospectus. The term 'expert' comprises an engineer, a valuer, an accountant, and any other person whose profession provides authority to-a statement made through him.

An expert is liable for in damages in respect of his own untrue statement, wrong statement or valuation made through him and incorporated in the prospectus. Also he is liable to pay compensation under Section 62. Though he shall not be liable if he proves that:

- 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
- 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 so; or
- He was competent to create the statement, and whispered on reasonable grounds that it was true.

Criminal Liability for Misstatements in the Prospectus

Section 63 of the Act also gives for criminal liability for misstatements. It gives that where a prospectus contains a misstatement, every person who authorized the issue of the prospectus shall be punishable with imprisonment for a ten which may extend to two years, or fine which may extend up to five thousand rupees, or with both, unless he proves

- That the statement was immaterial, or
- That he had reasonable ground to consider and did up to the time of the issue of the prospectus consider that the statement was true.

Though, 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 creates 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,

REVIEW QUESTIONS

- Describe the term prospectus.
- What is the purpose of a prospectus?
- Enumerate some of the particulars which are required to be incorporated in a prospectus.
- What do you mean through “issued to the public"? Illustrate your answer.
- What is a “statement in lieu of prospectus” ?

PART 3. CAPITAL AND MANAGEMENT

CHAPTER 8

Share and Loan Capital

STRUCTURE

- Learning objectives
- Meaning and Kinds of Share Capital
- Meaning and Kinds of Shares
- Meaning of Stock
- Meaning and Kinds of Debentures
- Variation Flanked by Shares and Debentures
- Public Deposits
- Review Questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain the meaning of shares and kinds of shares
- Describe the kinds of capital
- Distinguish flanked by shares and stock
- Explain the meaning of debenture
- Classify debentures
- Distinguish flanked by shares and debentures
- Explain the meaning of the term 'deposits'
- List the rules concerning acceptance of deposits through companies.

MEANING AND KINDS OF SHARE CAPITAL

You know that to carry on any business, some money is needed. The term 'capital' usually means a scrupulous amount of money with which a business is started. In the case of a company where big amount of money is required, it is raised through the issue of shares. The amount so raised is described the 'share capital' of the company.

A company limited through 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 instance, the share capital of a company may be divided into shares of Rs. 10 each. The persons contributing towards the share capital are recognized as 'shareholders'. You should note that the money borrowed through the company through issuing debentures, is not part of the share capital of the company. It is in the form of a extensive-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:

- ***Nominal or Authorized 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 authorized to raise through issuing the shares. This is also recognized 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 foundation of present and future capital needs of the company. It can be increased or decreased through adopting the prescribed legal procedure.
- ***Issued Capital:*** It is that part of the authorized 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 information, the term 'issued capital' means that part of the share capital which has been actually issued or allotted through the company. So, the issued capital can never be more than the authorized capital. It can at the mainly be equal to the nominal capital. The balance of nominal capital remaining to be issued is described 'unissued capital'.
- ***Subscribed Capital:*** It is that part of the issued capital which has been actually subscribed through 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, so, 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 similar as the subscribed capital.

This distinction flanked by the issued and subscribed capital is only relevant from the accountants paint of view. The law does not recognize this variation and uses the two in the similar sense'.

- ***Described-up Capital:*** It is that part of nominal value of issued capital which has been described-up or demanded on the shares through the company. Normally, a company does not collect the full amount on shares it has allotted. It collects it in installments recognized as application money, allotment money, first call, second call and soon, The .amount of installments 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 described.
- ***Paid-up Capital:*** It is that part of the described-up capital which has actually been received from the shareholders. For instance, a company has described-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 recognized as 'calls in arrears'. In the instance, 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 similar as’ the described-up capital.
- ***Reserve Capital:*** That part of the uncalled capital of a company which it has decided, through special resolution, not to call except in the event, and for the purpose of the winding up of the company, is described the 'reserve capital'. The company cannot demand such uncalled amount throughout 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 accessible only for the creditors on winding up of the company.

MEANING AND KINDS OF SHARES

Meaning of a Share

You learnt that the capital of the company is divided into dissimilar units of a fixed amount. Each of such unit is described a 'share'. Section-2(46) of the Companies Act defines a share, "as a share in the share capital of the company, and comprises stock except where a distinction flanked by stock and shares is expressed or implied." This definition is easy but is not exhaustive as it fails to bring out the true nature of a share.

In Boreland’s Trustee v. Steel Bros., Justice Farewell defined the share as, "a share is the interest of shareholder in the company, measured through a sum of money for the purpose of liability and dividends in the first lay, and of interest in the second, and also consisting of a series of contracts entered into through all the shareholders inter se in accordance with the provisions of the Companies Act and articles of association." Therefore, a share is not a sum of money, but is an interest measured through sum of money and made up of several rights contained in the contract.

In the Commissioner of Income Tax v. Average Vacuume Oil Company, the Supreme Court of India defined a share therefore “Through a share in the company is meant not any sum of money but an interest measured through a sum of money and made up of diverse rights conferred on its holders through the articles of the company which constitute a contract flanked by him and the company."

A share carries along with it sure rights and liabilities in the company. The rights of a shareholder are proportionate to the number of shares held through 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 identifies the number of shares held through 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 through 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 gives that the share is a movable property transferable in the manner provided through the articles of the company. But you necessity note that the share is not a movable property in the similar method in which a bale of cloth or a bag of wheat is a movable property. Therefore shares cannot be transferred through mere delivery as in the case of movable property. You should also keep in mind that a share certificate, though it can be transferred to another person, is not a negotiable instrument.

Kinds of Shares

According to Section 86 of the Companies Act, 1956, the share Capital of a company limited through shares shaped after the commencement of the Act of 1956, or issued after such commencement shall be of two kinds, namely, (a) preference share capital and (b) Equity share capital. Therefore a public limited company can issue only two kinds 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 arid their rights and liabilities are governed through 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 self-governing 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 accessible for sharing. 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 several resolutions in proportion to his share of the paid-up equity capital, whereas preference shareholders have, usually, no voting rights.

Preference Shares

- Under Section 85(1) of the Companies Act, a preference share is one which fulfils the following two circumstances:
- With respect of dividend, it carries a preferential right to be paid a fixed amount or an amount calculated at a fixed rate.
- 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 necessity be paid back before anything is paid to the equity shareholders.

The two circumstances clearly illustrate that the preference shares carry a preferential right to receive dividend. Though, the amount or rate of dividend is fixed. Likewise, at the time of winding up of the company, the preference shareholders are paid their amount prior to the payment to equity shareholders.

Kinds of Preference Shares

The preference shares may be of the following kinds:

- ***Cumulative Preference Shares:*** These shares are entitled to dividend at a fixed rate whether there are profits or no profits. If in a scrupulous year due to inadequate amount of profits, the dividend could not be paid, then the unpaid dividend shall be accepted forward to the subsequent years and shall be paid in the succeeding year out of the profits along with the fixed dividends for that year. Since the dividends can be accumulated, they are described '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.
- ***Non-Cumulative Preference Shares:*** These are the shares on which the dividend does not go on accumulating. If in a scrupulous year there are no profits or profits 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 easy words, on such shares the unpaid dividends do not accumulate but lapse, i.e., the shareholders lose them forever.
- ***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 beside with equity shareholders after divided at ascertain rats 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 conditions of issue.
- ***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.
- ***Convertible Preference Shares:*** The holders of such shares have a right to convert these shares into equity shares within a sure era.

- ***Non-convertible Preference Share:*** The preference shares, where the holders have no right to convert their shares into equity shares are recognized as non-convertible preference shares.
- ***Redeemable Preference Shares:*** Ordinarily, the amounts received through the company on shares is not returned except on the winding up of the company. A company limited through shares, if authorized through its articles, may issue preference shares which are to be redeemed or repaid after a sure fixed era. Therefore, the amounts received on such shares-can be returned throughout 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 circumstances:
- Only such shares shall be redeemed which are fully paid-up.
- Such shares shall be redeemed only out of the profits of the company accessible for dividends or out of the proceeds of a fresh issue of shares issued for this specific purpose.
- 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.
- 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 gives 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. Therefore , now onwards, a company can issue only redeemable preference shares which are redeemable within ten years of its issue. You should, though, keep in mind that the redemption of preference shares should not be measured as reduction in the amount of authorised capital of the company.

- ***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 necessity be. redeemed within five-years from 15.6.1988 and if they are not redeemable before the expiry often years from the date of issue, then such shares necessity be redeemed as per the conditions of issue or within a era of ten years from the commencement of the Amendment Act, 1988, whichever is earlier.
- ***Cumulative Convertible Preference (CCP) Shares:*** These shares were introduced through the Government of India through a notification issued in 1985. These shares can be issued to raise finance for new projects, for expansion, diversification, and modernization 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.

MEANING OF STOCK

Stock is the aggregate consolidated holdings of the share capital of person. In easy words, it means a number of shares put jointly in a bundle. The stock is expressed in conditions of money and not as so several 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 comprises stock except where a distinction is planned. Therefore, a company, if authorized through its articles, can convert its fully paid-up shares into stock through passing an ordinary resolution. From this it should be clear to you that a company cannot create an original issue of the stock. When the shares are converted into stock, the company necessity provide a notice to the Registrar of such conversion within thirty days of doing so. On conversion of shares into stock, the register of members necessity illustrate the amount of stock held through each member instead of that amount of shares. For instance, 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 connection flanked by the holder and the company, the stockholder still remnants a member. The holders of stock shall have the similar 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 through an ordinary resolution.

Distinction Flanked by Share and Stock: Stock possesses all the characteristics of a share, but there are several points of variation flanked by 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.

MEANING AND KINDS OF DEBENTURES

Meaning and Features

The mainly general form of raising loan from the public is through issue of debentures. A certificate issued through the company under i seal acknowledging a doht due through it to its holder, is recognized as debenture, The necessity essential characteristic of a debenture is the admission or record of indebtedness. According to Chitty, J. “debenture means a document which either makes a debt acknowledges it, and any document which fulfils either of these circumstances is a debenture." Section 2(12) of the Companies Act states that a debenture comprises debenture stock, bonds and my other securities of the company whether constituting a charge on the Company's assets or not’. In easy words, it means a document which cither makes a debt or acknowledges it. A debenture contains the conditions and circumstances of its issue, It may also be stated in the debenture that the company shall pay buck the money to 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, hut it may be without a charge as well because debentures may be unsecured.

From the explanation of the term ’debenture’, the main features of a debenture can be summarized as follows:

- A debenture is in the form of a certificate issued under the seal of the company. Though, the seal of the company is not necessary for the validity of a debenture.
- This certificate is an acknowledgement of debt through the company to its holder.
- A debenture usually gives for the repayment of a specified principal sum on a specified date. Though, there is no restriction on the issue of irredeemable debentures.
- It usually gives for the payment of interest at regular intervals at fixed dates until the principal amount is totally paid back.
- 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. Though, a debenture may also be issued without any charge on company's assets.
- Debenture certificates are freely transferable presently like shares.
- Debentures arc usually issued in series hut even a single debenture issued to one person is quite valid.
- A debenture holder has no right to vote at any meeting of the company.

Kinds of Debentures

A company can issue several kinds of debentures which can be classified on the foundation of security, permanence convertibility, and records.

- ***Registered arid Bearer Debentures:*** Registered debentures are made out in the name of a scrupulous person, whose name is recorded in the company's register of debentures. The name of the debenture holder appears in the debenture certificate. Such debentures are transferable in the similar manner as shares through transfer deeds. Interest on such debentures is payable to the person whose name is registered with the company in the register of debenture holders. Bearer debentures are those which are payable to the bearer (i.e. the holder of the debenture). The company keeps no register of such debenture holders. Like negotiable instruments, bearer debentures are transferable through mere delivery. Interest on such debentures is payable on the foundation of coupons attached with the debenture certificate.
- ***Secured and Unsecured Debentures:*** Secured debentures are those debentures which are secured either through the mortgage of a scrupulous asset of the company recognized as 'Fixed Charge' or through the mortgage of common assets of the company recognized as ‘Floating Charge’. Secured debentures are also recognized as ‘Mortgage debentures'. Unsecured debentures, on the other hand arc those debentures which arc not secured through any charge or mortgage on any property of the company. Unsecured debentures arc also recognized as ‘Naked debentures’. The debenture holders of such debentures arc the unsecured creditors of the company. Only good companies of strong financial standing can issue such naked debentures.
- ***Redeemable and Irredeemable Debentures:*** Redeemable debentures means such debentures which arc repayable after a specified era. A redeemed debenture may be re-issued until it is cancelled. Upon the re-issue of redeemed debentures, the debenture holders will continue to

have the similar 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 extensive as the company is functioning and docs not create default in interest payment. Irredeemable debentures arc also recognized 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.

- ***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 swap on the expiry of a specified era. On conversion, the debenture holders become the members of the company, Non-convertible debentures, on the other hand, are those debentures for which the debenture holder does not have any right for conversion into equity shares.

VARIATION FLANKED BY SHARES AND DEBENTURES

You have learnt that presently as shares arc uniform parts of the share capital debentures are uniform part of the loan capital of a company, But it is necessary to distinguish flanked by a share and a debenture because the rights and privileges as also the liabilities accompanying these instruments are very much dissimilar from one another. The main points of variation are as follows:

- Shareholders are owners of the company whereas the debenture holders are creditors of the company. So, while the shareholders have a multi-faceted interest in the welfare of the company, the debenture holders have a very limited interest (limited to getting interest on time) in the company.
- A shareholder enjoys the rights of proprietorship of a company whereas a. debenture holder can enjoy the rights of a lender only.
- A shareholder has a right of control in excess of the working of the company through attending and voting in the common meeting. They

are able to decisively power the composition of Board of Directors and other senior management positions. The debenture holders do not have any voting right, and so, they are unable to exercise any such power.

- 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 debenture holders are entitled to interest at a fixed rate which the company necessity pay whether or not there are profits.
- A debenture holder gets a fixed rate of interest per annum payable on 'fixed dates' whereas a shareholder gets a dividend distant higher if the company earns good profits.
- In respect of shares, dividend is payable only when the proposal to pay dividend is passed through the shareholders at the annual common meeting of the company. There is no need of such approval in the case of payment of interest on debentures.
- 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.
- A shareholder has a claim on the accumulated profits of the company and is normally rewarded with bonus shares whereas a debenture holder has no such- claims whatsoever after he has been paid the interest amount.
- Shareholders cannot be paid back (except in case of redeemable preference shares) so extensive as the company is a going concern. Debentures are normally issued for a specified era after which they are repaid.
- A company cannot purchase its own shares from the market whereas it can purchase its own debentures and cancel them or re-issue them.
- In the event of winding up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture holders being secured creditors get priority in payment in excess of the shareholders.

PUBLIC DEPOSITS

You have learnt in relation to the two main sources of raising funds through a company i.e. shares and debentures. Public deposit is another significant source of meeting short-term capital necessities. In order to draw deposits, companies often offered interest at a high rate and accepted deposits distant beyond their capacities. As a result thereof, several 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 Sections58A and 58B were introduced through the Amendment Act of 1974. Government has now the powers to regulate the limits, manner, and circumstances of acceptance of public deposits through companies. For this purpose Companies (Acceptance of Deposits) Rules; 1975 have been framed.

Meaning of Deposit

According to Explanation to Section 58A of the Companies Act, the term 'deposit' means any deposit of money with, and comprises any amount borrowed through a company. Deposit comprises all kinds of deposits - public or private. It comprises inter-company deposits.

A number of amounts received through the company are not measured as deposits within the meaning of this section. The following amounts are not treated as deposits:

- Any amount received from the central or a state government or from a local authority or a foreign government.
- 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.
- Any amount received as a loan from financial organizations such as Industrial Finance Corporation of India, 'State Finance Corporations, and Unit Trust of India. Industrial Development Bank, Life Insurance Corporation of India, etc.
- Any amount received through a company from any other company
- Amounts received through method of security deposits from employees.
- 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.
- Amounts received through method of subscriptions to any shares, stock, or debentures pending then allotment.

- Amounts received in trust or any amount in transit.

Deposits and Loan

Sonic people say that deposits are nothing hut a type of loan, but this is not true. Whether a scrupulous transaction is a deposit or loan, we should sec 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 so or according to the conditions of the agreement. In easy words, unlike a loan, there is no immediate obligation to repay in the case of a deposit.

Deposits and Debentures

Some persons put deposits and debentures in the similar category because the element of indebtedness is general. Rut 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. Therefore, the era of deposit is restricted while there is no such limit in case of debentures. Then, unlike debentures, deposits are not transferable.

Roles Concerning Acceptance of Deposits

The acceptance of deposits through non-banking and non-financial companies are controlled through the Reserve Bank of India. As per the new Section 58 A the control on acceptance of deposits through 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 (CLR). The rules concerning acceptance of deposits through a company are as follows:

- A company desirous of raising funds through public deposits has to provide a public advertisement in the newspapers showing therein the financial location, management structure and other specified particulars of the company. The advertisement should also provide brief particulars of the latest audited balance sheet of the company and the proposed utilization 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 docs nut want to provide a public advertisement then a statement in lieu of such advertisement should be filed with the Registrar.

- The company should give to a prospective depositor a form for creation an application for deposit. 1 his form should contain a declaration, to be signed through the depositor, to the effect that this deposit is not being made out of funds acquired through him through borrowing or through accepting deposits.
- The company is required to furnish to cacti 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.
- A company can accept deposits for a era which will not be less than six months and more than thirty six months. A finance company can accept deposits for a era of sixty months,
- A company may accept short-term deposits repayable not earlier than three months hut not later than six months subject to the following two circumstances:
- The funds are needed to meet short- term requirement, and
- The amount of such short-term deposits does nut exceed ten per cent of the paid- up capital and free reserves.

Though, in no case, a company shall accept deposits repayable before three months.

- A company cannot accept or renew deposits payable on demand.
- 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 through 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 contain both preference and equity capital.
- No government company shall accept any deposits in excess of thirty-five per cent of its paid-up capital and free reserves.

- 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).
- Every deposit accepted through a company, shall unless renewed, be repaid in accordance with the conditions and circumstances of such deposit. Where any deposit is accepted through a company in contravention of the provisions of the Act or Rules made through the Central Government, the deposit necessity be refunded within thirty days from the date of acceptance of such deposit. This era of 30 days may be extended through the Central Government through another era but not exceeding 30 days.
- If a company fails to create repayment of a deposit in accordance with the 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 realized. 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.
- 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:
- 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.
- 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.
- Every company accepting deposits is required to uphold one or more registers of deposits containing all the required information and should

be preserved in good order for a era of not less than eight calendar years from the financial year m which the last entry is made in the register.

- 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 through the Companies (Amendment) Act, 1988 to give that in the event of the failure of a company to repay any deposit or part thereof in accordance with the conditions and circumstances of such deposit, the Company Law Board may either on its own motion or on the application of the depositor, direct the company to create repayment of such deposit forthwith or within such time and subject to such circumstances as may be specified in the order. Though, before creation any order the CLB shall provide 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 through 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 throughout which such non-compliance continues.

REVIEW QUESTIONS

- What is meant through 'Registered Capital’? What are the two types of share capital?
- What is a reserved capital? Can a charge through created on reserve capital?
- What do you mean through the term 'Share'? Distinguish flanked by ‘Share’ and 'Stock'.
- Enumerate the provisions for redemption of preference shares.
- Distinguish flanked by shares and debentures.

CHAPTER 9

Allotment of Shares

STRUCTURE

- Learning objectives
- Allotment of shares
- Irregular allotment and its consequences
- Issue of shares at a discount
- Issue of shares at a premium
- Share certificate
- Share warrant
- Calls on shares
- Forfeiture of shares
- Re-issue of forfeited shares
- Surrender of shares
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain the meaning of allotment of shares
- Describe the rules relating to allotment of shares
- Explain the con-sequencer, 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 flanked by 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.

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 through submitting the prescribed application form. If the application is accepted through the company, it proceeds to allot him the shares. With the issue of the latter of allotment, the offer stands accepted thereby giving rise to a legally binding contract flanked by the company and the shareholder. Therefore, an allotment is the acceptance through 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 through the Board of directors of a sure 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 sure number of shares to a person.

Notice of Allotment

An allotment is the acceptance of an offer to take shares through an applicant, and like any other acceptance, it necessity be communicated. There can be no binding contract unless the acceptance of the offer is properly communicated. Therefore, notice of allotment necessity 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.

Rules Concerning Allotment of Shares

The rules concerning allotment of shares can be discussed under the two broad headings (a)'common rules and (b) the legal rules.

Common Rules

You know that the allotment is the acceptance of an offer to purchase sure number of shares. So, the common rules relating to valid acceptance of an offer necessity be followed. The common rules concerning allotment of shares are as follows:

- ***The allotment necessity be made through proper authority:*** It is the duty of the Board of directors to allot the shares. Though, 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 through an improper authority will create it void.

- ***The allotment should be made within a reasonable time:*** The offer to purchase shares of the company necessity 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 information in each case.
- ***It necessity 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 sure shares in a company. The letter of allotment was dispatched to him but it never reached. It was held that 'G' was liable as a shareholder (Household Fire Insurance Co. Ltd. v. Grant).
- ***It necessity be absolute and unconditional:*** The allotment of shares necessity conform to the conditions and circumstances of the application. If the allotment is not according to the conditions and circumstances, the applicant may refuse to accept the shares even though allotment has been made to him. If the circumstances are not fulfilled, the applicant necessity reject the shares promptly. His silence or acceptance will debar him from this right.

Legal Rules

You should note that so distant 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 sure restrictions concerning the allotment of shares through 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:

- ***A prospectus necessity be issued and a copy of the similar 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 recognized as 'the time of the opening of the subscription lists'. The substance 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, though, does not specifically give for the time of closing the subscription list. It means that the company may stay the subscription list open for any length of time it wants. According to stock swap regulations where the shares are listed on any stock swap, the subscription list necessity be kept open for at least three days, In such cases, the prospectus usually mentions the time of closing of the subscription lists.
- ***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 through the company in cash. If the company does not receive the minimum subscription of 90% of the issue amount, the whole 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 through more than ten days, the company is liable to pay interest at the rate of 15% per annum for the delayed era.
- ***Application money:*** It is the amount which is payable on each share along with 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.

- ***Application money to be deposited in a scheduled bank:*** All the money received from applicants necessity be deposited in a scheduled bank and it shall remain there until the certificate to commence business is received.
- ***Allotment of shares to dealt in on stock swap:*** According to Section 73(1) of the Companies Act, every company intending to offer shares to the public for subscription through the issue of a prospectus shall, before such issue, create an. application to one or more recognized stock exchanges for permission for the shares to be dealt with in the stock swap. Therefore, now it is made compulsory that the shares necessity be listed on a recognized swap. The prospectus necessity state the name of the stock swap or each of such exchanges where the application has been 'made, the permission has not been granted before the expiry of ten weeks from the date of closing of the subscription lists, the company necessity immediately repay the money received from the applicants. If it is not repaid with in has the directors shall be liable to repay it with interest at such rate, which should be less than four per cent and more than fifteen per cent per annum. Though 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 concerning the subsequent allotment of shares are the similar except the rule concerning minimum subscription.

Procedure of Allotment

When the company receives from bankers all the share applications, a share application list is prepared. You should keep in mind 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 concerning allotment have been complied with, and then they will proceed with the allotment of shares. If the issue has been presently fully subscribed, then there is no trouble in allotment, the directors can allot to each applicant the number of shares asked for.

But the real difficulty arises in case of in excess of-subscription. An issue is said to be in excess of subscribed if the number of shares applied for is greater than the number of shares accessible for allotment. In case of in excess of-subscription, the applicants will have to be allotted less number of shares than applied for, it is recognized as partial allotment. A scheme of foundation of allotment is framed in consultation with the stock swap where the shares are to be listed. This guidelines the Government has emphasized 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 lay. In order to ensure that no one corners a major portion of the shares accessible, the multiple application from the similar person have been prohibited.

In case of in excess of-subscription, the shares are allotted either through draw of lots (lottery): or- on pro-rata foundation i.e. through allotting 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 through the Controller of Capital Issues, the case of equity shares, the companies are allowed, at their option, to retain in excess of-subscribed equity to the extent of 15 per cent of the amount for which consent of the CCI has been sought.

You should keep in mind 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, and then they can proceed with the allotment work. When the Board of directors pass a resolution confirming the allotment and, if for some cause, no shares are allotted to an applicant, then a letter of regret is sent to him along with a crossed cheque for the refund of the share application money,

Return as to Allotment

You learnt the rules and the procedure of allotment of shares. Section 75 of the Companies Act gives that when a company having a share capital creates any 'allotment of its shares, the company necessity within 30 days of the allotment, file with the Registrar a statement recognized as "return as to allotment". The return necessity contain particulars relating to the number and nominal amount of shares allotted, the names, addresses and job 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 through the company authorizing such issue jointly with the order of the Company Law Board sanctioning the issue shall also be filed with the Registrar Allotment of shares.

In the case of bonus shares, the return necessity state the number and nominal amount of such shares and names, addresses and occupations of the allottees and a copy of the resolution authorizing 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 basically a resale of shares.

IRREGULAR ALLOTMENT AND ITS CONSEQUENCES

An allotment of shares shall be termed irregular if it is made without fulfilling the circumstances precedent to a regular allotment. The allotment of shares is irregular in the following cases:

- Where an allotment is made without getting the minimum subscription.
- Where an allotment is made without getting at least five per cent of the nominal value of shares as application money.
- Where an allotment is made without depositing the application money in a scheduled bank...
- 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.
- Where the company fails to apply for listing of its shares in one or more recognized 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 through the stock swap before the expiry of ten weeks from the date of the closing of the subscription list.

- 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:

- ***Voidable at the option of the allottee:*** In the first four cases the allotment is voidable at the option of the allottee. But this right should be exercised through the allottee within two months after the holding of the statutory meeting through 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 necessity commence legal proceedings within the said era, what is required is that he necessity provide 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.
- ***Fine:*** Where time limit concerning the opening of the subscription list is not observed, the allotment remnants valid but the company and every officer who is in default are liable to a fine upto Rs. 5.000 each.
- ***Allotment is void:*** 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 swap has not been granted within the prescribed time, the allotment shall be void. In this case the money necessity 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 era of delay in creation repayment.
- ***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 through

them. Though, the action to recover such loss or damage or cost necessity be started within two years of allotment.

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 instance. 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. Usually, 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 gives that a company may issue shares at a discount, if the following circumstances are satisfied:

- The shares offered at a discount necessity be of a class already issued i.e., the first issue cannot be at a discount.
- At least one year necessity 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.
- The issue necessity be authorized through an ordinary resolution passed in the common meeting of the company and this necessity be confirmed through the Company Law Board.
- The resolution necessity specify the maximum rate of discount which in no case shall exceed 10%. Though, a higher rate of discount may be allowed if the Company Law Board agrees to a higher rate.
- The shares necessity be issued within two months after getting the sanction of the Company Law Board or within such extended time as the Company Law Board may allow.
- 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.

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 instance, 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 give for any circumstances for the issue of shares at a premium, it regulates the disbursement of the amount composed as premium.

The premium amount cannot be treated as profits and as such it cannot be used for paying dividends. The premium amount necessity be transferred to a separate amount recognized 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 necessity 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:

- Issue of fully paid bonus shares to the members of the Company.
- Writing off the preliminary expenses of the company.
- Writing off the expenses, commission paid or discount allowed on the issue of the shares of the company.
- To give for the premium payable on the redemption of preference shares or debentures of the company.

The balance sheet of the company necessity disclose the amount of share premium, and if it has been disposed of, partly or wholly, it necessity 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.

SHARE CERTIFICATE

A share certificate is a certificate issued through the company under its general seal specifying the shares held through any member and the amount paid on each 'Share. A share certificate is an proof 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. Though, it should be remembered that it is not' a negotiable instrument, The share certificate may be in any form, but a valid share certificate necessity have the following contents:

- Name of the company;
- Name and address of the shareholder;
- Number of shares held through him;
- Distinctive number of shares;
- Amount paid on each share;
- Date of issue;
- Share certificate number;
- Stamp;
- 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 measured to the prima facie proof of the title of the member to the shares mentioned in the certificate.

Issue of Share Certificates

The Companies Act has laid down time limits within which the share certificate necessity be delivered. According to Section 113 of the Act, every company necessity 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. Though, in appropriate cases the Company Law Board may extend this era upto a further era 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 throughout, which the default continues.

If a company creates 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 create good the default. If the default is not made good within ten days of the service of the notice, the CLB may create an order directing the company and any officer of the company to create good the default within such time as may be specified in the order.

Effects of a Share Certificate

You have learnt that share certificate is prima facie proof of the title of the member to the shares specified therein. Following are the effects of a share certificate:

- ***Proof 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. Though, it is not a conclusive proof of the title of the holder. If a person has obtained some shares on the foundation of a forged transfer, the company can refuse to register the transfer of shares. You should keep in mind that share certificate is only an proof of title and is not a document of title. It is not a negotiable instrument which can be transferred through mere delivery of the certificate.
- ***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 instance, 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.

Duplicate Share Certificate

A certificate may be renewed or a duplicate of a certificate may be issued if such a certificate

- Is proved to have been destroyed or lost; or
- Having been defaced, mutilated or torn, is surrendered to the Company.

The information of being a duplicate share certificate necessity 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 company shall be punishable with fine which may extend to Rs. 10,000 and very 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,

SHARE WARRANT

A share warrant is a bearer document of title to the specified shares. A share warrant is a document issued under the general 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 through mere delivery. Therefore, the holder of a share warrant is entitled to the shares specified therein.

Rules Concerning Share Warrants

A public company limited through shares may issue share warrants under its general seal in the following circumstances:

- If it is authorized through its articles;
- Shares are fully paid-up; and
- Previous approval of the Central Government is obtained.

It should be clear to you that share warrants can be issued only through 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 creates a note in relation to 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 through 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. So, coupons are attached to a share warrant to give for the payment of dividends.

Ordinarily, the holder of a share warrant is not measured as a member of the company. But, if the articles so give, 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.

Distinction flanked by a Share Certificate and a Share Warrant

You have learnt in relation to the nature of a share certificate and share warrant. Now you should be able to distinguish flanked by the two. The distinction flanked by the two may be noted as follows:

- A share certificate can be issued through private as well as public companies, whereas share warrants can be issued only through public companies.
- 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.
- 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 necessity be obtained.
- The holder of a share certificate is a member of the company. But the bearer of the share warrant is ordinarily not measured 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. Though, if the articles so give, the bearer of the warrant may be treated as member for the purposes defined in the articles.
- The share certificate can be transferred through executing a transfer deed and delivering the share certificate along with it, while share warrants can be transferred through more delivery.
- Stamp duty is payable on transfer of shares, while no stamp duty is payable on transfer of share warrants.
- A share certificate is not a negotiable instrument, while a share warrant is measured to be a negotiable instrument.

CALLS ON SHARES

When a company issues shares, the applicants are usually not required to pay the full value of the shares in one installment. 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 described through the company in installments. Each installment is termed as a 'call'. You necessity keep in mind that the amount paid on application and allotment are not termed as calls.

A call may be defined as a demand through the company on the shareholders to pay whole or part of the balance remaining unpaid on each share, made at any time throughout the ' life-time of the company,

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. So, once a call has been made, the shareholder is under an obligation to pay the amount described. 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:

- The call necessity be made under a resolution of the Board of directors, The resolution necessity be passed in a properly convened meeting of the directors,
- The resolution necessity specify the amount of call, and the time and lay of payment of calls.
- Call should be made on a uniform foundation, on all shares, falling under the similar class i.e., no differentiation should be made flanked by shareholders of the similar class.
- The power to create call is in the nature of trust and so, the directors necessity exercise this power in good faith and for the benefit of the company. The directors should not create calls for their own benefit, if it is for their own benefit, it shall be an invalid call.
- The call necessity be made according to the provisions of the articles of association, some of the rules are:
- The maximum amount per call shall not be more than 25 per cent of the nominal value of shares.
- There necessity be at least one month's interval flanked by two calls.
- At least fourteen days' notice necessity be given to each member.
- The directors have the discretion to revoke or postpone a call.

Payment of Calls in Advance

Section 92(1) of the Companies Act empowers the company to receive from shareholders the money not yet described up. It gives that a company may, if so authorized through its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held through him, although no part of that amount has been described up.

Though, the shareholder shall not be entitled to any extra voting rights in respect of the money paid in advance,' until the similar become payable through a valid call. You necessity note that advance calls should be received only for the benefit of the company.

According to Section 93 a company may, if so authorized through its articles, pay dividends in proportion to such amount. Articles may give for the payment of interest on calls in advance, but it shall not be mare 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 got accessible. Later on, when the company creates the calls, the money received in advance ' is accordingly adjusted and then the shareholders get the necessary voting right in respect of them.

FORFEITURE OF SHARES

You have learnt that the company does not require the shareholders to pay the full amount of shares in one installment. It creates 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 procedure. So, the company usually decides to forfeit such shares.

The term 'forfeiture' means taking them absent 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 necessity note that shares can be forfeited only for non-payment of any call or installment of a call and not for any other debt due from a member.

The following rules are applicable relating to the forfeiture of shares:

- The power to forfeit shares necessity be given in the articles of the company. '
- Shares can be forfeited only for non-payment of calls. A forfeiture on any other ground is invalid.

- The company necessity serve a proper notice on the defaulting member asking him to pay the amount within a fixed era, failing which the shares shall be forfeited. The shareholder necessity be given at least fourteen days notice to pay the amount. The notice necessity indicate the exact amount to be paid. If there is a slight defect in the notice, the forfeiture will become invalid.
- The Board of directors necessity pass a resolution for the forfeiture of shares.
- The power for forfeiture necessity 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

- 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.
- The shareholder cannot be sued through the company for unpaid calls. The articles of the company may, though, create him liable for the unpaid calls. Any action necessity be taken within three years from the date of forfeiture.
- The former share holder' can be placed on the "B’ list of contributories, if the company is wound up within twelve months of the date of forfeiture.
- After forfeiture, the shares become the property of the company and the company can dispose them of in any manner it likes. Usually, 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 there issue of forfeited shares, he can sue the company for damages.

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. So, the forfeited shares are usually reissued through the company. The forfeited shares can be reissued at any price i.e., even at discount. But the amount of discount necessity not exceed the amount forfeited on such shares. The reissue is done through 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 similar 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 through any irregularity or invalidity in proceedings with reference to forfeiture. It should though, be noted that reissue of forfeited shares is a sale of shares and it does not amount to an allotment. So, return of allotment need not be filed with the Registrar.

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' gives for the surrender of shares. But, the articles may give for the surrender of the partly paid-up shares under circumstances where forfeiture appears to be justified.

You necessity 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 through the company of its own shares which is prohibited through Section 77 of the Companies Act.

Surrender of shares may be allowed in the following cases if its acceptance is authorized through the articles of the company:

- When shares are surrendered in swap for new shares of the came nominal value, as it does not amount to any reduction of capital.
- When the circumstances are such where forfeiture is justified, because surrender is a short-cut to forfeiture.

If the surrender of shares is accepted through the company for any other cause, 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.

REVIEW QUESTIONS

- Explain the procedure of allotment of shares.
- What is an irregular allotment? What are its consequences?
- What is meant through return of allotment?
- Under what circumstances can a company issue shares at a discount?
- When shares can be issued at a premium? For what purposes the premium amount can be utilized?

CHAPTER 10

Directors

STRUCTURE

- Learning objectives
- Definition of a director
- Location of directors
- Number of directors and directorships
- Qualifications of a director
- Disqualifications of directors
- Appointment of directors
- Vacation of office through directors
- Removal of directors
- Powers of directors
- Duties of directors
- Liabilities of factors
- Meetings of directors
- Review questions

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- Describe a director
- Explain the legal location of directors '
- Describe the qualifications and disqualifications of a director 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'

DEFINITION OF A DIRECTOR

The directors are the person selected through 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 location of director through whatever name described." 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. Therefore , it is immaterial through what name be is described. Though, the experts who provide 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.

LOCATION OF DIRECTORS

It is not easy to explain the legal location of the directors because the similar have not been defined through 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 the scrupulous purpose, be measured." Therefore , the real location 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 talk about their location under several 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 recognized as directors. They are elected representatives of the shareholders and may be termed as agents of the company. The connection flanked by the company and its directors is that of principal and agent. So, the common principles of the law of agency govern the dealings of the company and its directors. As agents, it is their duty to carry on the business with reasonable care and diligence. They necessity act within the authority conferred upon them through 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. Though, you should note that the acts done beyond the powers of the directors may be ratified through the shareholders in common meeting of the company provided such acts are not, beyond the powers of the company.

To bind the company, the directors necessity act in the name of the company. Directors are the agents of the company and not of the individual shareholders.

It is, though, 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 self-governing powers while the directors have self-governing powers on sure 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 similar.

The directors necessity 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 capability in relation to the company. The similar degree of integrity arid average 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.

Though, you should keep in mind 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 through 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 common 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 through 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 director may hold a salaried employment in the company and in that cast he will be treated as an employee or servant of the company and he will enjoy all the rights accessible to an employee.

Therefore , it is clear from the directors are neither the agents, nor the trustees, nor managing partners, nor employees of the company. In information, they combine in themselves all these positions. They stand in a fiduciary location towards the company in respect of their powers and capital under their control.

NUMBER OF DIRECTORS AND DIRECTORSHIPS

The Companies Act has fixed the minimum number of directors which a company necessity have. According to Section 252 of the Act:

- Every public company shall have at least three directors, and
- 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 augment or decrease the number of its directors, through passing an ordinary resolution in the common meeting [Section 258]. ' '

If a public company or a private company which is a subsidiary of a public company wishes to Augment the number of directors beyond the limit laid down in the articles, it can do so only with the approval of the Central Government. Though, if the augment in the number of directors does not create 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 similar 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 create a choice within the said fifteen days.

While calculating the number of twenty companies, the following shall he excluded:

- An unlimited company;
- A private company which is neither a subsidiary nor a holding company of a public company;
- An association not carrying on business for profit;
- 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.

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. Though, the articles of association of the company usually give for the share qualification of a director. Such shares are recognized 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 T able A gives that a director necessity hold at least one share. The articles specify the number or value of shares to constitute qualification shares.

Where the articles give for qualification shares, a director necessity obtain qualification shares within two months of his appointment. Any provision in the articles requiring a person to hold qualification shares within a era shorter than two months of his appointment shall be void. You should note that it is not necessary that a person necessity acquire qualification shares before his appointment.

The nominal value of the qualification shares necessity 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 through him either directly from the company or from the market.

The provisions concerning qualification shares do not apply to

- Technological directors unless expressly provided in the articles;
- Directors on behalf of special interest;
- Directors appointed through central government and
- In the case of an self-governing private company.

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:

- He has been establish to be of unsound mind through a competent court;
- He is an undischarged insolvent;
- He has applied to be adjudicated as an insolvent and his application is pending;
- He has been convicted through a court of any offence involving moral turpitude and sentenced to imprisonment for not less than six months and a era of five years has not elapsed since the expiry of his sentence;
- He has not paid any call in respect of the shares of the company held through him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;
- He has been disqualified through 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, through 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, through its articles, give for additional grounds for disqualification. Therefore , a public company or a private company which is a subsidiary of a public company cannot give for additional disqualifications in its articles.

APPOINTMENT OF DIRECTORS

You know that only individuals can be appointed as directors of the company. Any appointment as a director of the company. Directors may be 'appointed in any of the following ways (i) through the articles; (ii) through the shareholders in the common meeting; through the Board of directors; (iv) through the Central Government and (v) through third parties.

Through 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 common meeting.

A person cannot be appointed as director through articles or named as a director, or named as a proposed director in the prospectus unless he or his authorized agent has signed and filed with the Registrar his consent in writing to act as such director; and 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 restrictions, though, 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.

Through Shareholders

In Common Meeting: The first directors of the company shall hold the office till the first annual common meeting. According to Section 255 of the Act, directors of a public company necessity be appointed every year in its annual common meeting. Unless the articles give for retirement of all the directors at every annual common meeting, at least two-thirds of the total number of directors necessity retire through rotation. Therefore , only one-third can be the permanent or non-retiring or ex-officio directors.

At every subsequent annual common meeting, out of the two-thirds directors liable to retire through rotation, one-third or the number adjacent to one-third necessity retire. The directors who have been longest in office since their last appointment shall retire, but in case if the dare of appointment is the similar, the retirement will be determined through an agreement in the middle of them and if there is no agreement, it shall be determined through 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 necessity provide a notice in writing to the company at least fourteen days before the meeting. The company is then required to inform the members either through individual notices or through advertisement of at least seven days before the meeting in relation to the such a candidature.

If the vacancies could not be filled up in the annual common meeting, the meeting is adjourned for the after that week to be held at the similar time and at the similar lay. If at the adjourned meeting also the lay 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 common meeting necessity be made through a separate resolution, unless the meeting unanimously decides otherwise. In other words, two or more directors cannot be appointed through one resolution.

- ***Through Board of Directors:*** The Board of directors may also appoint directors in the following cases:
- ***Additional Directors:*** The Board of directors may, if authorized through the articles, appoint additional directors. But care should be taken to see that the total number of directors including the additional director necessity not exceed the maximum number fixed through the

articles. Such an additional director shall hold office only upto the date of the after that annual common meeting.

- ***Alternate Director:*** The board may appoint the alternate director if the articles authorize such an appointment. An alternate director is appointed to act in lay of a director who remnants 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 lay he was appointed) returns or on the expiry of the original director's term.
- ***Casual Director:*** If the office of any director falls vacant for some cause before the expiry of his term of office, such a casual vacancy may be filled through the Board of directors according to the regulations of the articles. Such a vacancy may be caused through death, resignation, insanity, insolvency etc. The person who is appointed through the Board to fill up the casual vacancy, shall hold the office only upto the date upto which the director in whose lay he is appointed, would have held the office.

Through 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, through 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 through 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 through rotation. Though, such directors can be removed through the Central Government at any time and appoint some other person in his lay.

Through Third Parties

The articles of the company may authorize the third parties to appoint persons on the Board of directors as their nominee. But the number of directors so nominated necessity not exceed one-third of the total number of directors. The term 'third parties' here means the debenture holders, financial organizations, or banks, etc., who have lent money to the company. The thought 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 through rotation.

You have learnt that for the appointment of every director, a separate resolution has to be passed. Normally, they are elected through a easy majority. As a result it is possible that the minority of the shareholders may not be in a location to send their . representative on the Board of directors. So, Section 265 of the Act gives them an opportunity to have their representative on the Board. This is done through adopting the system of proportional representation. The articles may have a provision to this effect through which not less than two-third of the total number of directors of the company be appointed through the single transferable vote, or through a system of cumulative voting or otherwise. Such appointments may be made once in three years and any casual vacancy may be filled up through the Board of directors.

VACATION OF OFFICE THROUGH DIRECTORS

According to Section 283 of the Companies Act, the office of a director shall become vacant if -

- He fails to obtain or ceases to hold the qualification shares;
- He is establish to be of unsound mind through a competent court;
- He applies to the court to be adjudged an insolvent;
- He is declared insolvent;
- He is convicted of any offence involving moral turpitude and sentenced to six month's imprisonment;
- He fails to pay any call for six months on shares hold through him;
- He absents himself from three consecutive meetings of the board of directors or from all the meetings of the board for a continuous era 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;
- He accepts a loan or any guarantee or security for a loan from the company without the previous approval of the central government;
- He fails to disclose to the board his interest in any contract entered into through the. Company as required through section 299;

- He becomes disqualified through an order of the court under section 203 which restrains fraudulent persons from managing the affairs of companies;
- He is removed through an ordinary resolution of the company;
- He had been appointed a director through virtue of his holding any office and he ceases to hold such office;
- He is convicted of an offence in connection with the inspection of books of accounts and other records through the Registrar.

A private company which is not a subsidiary of a public company may, through its articles, give for additional grounds on which the office of a director shall fall vacant.

The grounds 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 through whomsoever . appointed and for whatever era appointed. The Board has no power to waive the event or condone the act.

Retirement of a Director

You know that two-third of the directors are liable to retire through rotation and if a director retires at an 'annual common meeting and is not re-elected, he ceases to hold the office.

Resignation through 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 through giving are asonable 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 instance, if it is made at the common meeting of the, company.

REMOVAL OF DIRECTORS

A director can be removed from office before the expiry of his term through (a) shareholders or (b) Central Government; or (c) Company Law Board.

Removal of Shareholders

A company may remove a director through giving a special notice and passing an ordinary resolution. Though, they cannot remove (i) director appointed through the Central Government; (ii) a life time director in a private company; a director on behalf of special interests e.g., creditors or debenture holders; and a director elected through proportional representation.

Special notice of fourteen days necessity be given for the resolution to remove a director at any meeting. On receipt of such a notice, the company necessity 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 similar 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 through the removal of a director may be filled up through the appointment of another director in this lay provided special notice of such appointment has been given to members. A director so appointed shall hold office only for the remaining era 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.

Removal through 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 mannered according to prudent commercial principles or the company is supervised through 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 linked with the conduct and management of the affairs of the company for a era of five years. Though, the Central Government may, with the previous concurrence of the Company Law Board. remit or reduce this era.

A director who is so removed is not entitled to any compensation for loss of office.

Removal through 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 capability in the company for a era of five years, Also he cannot sue the company for compensation for loss of office.

POWERS OF DIRECTORS

You know that the directors are appointed to manage and supervise the overall affairs of the company. So, the Board of directors has the power to do all such things which the company is authorized or empowered to do. The directors derive their powers from the memorandum or articles of the company and from dissimilar provisions of the Companies Act., 1956.

Section 291 of the Act gives 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 authorized to exercise and do. Therefore , the Board of , directors cannot exercise such powers which can only be exercised through the company in the common meeting.

The powers of the company are therefore divided into two parts: (i) powers to be exercised through the Board of directors, and (ii) powers to be exercised through shareholders in a common meeting. Within the limits laid down through the Act and the articles, the powers of the directors are supreme and the shareholders cannot alter or restrict their powers through 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 concerning company's affairs, decisions necessity be taken at the meetings of the Board or through circulation of proposal in the middle of the members of the Board.

But the Board has the power to delegate authority in sure compliments to an individual director or to a committee of directors.

Though the shareholders cannot usually interfere or restrict the powers of the directors, but, in the following exceptional cases, the common meeting of shareholders may exercise powers conferred on the Board of directors:

- Where the directors act mala fide and against the interest of the company, for instance, when their personal interest conflict with their duty towards the company;
- Where the board of directors for some valid reasons become incompetent to act, for instance, all the directors are interested in a scrupulous transaction;
- Where there is deadlock in management i.e., the directors are unwilling to exercise their powers, for instance, when the directors are equally divided and, so; cannot come to any decision.

Powers to be exercised through Board only: According to Section 292 the following powers can be exercised through the Board only through means of resolutions passed at meetings of the Board:

- The power to create calls;
- The power to issue debentures;
- The power to borrow money otherwise than on debentures;
- The power to invest the funds of the company; and
- The power to create loans.

The first two powers cannot be delegated through the Board to any committee but the remaining three powers can be delegated to any committee or sub-committee, if any.

Though, such delegation can be made through the Board through passing a resolution at the meeting of the Board, which necessity specify the nature and extent of power which can be exercised through the delegate. The shareholders, in common meeting, can impose . restrictions or circumstances on the exercise through 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:

- The power to fill up the casual vacancies on the Board;
- The power of sanctioning a contract on which a director is interested;

- 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;
- The power of creation investments in shares or debentures of companies under the similar management;
- The power of getting notice of disclosure of shareholdings through directors and persons deemed to be directors;
- The power to create declaration of solvency in the case of member's voluntary winding up.

The powers under clause (iii) and (iv) are to be exercised through the Board with the consent of all the directors present i.e., unanimously. You should keep in mind that each director shall have only one vote and all matters will be decided [except (iii) and (iv)] through easy 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 common meeting: Section 293 of the Act imposes sure restrictions on the powers of the Board of directors. There are sure powers which can be exercised through the Board of directors only with the consent of the company in the common meeting, they are:

- The power to sell, lease or otherwise of the company's undertaking;
- The power to remit or provide time for the repayment, of any debt due through a director;
- The power to invest, otherwise than in trust securities, the compensation received for compulsory, acquisition of 'the company's undertakings or property;
- The power to borrow money in excess of the total of the paid-up capital on the directors company and its free reserves; and
- The power to contribute to any charitable or other funds not directly linked with the business of the company or the welfare of the employees beyond rs. 50,000 in a year of 1 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 common 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 through this rule. You should note that the restrictions are not applicable to an self-governing private company. It should also be noted that as regards contributions to National Defense Finance or any other finance approved through the Central Government for the purpose of national defense, Section 293-B empowers the Board of directors to create such contributions without any limit and without obtaining the sanction of the company in common meeting.

Other restrictions on the powers of the Board: In addition to the restrictions imposed through Section 293, there are two more restrictions:

- ***Restriction on creation political contributions:*** According to Section 293-A, Government companies and companies which have been in subsistence for less than three financial years are prohibited from creation 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 necessity not exceed five per cent of its average net profits throughout the three immediately preceding financial years. Further, for creation such contributions, a resolution authorizing such contribution, should be passed at the meeting of the Board of directors. Every company is required to provide the necessary information in its profit and loss account concerning the amount of contribution and the name of the party or the person to whom the amount has been given.
- ***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 common 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:

- Power to create contracts with third parties on behalf of the company;

- Power to recommend dividends;
- Power to allot, forfeit and transfer shares of the company;
- Power to appoint director to fill up the casual vacancy;
- Power to take decision concerning the conditions and circumstances for the issue of debentures;
- Power to appoint managing director, manager or secretary of the company;
- Power to form policy and issue instructions for the efficient running of the business; and lastly
- Power of control and supervision of work of subordinates.

DUTIES OF DIRECTORS

You have learnt that directors of a company inhabit an significant location in the management of the company and they have vast powers, Though, 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 necessity 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 hound to provide 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:

- Statutory duties; and
- Common duties.

Statutory Duties

Some of the statutory duties of directors are:

- Every director necessity disclose his shareholdings in the company [Sec. 308].
- Every director necessity disclose his personal interest in contracts to be entered into through the company [Sec. 299],

- Directors necessity not receive any loan from a public company or its subsidiary of which he is a director in contravention of Section 295.
- To hold statutory and annual common meetings and lay before the company a Balance Sheet and Profit and Loss Account and other reports.
- To convene extraordinary common meeting on the requisition of the specified number of members.
- Directors necessity not receive remuneration in contravention of Section 309 read with Section 198.
- To file with the Registrar the reports and resolutions as required through the Act.
- To uphold books and registers required under the Act and articles.
- To perform all such duties as required under the Act and articles.

Common Duties

There are some duties of a common nature which every director necessity discharge. The following are some of the common duties:

- ***Duty of good faith:*** The directors inhabit a fid salary location in a company. Fiduciary location means a location of trust and confidence. So, directors necessity act honestly and diligently in the interest of the company and shareholders. They necessity not create any secret profits from their dealings with the company. If a director creates some secret profits through utilizing his location, he shall be liable to account for it.
- ***Duty of reasonable care:*** The directors should discharge their duties with reasonable care. The degree of care expected from him is the similar as is reasonably expected from persons of their knowledge and status. If the directors fail to exercise due care and ability in the performance of their duties, they shall be liable for negligence. But they cannot be held liable for mere errors of judgment.
- ***Duty to attend the Board Meetings:*** The duties of directors are of an intermittent nature to be performed at periodical board meetings. So, 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 era of three months (whichever is longer) without obtaining permission, his office shall automatically falls vacant.

- ***Duty not to delegate:*** The directors necessity perform their duties personally. They are appointed because of their ability, competence and integrity, so, the maxim delegatus non potest delegare (a delegate cannot delegate further) is applicable to them. But if permitted through articles of the company, the directors can delegate sure functions to the extent permitted through the Act of the articles.
- ***Duty to disclose interest:*** The fiduciary location of a director requires him to disclose. Director to the Board his personal interest in any contract to be entered through the company. This is necessary to prevent any disagreement flanked by 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 necessity disclose this interest.

LIABILITIES OF DIRECTORS

The liabilities of directors can be discussed under several heads.

- ***Liability as shareholder:*** The director's liability as shareholder is usually the similar as that of any other shareholder. But a company may alter its memorandum and create the liability of all or any of the directors unlimited. This, though, 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 arrears for more than six months, he shall have to vacate the office of director.
- ***Liability to outsiders:*** Directors act for the company, as such they cannot be held personally liable to outsiders for any acts done through them on behalf of the company. They would, though, be personally liable to outsiders in the following circumstances:

- When they enter into contracts in their own names and not in the name of the company. For instance, when they sign a negotiable instrument without mentioning the name of the company, they shall be personally liable.
- 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.
- Where they have permitted the issue of a prospectus which contains misstatements or which does not present the true location, the directors shall be personally liable.
- Where the directors fail to return the application money within the specified time, if the minimum subscription is not subscribed.
- Where there is irregular allotment of shares,
- Where the directors act fraudulently, for instance, when they purchase goods or incur liability at a time when they know that the company will never be liable to pay the amount,
- ***Liability to Company:*** Directors have some duties towards the company through virtue of their office. The directors are liable to the company in the following cases:
- *Ultra vires Acts:* Directors are personally liable to the company for ultra vires acts i.e., acts which are beyond their powers. For instance, if they pay dividends out of capital, they will be liable to the company f6r any loss or damage suffered due to such ultra vires acts.
- *Negligence:* If the directors perform their functions in a negligent manner, they incur personal liability to the company. They are, though, not liable for errors of judgment.
- *Breach of trust:* The directors inhabit a fiduciary location towards the company. They necessity act honestly and in the interest of the company. If the directors create some secret profits or use the company's property for their personal use, then they shall be liable to the company.

- *Misfeasance:* The misfeasance means willful misconduct or willful negligence resulting in some loss to the company. The company can take action against the directors for damages in case of misfeasance.
- ***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:
- Issue of a prospectus containing an untrue statement.
- Failure to deposit application money in a schedule Bank.
- Fraudulently inducing persons to invest money in the company.
- Accepting deposits or inviting any deposit in excess of the prescribed limit. Destruction, mutilation, alteration, or falsification of any books, papers, or documents.
- Failure to file annual returns.
- Default in holding the annual common meeting.
- ***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 exposed the fraud. But a managing director or the chairman signing the accounts without understanding its implications cannot escape liability.

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:

- A meeting of the Board of directors of every company necessity be held once in every three calendar months and at least four such meetings necessity be held every year. That Central Government may, though, through notification in the Official Gazette, exempt any class of companies from the 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 in relation to the lay 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 close to the lay of the registered office of the company.

- Notice of every meeting of the Board necessity be given in writing to every director in India at his usual address, The Act prescribes no scrupulous form of notice or mode of service or length of era of notice. Therefore even a few minutes notice would be enough. The failure to provide notice to any director renders the meeting invalid.
- 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, that the remaining directors who are not interested shall form the quorum throughout that time, provided their number is not less than two. In a Board meeting quorum necessity be present throughout the meeting and not merely at the commencement of the meeting,
- If a meeting of the Board could not be held for want of quorum, it shall stand adjourned till the similar day in the after that week at the similar time and at the similar lay. If that day happens to be a public holiday, then it will be held on the after that following day, which is not a public holiday.
- It is essential that all the proceedings of every meeting of the Board should be recorded in writing in a book described the minute book. Minutes of every meeting necessity be signed through the chairman in whose attendance those resolutions were passed or through the chairman of the after that succeeding meeting. As per Section 289, the resolution may also be passed through circulation.

REVIEW QUESTIONS

- Who are the directors of a company? How are they appointed?
- Explain the rules concerning the number of directors and directorships.
- Talk about the legal location of directors.

- What restrictions have been imposed through the Companies Act in respect of appointment of directors?
- Explain the qualifications and disqualification for the office of a director.

PART 4. MEETINGS AND WINDING UP

CHAPTER 11

Company Secretary

STRUCTURE

- Learning objectives
- Meaning of a company secretary
- Qualifications of a company secretary
- Secretary in whole-time practice
- Appointment of secretary
- Removal of secretary
- Location of a company secretary
- Duties of a secretary
- Liabilities of a secretary
- Rights of a secretary
- Role of a secretary
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Describe a company secretary
- Describe the qualifications and appointment of a company secretary
- Explain 'the location of a company secretary
- Describe the duties and liabilities of a company secretary.

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 keep in mind 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 mannered in accordance with the provisions of the Companies Act and articles of association of the company.

The Indian Companies Act, 1956 (as amended through 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 through 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(l) of section 2 of the Company Secretaries Act, 1980, and comprises any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed through 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 definition or a secretary, the following three points emerge:

- Only an individual can be appointed as a company secretary. Therefore a firm or a body corporate cannot be appointed as a company secretary.
- The company secretary should possess the qualifications prescribed through the Central Government.
- The duties of the company secretary are of a ministerial or administrative nature.

You should keep in mind 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 through directors, to act or enter into a contract or create symbols so as to bind the company.

QUALIFICATIONS OF A COMPANY SECRETARY

According to Section 2 (45) of the Companies Act, a company secretary necessity possess the qualifications prescribed through 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, necessity 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

- Every Company having a paid up share capital of Rs. 25 lakhs or more should have a whole time secretary.
- 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. So, companies having a paid up share capital of less than Rs. 25 lakhs may riot '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.

- A member of the 'Institute of Company Secretaries of India;
- Any person who has passed the Intermediate examination mannered through the
- Institute of Company Secretaries of India;
- Post-graduate degree in Commerce or Corporate Secretaryship granted through any University in India;
- Law graduate from any University;
- A member of the Institute of Chartered Accountants of India;
- A person holding post-graduate degree or diploma in Management science granted through any University or the Institutes of Management Ahmedabad, Calcutta, Bangalore, or Lucknow;
- A member of the Institute of Cost and Works Accountants of India;
- Post-graduate diploma in company secretaryship granted through the Institute of Commercial Practice, Delhi, under Delhi Administration or diploma in corporate laws and management granted through the Indian Law Institute, New Delhi;
- Post-graduate diploma in Company Law and Secretarial Practice granted through the University of Udaipur, or
- A member of the Association of Secretaries and Managers, Calcutta.

A company secretary should also possess some other qualifications. Me necessity have common knowledge including the knowledge of the industry and trade, then only he can render useful advice to directors. He necessity have a sound knowledge of dissimilar 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.

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 practicing 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. Therefore , 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 practice 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:

- To engage himself in the practice of the profession of company secretaries to, or in relation to, any company; or
- To offer to perform or perform service in relation to the promotion, forming, incorporation, amalgamation, reconstruction, re-organisation or winding up of companies; or
- To offer perform or perform such services as may be performed through—
- Authorized representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including shapes, applications and returns) through or on behalf of the company;
- A share transfer, gents;
- An issue house,
- A share and stock broker;
- A secretarial auditor or consultant;

- 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 through a recognized stock swap, the monopolies and restrictive trade practices act, 1969, the foreign swap (regulation act, 1973; or under any other law for the time being in force,
- Issuing certificates on behalf of, or for the purposes of a company; or
- To hold himself out to the public as a company secretary in practice; or
- 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
- To render such other services as, in the opinion of the Council, are or may be rendered through a company secretary in practice;

The amendment Act of 1988 has also specified sure areas wherein certifications through secretary in whole time practice have been recognized, namely:

- Under section 33(2) of the Companies Act, a statutory declaration in Form No. 1 of the Companies (Central Government) Common Rules & Shapes, 1956 for compliance of legal formalities for incorporation of the company can now be given through a company secretary in whole time practice.
- 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 through a secretary in whole-time practice has been filed with the Registrar that all the required formalities have been complied with.
- Under Section 161, annual return of a company whose shares are listed on a recognized stock swap, in addition to being signed through a director and the manager or the secretary is also required to be signed through a secretary in whole-time practice.

- Under Section 269 read with Schedule XIII to the Companies Act the statutory certificates of compliance with the necessities for appointment of managing director or whole-time director or manager can given through secretary in whole-time practice.

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. Though, in practice, every company usually appoints a secretary and the necessary provision is made in the articles of association for that purpose.

Presently like the first directors of the company, the first secretary may be appointed through 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 provide the person the right to be appointed as the secretary. He cannot sue the company if he is not so appointed subsequently through the Board of directors. There should be an self-governing contract flanked by the company and the secretary so named in the articles. So, the first secretary appointed through promoters should enter into a fresh contract with the company after its incorporation.

Normally, the appointment of a company secretary is made through the Board of 'directors in their first meeting through passing a resolution. A service agreement is executed flanked by the company and the secretary in which the conditions and circumstances of his appointment, remuneration etc. are stated. In big-sized companies, the managing director may be authorized through the Board to appoint a secretary.

A director, being an individual can be appointed as secretary, but it requires the 'approval of the company through 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 necessity be recorded in the Register of Directors/Manager/Secretary and the requisite particulars relating to such appointment necessity be filed in duplicate in the prescribed form with the Registrar of companies within thirty clays 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 common meeting for such appointment [Section 314],

REMOVAL OF SECRETARY

Company that the appointment of a company secretary is usually done through means can resolution of the Board of directors, as such he can be removed through the Board of directors or through the managing director, if he is so authorized through the Board.

When 2 secretary is appointed, the conditions and circumstances of his service are stated in the service agreement. Usually, there is a clause in the service agreement which gives 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 through the general law governing the connection of master and servant. Though, the secretary necessity be given due notice of termination of his employment in accordance with the conditions and circumstances of his employment. In case no era 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 conditions through giving him a reasonable notice.

The services of a secretary may, though, be terminated without notice for willful 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 along with other employees of the company..

LOCATION OF A COMPANY SECRETARY

The location of a company secretary has undergone a tremendous change duting the last so several years. He has arisen from the location of a clerk to an indispensable figure in the corporate hierarchy. Though, it is very hard to explain precisely the location of a company secretary. The Companies Act does not describe the exact location of a secretary. The location of a company secretary can be discussed under the following headings:

- ***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 location is that he is to do what he is told. There is a service agreement flanked by the secretary and the company and his employment is governed through the conditions and circumstances of this agreement, so 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 through the Board. He cannot exercise self-governing desertion in the work assigned to him.

- ***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 staff, workers, trade unions, shareholders and the outsiders. So he has to use his discretion in dealing with such matters. He is an significant link flanked by the company and the outsiders. All policy decisions are conveyed through the secretary to the staff and outsiders.
- ***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 several sections of the Act. He is responsible for the compliance of several legal formalities under dissimilar 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 through method 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 161i)], create declaration concerning commencement of business (Section 149), authenticate the Balance Sheet and Profit and Loss Account (Section 215), and to create declaration under Section 33(2) of the Act that all the formalities required through the Act and the Rules therein have been complied with in respect of registration of a company. The secretary is recognized as "principal officer” under the Indian Stamp Act, M.R.T.P. Act, Income Tax Act, Sales Tax Act etc.
- ***As an Advisor to the Board:*** The secretary plays an significant role and enjoys a unique location in the management of the company.

Though the policies of the company are formulated through the directors, but since the secretary has complete information in relation to the all internal matters and changes in the policies of the government, he is in a better location to supply the required information and advice to the directors. He advises the Board on several legal matters. He can be described as the real guiding spirit behind the Board of directors.

It should be clear to you that the location of the secretary has changed in excess of 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 arc the brains of the company, the secretary is its ears, eyes, and hands.

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, separately from the secretarial duties, the company secretary is normally entrusted with legal, administrative and management functions.

In big sized companies, there are separate managers in charge 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 capability, namely, as an agent of the Board of directors, as a person' in charge 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) common duties. The statutory duties can further be subdivided into two—duties under Companies Act and duties under other Acts,

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 through the company under Section 54.

- Filing of necessary documents and return his with the Registrar of Companies, e.g. return of allotment of shares, annual returns, annual accounts etc.
- Giving the notice of the augment 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.
- Creation 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 lay of its business and to get is engraved on the seal of the company (Section 147).
- Creation a statutory declaration for obtaining the certificate of commencement of business (Section 149).
- To create accessible for inspection and furnish copies of register of members (Section 163).
- Sending notice of common meetings to every member of the company (Section 171).
- Filing of sure agreements and resolutions with the Registrar (Section 192).
- Keeping minutes of the proceedings of common meetings and of Board of directors and other meetings. xiii) Maintaining the several registers and statutory books of the company, such as Register of Members, Register of Directors, Register of charges etc.

In several 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. A secretary, in the middle of others has been defined as an officer in default

Duties Under Other Acts: A company secretary has also to see to it that the necessities 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 authentication in the Government treasury. Under the Indian Stamp Act, the secretary should ensure that several documents like share certificates, transfer shapes etc. are properly stamped as per the necessities of the Indian Stamp Act.

The secretary is also required to comply with the provisions of several labour and industrial laws such as The Factories Act, The Industrial Disputes Act, and Minimum Wages Act. etc.

Common Duties

A secretary is required to perform many common duties as follows:

- To carry out the orders of the Board of directors.
- To assist the Board in the formulation of policy decisions.
- Not to disclose on confidential information relating to the affairs of the company.
- Not to create any secret profits on account of his location.
- To net as a medium and link flanked by the company and outsiders.
- To give information to the shareholders.
- To acquire supervise arid coordinate the office work.

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 and mannered in accordance with the provisions of the Companies Act and articles of association. If a default is made in complying with sure 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 significant officer of the company and he has to comply with not only the provisions of the Companies Act but also the necessities of the Income Tax Act, Indian Stamp Act, labour and industrial laws. The company secretary may be held for the following:

- Default in holding the statutory meeting and filing the statutory statement with the Registrar (Section 165),

- Default in holding the annual common meeting (Section 168), default in filing a return of allotment (Section 75),
- Default in the preparation of share certificate within three months of allotment and two months after the application for registration of transfer (Section 113), default in maintaining the register of members (Section 150), and default in circulating members' resolutions of which they have given notice to the company (Section 188).
- Default in getting the name of the company pointed or affixed outside the registered office and every office or lay of business, and engraving it on the seal of the company (Section 147), default in filing the annual returns (Section 162),
- Default in recording the minutes of the meetings of the shareholders and the Board (Section 193),
- Default in registering sure resolutions and agreements requiring registration (Section 192),
- Default in maintaining the register of directors (Section 303),
- Default in maintaining the statutory registers such as index of register of members, register of loans, register of charges etc.,
- Liability for creation any false or misleading statement. A secretary can escape from the liability if he can prove that his liability was expressly excluded either through law or through the articles of the company or through 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 skill under the circumstance. Separately 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, and Sales Tax Act .

Contractual Liabilities

In addition to the several statutory liabilities, a company secretary has many contractual liabilities which arise out of his service agreement, they are as follows:

- He shall be liable for any loss or damages caused to the company through willful neglect or negligence in the discharge of his duties;
- He shall be personally liable if he acts beyond his authority;
- He shall be liable to account for the. Secret profits made through him through virtue of his
- He shall be liable to indemnify the company for any loss suffered through the company as a result of disclosure of some secret information relating to the company some rights are given to the secretary through the Act. Board of directors and the common with the company.

ROLE OF A SECRETARY

The company secretary plays an significant 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.

Statutory Officer

As a principal officer of the company the company secretary is responsible for strict compliance with the several provisions of the 'Companies Act and the necessities of other Acts. He is responsible for proper maintenance of books of accounts and other registers. He has to sign many documents such as annual returns, return of allotment, and 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.

Coordinator

A company secretary is the link flanked by 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 flanked by 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 many self-governing 'departments such as sales, purchase, personnel etc., he acts as a coordinator with these functionaries for ensuring that the policy decisions are duly accepted out and if there are some matters which require further consideration, the secretary shall lay 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 big. He is to ensure the compliance of the provisions of companies Act and several 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 concerning the matters where the company can contribute to the welfare of the society.

Administrative Officer

As a common administrative officer, lie is responsible for efficient administration of the company. He has to supervise, control, and coordinate the functioning of dissimilar departments such as finance, personnel, and organisation. He should develop a strong and efficient organizational 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 lay, a secretary is expected to play a still more significant 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 organizations.

REVIEW QUESTIONS

- Describe the term 'Secretary' under the Companies Act. Who can be appointed as a secretary of a company?
- How is the secretary of a company appointed? State how can he be dismissed?
- State the qualifications which a company secretary should possess.
- Talk about the legal location of 3 company secretary state his main functions.
- Talk about the statutory 'and 'contractual liabilities company secretary.

CHAPTER 12

Meetings and Resolutions

STRUCTURE

- Learning objectives
- Meaning of meeting and its importance
- Types of meetings and their importance
- Statutory meeting
- Annual common meeting
- Extraordinary common meeting
- Requisites of a valid meeting
- Notice of meetings
- Quorum for meetings
- Proxies
- Voting
- Chairman
- Resolutions
- Minutes
- Review questions

LEARNING OBJECTIVES

After learning this Unit, you should be able to:

- Explain the meaning of a company meeting
- Talk about the importance of company meeting
- Explain the several kinds of meeting
- List the requisites of a valid meeting
- Explain the rules concerning the notice and quorum
- Explain the dissimilar kinds of resolutions and the purposes for which they can be passed.

MEANING OF MEETING AND ITS IMPORTANCE

Meeting may usually defined as the gathering, assembly or coming jointly 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 talk about matters of mutual interest and take significant decisions. Meetings give a lay for fruitful participation where free and frank discussion takes lay. The decisions taken at the meetings usually become acceptable and are met with least resistance.

To constitute a valid meeting there necessity be at least two persons, because a meeting cannot be constituted through one person. But there are sure circumstances where one person can constitute a valid meeting, they are:

- Where one person holds all the shares of a scrupulous class, he alone can constitute a meeting of that class;
- Where the meeting is described through an order of the Company Law Board, the Board may direct that one member of the company present in person or through proxy shall constitute a valid meeting.

Company meetings play a important role in decision creation procedure. They give 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 common meeting of shareholders. Meetings constitute a very significant aspect in the management and administration in the company form of organisation.

TYPES OF MEETINGS AND THEIR IMPORTANCE

Company 'meetings can broadly be classified as follows

- Meetings of Shareholders: Such meetings are also recognized as common meeting of the members which are held to exercise their communal rights. The meetings of the shareholders may again be of the following four kinds:
- Statutory Meeting;
- Annual Common Meeting;
- Extraordinary Common Meeting; and
- Class Meeting.
- 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 kinds:
- Meetings of the Board of directors; and

- Meetings of the committee of directors.
- Other Meetings: These meetings may be either of the following:
- Meetings of debenture-holders;
- Meetings of creditors.

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 through shares or limited through guarantee and having a share capital necessity hold a common meeting of members of the company within a era 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 described as the 'statutory meeting' and it necessity be specially stated so in the notice calling it. A private company is not required to hold a statutory meeting.

Purpose of Statutory Meeting

The primary objective of holding the statutory meeting is to inform the shareholders in relation to the facts relating to the formation of the company, shares taken up, money received, contracts entered into, preliminary expenses etc. It provides an opportunity to the members to talk about matters relating to the formation of the company. This enables them to know the location and future prospects of the company. This meeting enables the members to meet the directors and they can satisfy themselves that the money subscribed through them is being properly used.

Notice of Statutory Meeting

Statutory meeting is treated as a common meeting and as such 21 days clear notice in writing necessity 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 through members holding at least 95 per cent of the paid-up capital carrying voting rights, or on behalf of 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 necessity expressly state that the meeting is the statutory meeting of the company. A copy of the statutory statement necessity also be sent along with the notice.

Statutory Statement

The Board of Directors is required to prepare a' statement described the 'statutory statement'. You have learnt that along with the notice convening the meeting, this statutory statement should also be sent to each Member. If the statutory statement 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 Statement

According to Section 165(3) of the Companies Act, the statutory statement necessity provide the following information:

- 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;
- An abstract of receipts and payments of the company upto a date within seven days of the date of the statement and the balance of cash in hand;
- 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;
- Names, addresses, and job of the directors, auditors, manager, and secretary. Changes, if any, in these compliments, since the incorporation, are also required to be given;
- 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;
- The extent to which underwriting contracts have not been accepted out, and reasons therefore;
- The arrears, if any, due on calls from directors and from the manager; and 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 statement necessity be certified as correct through not less than two directors, including the managing director, where there is one. -With regard to the shares allotted through the company and the cash received in respect of such shares and the receipts and payments is also required to be certified as correct through the auditors.

A certified copy of the statutory statement necessity be sent to the Registrar after sending the statement 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 along with the number of shares held through them. This list shall remain open and accessible to any member of the company throughout the continuance of the meeting.

The members present at the meeting are free to talk about any matter relating to the formation of the company or arising out of the statutory statement, 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 statement, 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 statement is not filed with the registrar.

ANNUAL COMMON MEETING

The annual common meeting of the company is an significant 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 throughout a year. The shareholders can lay their views before the management and can seek clarifications on matters in relation to the which they are not satisfied. Therefore , you note that an annual common meeting is very significant.

Every company, public or private, necessity in each calendar year, hold in addition to any other meeting a common meeting as its annual common meeting and the notice necessity specify that it is the annual common meeting.

The holding of an annual common meeting is a statutory requirement.

Following are the rules concerning annual common meetings:

- The first annual common meeting of the company necessity be held within a era of 18 months from the date of its incorporation, and if such a common meeting is held within that era, it shall not be necessary for the company to hold any annual common meeting in the year of its incorporation or in the following year. For instance, a company is incorporated on 5th October, 6989 and holds its first annual common meeting 10th March, 1991 (i.e. within 18 months of incorporation), then it need not hold any other annual common meeting in 1990 and 1991. But from the year 1992 onwards, it necessity hold such a meeting in every calendar year,

- The gap flanked by two annual common meetings necessity not exceed 15 months. The Registrar may, though, for any special cause extend the above time through a era not exceeding three months.
- At least 21 clear days' notice of the meeting in writing necessity be given to every shareholder, directors and auditors of the company, A shorter notice may also be given if it is agreed to through all the members entitled to vote at the meeting.
- The annual common meeting of the company necessity be described on a working day throughout business hours either at the registered office of the company or at some other lay within the city in which the registered office of the company is situated. Therefore , no meeting can be described on a public holiday, for instance on 15th August, 2nd October, and 26th January. If any day is declared through the Central Government to be a public holiday after the issue of notice convening the annual common meeting, it shall not be deemed to be a public holiday and the meeting could be held on that day as scheduled.
- The Board of directors can cancel or postpone the holding of the meeting on the scheduled date, but this power should be exercised through 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 through the meeting.

Consequences of not holding Annual Common Meeting

You learnt that holding of the annual common meeting is a statutory requirement. If a company creates a default in holding the annual common meeting in accordance with the provisions of Section 166 of the Companies Act, the following two consequences will follow:

- 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 contain a direction that one person present in person or proxy shall constitute the annual common meeting. A meeting described through the order of the Company Law Board shall be deemed to be annual common meeting of the company.

- 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 throughout which the default continues.

The Business to be Transacted

According to Section 173 of the Companies Act, at the annual common meeting ordinary business is to be transacted. Any other business can also be transacted at the annual common meeting, but that will be termed as ‘special * business'. Therefore , the annual common meeting can transact both ordinary and special business. The following ordinary business is usually transacted at every annual common meeting:

- The consideration of the account, balance sheet and the reports of the Board of directors and auditors;
- The declaration of dividend;
- The appointment of directors in the spaces of those retiring; and iv) the appointment of the auditors and fixing their remuneration.

If any other business is to be transacted at the annual common meeting, it shall be treated as special business. Special business can be transacted at an annual common 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 through an ordinary resolution or special resolution as required through the Act.

EXTRAORDINARY COMMON MEETING

All common meetings of a company other than the statutory and annual common meeting are described 'extraordinary meetings'. Extraordinary common meeting is a meeting which is held flanked by two annual common meetings. These meetings are described in emergencies or on special occasions: This meeting is described to talk about some urgent special business which cannot be postponed till the after that annual common meeting, for instance, 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 common meeting may be described through

- Board of directors on its own motion;
- the Board of directors on the requisition of members; or
- the requisitions themselves; or
- the Company Law Board.
- Through the Board of Directors: Clause 48 of Table A states that "the Board may, whenever it thinks fit, call an extraordinary common meeting," Though, the Board has to gas the resolution for convening such meeting.
- Through the Board on requisition: According to Section 169 of the Act, the Board of directors necessity call an extraordinary common meeting of the company on the requisition of required number of members. The requisition letter for calling this meeting necessity be signed through members holding at least one-tenth of the paid-up capital and having a right to vote an the matter of requisition. In the case of a company having no share capital, it necessity be signed through those members who have at least one-tenth of the total voting' power. The requisition necessity state the purpose for which the meeting is requisitioned and it necessity 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 necessity 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 common 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 judgment on the business.

- Through the Requisitianist: 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 necessity hold the meeting within three months from the deposit of the requisition. Such meeting necessity, as almost as possible, be held in the manner as described through 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 described through 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.

Through 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 cause it is impracticable to call or conduct an extraordinary common 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 instance, if the meeting cannot be described 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 influenced that it is in the superior interest of the company. While calling a meeting, the Company Law Board may provide such directions as it thinks fit, including the direction, that one member present in person or through proxy would constitute the quorum.

Like any other common meeting, the notice of the extraordinary common meeting necessity also be given at least 21 days before the date of the meeting specifying the date, time and lay of the meeting. The notice necessity also specify the special business to be transacted at the meeting. You should note that unlike an annual common meeting, extraordinary common meeting may be held on any day including a public holiday. The meeting may be held at a lay other than the registered office of the company or even outside the city in which the registered office is situated.

REQUISITES OF A VALID MEETING

The decisions taken at the common meeting shall be valid and binding only if the meeting itself has been properly described and mannered. Any irregularity in calling or conducting the meeting shall invalidate the proceedings of the meeting. The company meetings necessity be mannered 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:

- ***Proper Authority:*** The meeting shall be valid only when it is described through 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 common meeting, otherwise the notice calling the meeting will become invalid and the proceedings of the company shall not be effective (Harban V. Phillips). Therefore , a notice issued through 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 common meeting, but under sure circumstances the meeting may be described through requisitionists or through the Company Law Board.
- ***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, and directors of the company and to every such person who is entitled to attend the meeting. The notice necessity be clear and should state the purpose for which the meeting is described. The notice necessity be in writing and it necessity 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. Likewise, the non-receipt of the notice will not affect the validity of the meeting. The notice necessity state the date, time and lay of meeting.
- ***Quorum:*** Quorum means the minimum numbers of members whose attendance is necessary at the meeting for transacting the business of the company. In the absence of a quorum, no meeting can be held every resolution passed at a meeting without quorum shall be invalid.

- ***Chairman:*** Every common meeting of the company should be presided in excess of through a chairman. The chairman has to be there to conduct the meeting In a proper and smooth manner. The articles usually give the mode of appointment of the chairman of a meeting. If the articles do not give 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 necessity act in an impartial manner.
- ***Properly Mannered:*** It is essential that the business at the meeting necessity be mannered according to rules. Company meetings are held for discussing scrupulous issues relating to the company " working and taking a decision on the similar. The matter should be placed in the form of a resolution, it should be discussed thoroughly, amendments to it should be cautiously measured and then it should be decided through voting through illustrate of hands or poll.
- ***Proper Record:*** A proper record of the proceedings should be kept in the Minutes Book. Every company is required to uphold minutes of the proceedings of every common meeting and meetings of the Board and its Committees. When the minutes are confirmed and signed through the chairman, they are acceptable in a court of law as proof of the proceedings. '

NOTICE OF MEETINGS

The normal rule for any meeting of shareholders of a public company is that the meeting should be described through giving a notice of not less than 21 clear days. 'Though, a private company may give in its articles for a shorter notice. The essentials of a valid notice are:

- It necessity clearly state the date, time and lay of the meeting as also the purpose. of the meeting,
- The notice necessity be issued on the authority of a resolution of the Board of directors. .
- The notice should be signed through a person authorized through the Board. Usually, a director of the Board or the company secretary would sign the notice.

- It necessity 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. Therefore in normal practice, 21 clear days would mean 23 days. Further, if the notice is to be sent through post, another 48 hours are to be added to the 23 days. Therefore the notice necessity be sent at least 25 days before the date of the meeting. 'A shorter notice can also be given. In the case of annual common 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 common meeting are:

- Every member of the company;
- Persons entitled to a share in consequence of the death or in solvency of the member;
- Auditors of the company for the time being;.
- Public trustees in respect of holdings to which Section 153B is applicable.

Further, if the notice pertains to the meeting of a scrupulous class of shareholders, then , it should be sent only to the shareholders of that class.

QUORUM FOR MEETINGS

A quorum is the minimum number of persons who necessity 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 in transacted at such meeting will be invalid. The main purpose of having a quorum is to avoid decisions being taken at a meeting through a small minority which may not be acceptable to the vast majority of members.

Usually, the quorum is fixed through the articles of the company. According to Section 174 of the Companies Act, unless the articles give for a superior number, five persons personally present (and not through 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 common 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 described 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 similar day in the after that week, at the similar time and lay, or to such other day and at such other time and lay 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 necessity keep in mind that there necessity be at least two persons to hold the meeting. These provisions are also applicable to private companies, if the articles do not give otherwise.

According to Article 49 of Table A, the quorum necessity be present at the time when the meeting begins and proceeds, to take up business. It means that the quorum necessity, 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 necessity be present throughout the meeting. You should note that a quorum is presumed unless it is questioned at the meeting.

PROXIES

The term 'proxy' is used both for the person who is authorized to act and vote for another at a meeting of the company and the instrument through which such a person is named and authorized 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. Therefore , any person may be appointed as a proxy whether he is a member of the company or not.

Unless the articles give 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 similar occasion. The instrument appointing a proxy necessity be in writing and signed through the appointor or his attorney duly authorized in writing and necessity 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 similar to the Chairman for answer. For each meeting a separate proxy is required. A proxy can demand a poll and unless the articles otherwise give a proxy is not allowed to vote except on a poll.

Every notice of a meeting necessity 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 throughout the business hours. You necessity keep in mind that a proxy is always revocable, but it can be revoked before the proxy has voted. For revoking the proxy, the company necessity 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.

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 talk about every proposed resolution and propose amendments therein. After the motion is discussed, it is put to vote. The voting may be (a) through illustrated of hands or (b) through taking a poll.

Through Illustrate of Hands

At any common meeting, a resolution put to vote is decided first through illustrate of hands. On a illustrate of hands, each member shall have one vote. Unless the articles otherwise give, 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 information. Though, the dissatisfied shareholders may challenge the validity of the passing of the resolution or they may demand a poll.

Through Taking a Poll

If there is dissatisfaction in relation to the result of voting through illustrate 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 illustrate of hands.

In the case of a public company having a share capital, a poll may be demanded through 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 through one member personally present or through proxy if seven such members are personally present in the meeting or through 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 through voting through illustrate 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 give, members holding shares on which calls are in arrears 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 through 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 . necessity be taken immediately and in all other cases, the chairman necessity 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 statement 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.

CHAIRMAN

Chairman is the person who has been designated or elected to preside in excess of and conduct the proceedings of a meeting. A chairman is necessary for conducting at meeting properly. He is the chief authority in the meeting, he is the umpire of, debates, and he regulates the meeting.

Articles usually give 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 Meetings and Resolutions elect one of themselves to be the chairman of the meeting. If a poll is demanded on the election of the chairman, it necessity 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 520 f Table A state the rules concerning the appointment of chairman. The articles usually give at the common 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 provide 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 authorized through the articles, the chairman may provide his casting vote to decide the issue where the members are equally divided for and against the resolution.

The chairman necessity see to it that the proceedings of the meeting are mannered 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 necessity act bonafide at all times and in the interest of the company.

RESOLUTIONS

Decisions of the members at a common meeting are expressed through method of resolutions. At the meetings a definite proposal in the form of a 'motion' is placed, it is discussed thoroughly and finally is gut to vote. When the motion is gassed through a majority, it is described a resolution. In easy words, resolution means the decision taken at the meeting.

The Companies Act gives for three kinds of resolutions that may be passed at the common meeting of a company — (i) Ordinary resolution; (ii) Special resolution; and (iii) Resolution requiring special notice.

Ordinary Resolution

An ordinary resolution is one which is passed through a easy majority, that is to say that the votes cast in favor of the resolution exceed the votes cast against the resolution. For instance, if at a meeting where, say, 81 members cast their votes in a manner that 41 cast votes in favor and 40 against the motion, the ordinary resolution is said to be taken as passed. The voting may be either through illustrate of hands or through 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.

Special Resolution

A special resolution is one which is required for transacting special business and is required to be passed through a three-fourths majority. The voting may be either through illustrate of hands or through polls. In determining the three-fourths majority, all the votes cast through members, whether personally or through proxy, are measured.

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 common meetings;
- The notice has been duly given of the common meetings; and
- The votes cast through members in favor of the resolution are not less than three times the number of votes cast against the resolution.

The special resolution is necessary to transact significant 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 sure matters. The following are some of the instances where special resolutions are necessary:

- To alter the memorandum of association;
- To alter the articles of association;
- To make reserve capital;
- To reduce capital;
- To pay interest out of capital;
- To allow a director to hold office of profit in the company;
- For voluntary winding up of the company.

Resolution Requiring Special Notice

A resolution requiring special notice is, in information, not a kind of resolution, but is a type of ordinary resolution for which a prior notice of intention to move the resolution has to be given to the company. With regard to sure matters, a special notice is required to be given of a resolution to be moved at a meeting of the company. The substance is to provide members enough time to consider the proposed resolution. Where special notice of a resolution is required through the Act or the articles, the notice of the intention to move the resolution necessity be given to the company at least 14 full days before the date of the meeting. On receipt of such a notice the company necessity provide 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 through the articles.

According to the Companies Act, a resolution requiring special notice is required to transact the following business:

- To remove a director 'before the expiry of his term;
- To appoint an auditor in lay of the retiring auditor;.
- To appoint a new director in lay of the removed director;
- To pass a resolution that retiring auditors shall not be reappointed.

MINUTES

The Companies Act, gives that every company necessity stay 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 described the minute book, kept for the purpose. Each page of the minute book should be initialed and last page signed and dated through the chairman of the meeting: The minutes duly signed through the chairman are presumptive proof that the meeting was duly described and held and all proceedings duly accepted out. The minutes book should be kept in the safe custody so as to avoid any tempering of the similar. The minutes of a common meeting should also be signed within 30 days of the meeting, through the chairman of the meeting or any other authorized person. The minutes book relating to the common meeting is open to inspection of any member of the company without charge throughout 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 common meeting op payment of such sum as may be prescribed for every 100 words or part thereof. ”

REVIEW QUESTIONS

- What are the dissimilar kinds of meetings of a company? Explain the purpose of holding such meetings.
- What are the requisites of a valid meeting?

- What is a statutory meeting? When is it held? What business is transacted at such meeting?
- What is a statutory statement? What it necessity contain?
- What is 'notice' of a meeting? Explain briefly the rules concerning the notice of common meeting.
- What is the significance of annual common meeting? What business is usually transacted at such meetings?

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