

LEGAL ASPECTS OF BUSINESS

Content

- Articles of Association
- Prospectus
- Share Capital

ARTICLES OF ASSOCIATION (AOA)

‘Articles’ means the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act. The articles of association are the rules and regulations of a company framed for the purpose of internal management of its affairs. The articles are framed for carrying out the aims and objects of the Memorandum of Association.

Contents of Articles of Association

1. Adoption of preliminary contracts
2. number and value of shares
3. allotment of shares
4. calls on shares
5. lien on shares
6. transfer and transmission of shares
7. forfeiture of shares
8. alternation of shares
9. shares certificate
10. conversion of shares into stock
11. voting rights and proxies
12. meetings
13. directors, their appointment etc
14. borrowing powers
15. accounts and audit
16. dividends and reserves
17. winding up

In the case of companies with the liability limited by guarantee, the articles must also state the number of members with which the company is to be registered. It must also state the extent of liability in the event of winding up. In the case of a private company the articles must also contain the following provisions;

- a. restricting the right to transfer shares, if any
- b. limiting the number of its members to 200 excluding the past and present employee members
- c. prohibiting any invitation to the public to subscribe for any shares in or debentures of the company
- d. prohibiting any acceptance of deposits from the persons other than the directors, members or their relatives.

Memorandum and Articles – Distinction

1. Content and Scope

MOA is the charter of the company and defines the scope of its activities. AOA of the company is a document, which regulates the internal management of the company.

2. Relationship between company, members and outsiders

MOA defines the relationship of the company with the outside world, whereas AOA deals with the right of the members of the company intense and also establishes the relationship of the company with the members.

3. Alteration

MOA cannot be altered except in the manner and to the extent provided by the Act, whereas the AOA being only the bylaws of the company can be altered by a special resolution.

4. Supremacy

Memorandum is a supreme document of the company, whereas articles are subordinate to the memorandum.

5. Ultra-vires Acts

A company cannot depart from the provision contained in the memorandum, and if it does, it would be ultra-vires the company, anything done against the provisions of Articles, but which is ultra-vires the Memorandum, can be ratified.

Doctrine of Constructive Notice

The Memorandum and Articles of association of every company are required to be registered with the registrar of companies. On registration they become public documents and are open for public inspection on payment. Everyone dealing with the company, whether a shareholder or an outsider, is presumed to have read the two documents. This deemed knowledge of the contents of the two documents is known as the constructive notice memorandum and articles.

Doctrine of Indoor Management

The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are presumed to have read these documents and to see that the proposed dealing is not inconsistent therewith, but they are bound to do more; they need not inquire into regularity of the internal proceedings as required by the memorandum and the articles. They can presume that all is being done regularly.

This limitation of the doctrine of constructive notice is known as the “doctrine of indoor management”.

Exceptions

1. Knowledge of Irregularity

Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he can't claim the benefit under the rule of indoor management.

Example: Howard V. Patent Ivory Company. The directors of a company could borrow any amount up to \$ 1, 000 without the approval of the shareholders in general meetings. But for any amount beyond \$ 1, 000 they had to obtain the consent of the shareholders in the General Manager.

The directors themselves lent to the company an amount in excess of the borrowing powers of the company without the consent of the shareholders in General manager. Hence the company was liable to them only for \$ 1, 000.

2. Negligence

Where a person dealing with a company could discover the irregularity if he had made proper inquiries he can't claim the benefit of the rule of indoor management.

Example: Anand Bihari Lal V. Dinshaw and Company, In this case accepted of a company property its accountants. Held, the transfer was void as such as transaction was apparently beyond the scope of the accounting authority.

3. Forgery

The indoor management does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgery committed by its officers.

4. Acts outside the scope of apparent authority

If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound.

PROSPECTUS

Sec.2 (36) defines “Any documents described as a prospectus and include any notice circular, advertisement or documents inviting deposits from the public or inviting offer from the public for the purchase of any shares in or debentures of a body corporate.

Formalities in issuing a prospectus

- Every company is issued by or on behalf of a company must be dated; this date is regarded as a date of its publication
- It should be signed by every director \ agent delivered to registrar on or before the date of application
- The prospectus issued to the public should mention copy of prospectus along with specified with document filed with registrar.
- Authorized form securities exchange board of India
- A prospectus must contain the necessary information to enable the public to decide whether or not to subscribe for its shares.

Contents of a prospectus

1. General Information

- Name and address of registered office of the company
- Details of letter of intent \ industrial license
- Name of stock exchange where listed
- Date of opening, closing of the issue

- Name, address of lead manager, bankers to the issue, brokers to the issue
- Underwriting arrangement

2. Capital Structure of the company

- Authorized, issued, subscribed, paid up capital of the company should be mentioned
- Size of the issue

3. Details of the issues

- Object of the issues
- Tax benefits available to the company
- Rights of the information holders
- Authority for the issues and details of resolution passed for the issues
- Terms of payment

4. Details about the company management

- History, main objects, present business of the company
- Subsidiaries of the company
- Promoters and their background
- Name, address occupation of manager, managing director's relationship with the company

5. Details about the Project

- Cost of the project and means of financing
- Location of the project
- Plant & machinery for the projects
- Infrastructure facilities for raw materials
- Expected date of trial production and commercial production
- Schedule of implementation of the projects

6. Financial Information

- A report from the auditors on profit and losses of the company
- Asset and liabilities of the company
- Rate of dividend paid by the company

7. Statutory and other Information

- Minimum subscription as laid down in the SEBI guidelines

- Underwriting Commission and brokerage
- Fees payable to the lead manager
- Date of listing on stock exchanges

8. Other Information

- In respect of any issue made by the company and other listed companies under the same management, the following details;
- Name of the company, year of issue, types of issue, amount of issue and date of completion of the projects
- Procedure and time schedule for allotment and issue of certificates
- Management perception of risk factors
- Procedure for making application and availability of forms, prospectus and mode of payment
- Changes in directors and auditors in the last 3 years.

Liability for Misstatements in Prospectus

A. Civil Liability

A person who has been induced to subscribe for shares in a company on the strength of misstatement or omission in the prospectus may have a remedy either against the company or against the promoters or directors.

Remedies against the company

a. Rescission of contract

Where a person has purchased the shares of a company on the faith of a prospectus which contained misleading, but no necessarily fraudulent statement, he can seek rescission of the contract.

b. Claim for damages

The shareholders have to return the shares to the company and the claim the money with interest from the company.

Remedies against the directors \ promoters

Any person who has purchase shares \ debentures on the faith of the prospectus containing untrue statement may sue directors, promoters and experts

a. Damages for deceit \ fraud

Any persons induced to invest in the company by fraudulent statement in a prospectus can sue the company and persons responsible for damages. The share should be first surrendered to the company before the company is sued for damages.

b. Compensation

The above persons shall be liable to compensation to every person who subscribes for any shares \ debentures for any loss or damages sustained by him by reason of any untrue statement included therein.

B. Criminal Liability

Every person who authorizes the issue of prospectus shall be punishable for untrue statements with imprisonment for a term which may extend to 2 years or with fine extend upto Rs.50, 000.

SHARES and SHARE CAPITAL

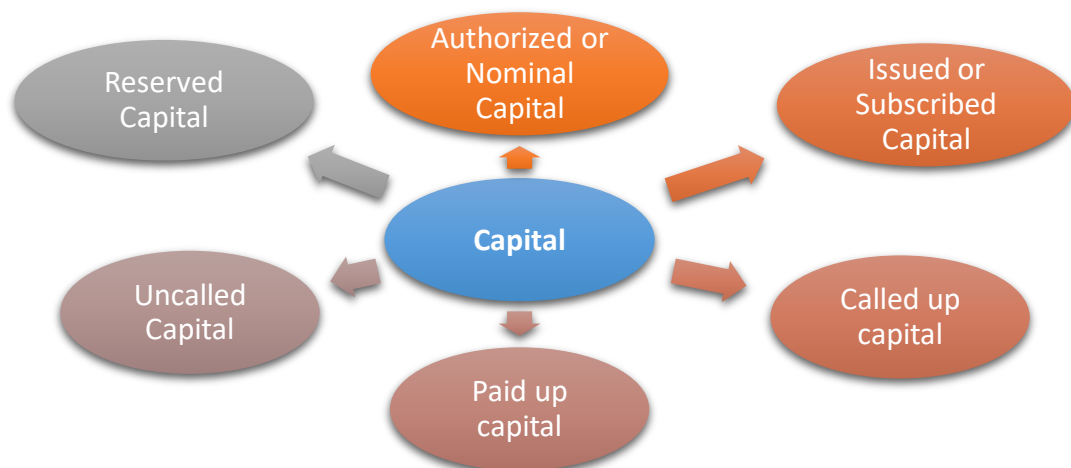
Meaning

The capital of a company is divided into units of a fixed denomination. Share refers to only such a unit. It is therefore clear that a share is a fractional part of the company's share capital. Otherwise, share capital means the capital raised by a company by the issue of shares.

Definition

According to section 2 (46) of the companies act, a share means a share in the share capital of the company and includes stock, except where a distinction between stock and shares is express or implied. A share indicates certain rights and liabilities.

Various Forms of Capital



1. Nominal or Authorized Capital

This is the nominal value of the shares which a company is authorized to issue by its MOA. This is the maximum capital which the company will have during its lifetime unless it is increased.

2. Issued and Subscribed Capital

Issued capital is the nominal value of the shares which are offered to the public for subscription. A company does not normally issue all its capital at once, so that issued capital in such a case is less than the nominal capital. The issued capital can never exceed the nominal capital. Sometimes, all the shares which are offered to the public for subscription may not be taken up. In such a case, that part of the issued capital which is taken up by the public is called the subscribed capital.

3. Called – Up Capital

This is that part of the issued capital which has been called up on the shares.

4. Paid-up Capital

This is that part of the issued capital which has been paid by the shareholders or which is credited as paid up on the shares.

5. Uncalled Capital

This is the remainder of the issued capital which has not been called. The company may call this amount any time but this is subject to the terms of issue of shares and the provisions of the Articles.

6. Reserve Capital

This is that part of the uncalled capital of a company which can be called only in the event of its winding up. According to Sec.99, a limited company may, by a special resolution, determine that any portion of its share capital which has not been already called up shall be capable of being called up only in the event and for the purposes of the company being wound up. Such capital is known as 'reserve capital'.

KINDS OF SHARES

According to the Companies Act, 1956 a company can issue only types of shares viz.,

1. Preference Shares and 2. Equity Shares

I. PREFERENCE SHARES

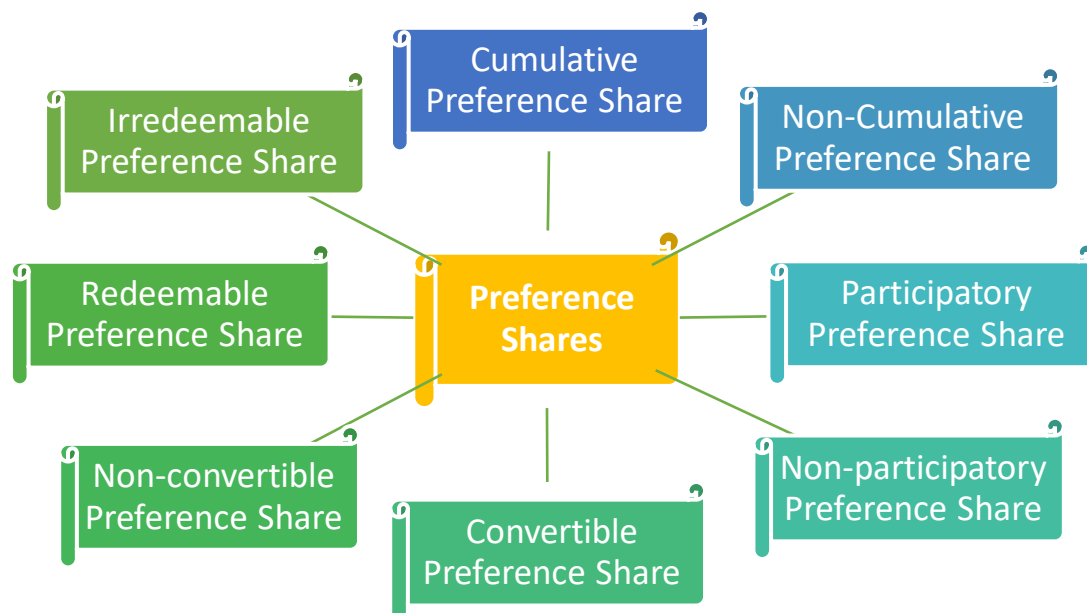
The term preference shares focus certain preferential rights over other types of shares. They are,

- i) A preferential right to get a fixed rate of dividend during the life of the company. It means that only after payment of dividend to preference shareholders, the surplus, if any, can be used for paying dividend to equity shareholders.
- ii) A preferential right to the return of share capital at the time of winding up of the company. This means that when the company goes into liquidation, after discharging debts due to outsiders, the surplus assets must first be used for returning the share capital contributed by the preference shareholders. The remaining surplus alone will be enjoyed by equity shareholders.

Preference shareholders must carry both these preferential rights. However, preference shareholders have certain disabilities. For instance, they do not normally enjoy voting rights. However they get the right to vote.

1. On any resolution affecting their rights
2. On all resolution when dividend has not been paid to them for certain period as prescribed in the Act.

Kinds of Preference Shares



Preference shares are of different types based on differing rights. They are briefly described below;

1. Cumulative Preference Shares

In case dividend is not declared, because of inadequate profit, the right to dividend for that year does not lapse in the case of cumulative preference shares. Dividends not declared and paid get accumulative so that they may be paid out of profits of subsequent years of arrears of dividend before any dividend is paid to equity shareholders.

Preference shares are always cumulative, unless the contrary is expressly stated in the Articles of Association.

2. Non Cumulative Preference Shares

In the case of non cumulative preference shares if dividend is not paid in any particular year, it lapses. Dividend is not allowed to accumulate and such unpaid dividend will not be paid in subsequent years even though sufficient profits are earned.

3. Participating Preference Shares

In addition to the fixed rate of dividend, these shares carry a further right to participate with equity shareholders in the surplus profits which remain after paying a certain rate of dividend to equity shareholders. Thus they get two kinds of dividend, one fixed rate and the other changing every year depending on the level of excess profits.

Similarly such preference shares have a right to participate in the surplus assets of the company on its winding up after paying in full the preference and equity share capital.

The right to participate in the surplus profits or surplus asset at the time of winding up is available to preference shareholders only if it is specially expressed in the articles. In other words preference shares are presumed to be non-participating unless specifically stated otherwise in the articles.

4. Non Participating Preference Shares

These shares are entitled to only a fixed rate of dividend. They do not participate either in the surplus or in the surplus assets. In such a case, the entire surplus goes to equity shareholders.

If the articles are silent with regard to this right to participate in the surplus profit or surplus assets, the preference shares will be considered to be only of non-participating type.

5. Convertible Preference Shares

Where preference shares entitle their shareholders to convert their preference shares into equity shares within a specified period, they are known as convertible preference shares.

6. Non-Convertible Preference Shares

Where preference shares cannot be converted into equity shares, they are called non-convertible preference shares. Once issued as preference shares, they continue to be only preference share throughout the life time of the company without any change in their characteristics.

If the Articles are silent regarding this right to convert, the preference share will be considered to be only non-convertible preference shares.

7. Redeemable Preference Shares

If the Articles of Association authorize, a company can issue redeemable preference shares. It means, that the capital raised by means of these shares can be returned after a specified period or at any time at its options after giving notice as per terms of issue. These shares can be redeemed either out of profits or out of the proceeds of a fresh issue of shares. Redeemable preference shares can be redeemed if they are fully paid-up. A company cannot convert existing preference shares into redeemable preference shares.

8. Irredeemable Preference Shares

Any preference share that cannot be redeemed during the lifetime of the company is known as irredeemable preference shares.

II. EQUITY SHARES

Equity shares are those, which are not preference shares. They were also known as ordinary shares. They are entitled to get dividend only after the fixed rate of dividend is paid to preference shareholders. Similarly at the time of winding up of the company, only after returning preference shares capital in full, and if there is any surplus, it will be paid to equity shareholders.

The rate of dividend varies from year to year depending on the profits earned by the company. The larger the profits the higher may be the dividend for equity shareholders. In the case of reputed companies, rate of dividend paid to equity shareholders is far higher than the fixed rate paid to preference shareholders. However, when there is no profit in any year, equity shareholders' dividend for that year will not be paid as arrears of dividend in subsequent year even though profits may be very large. Equity shareholders are entitled to vote on all resolutions.

VOTING RIGHTS

Equity shareholders' rights

An equity shareholder of a company limited by shares has a right to vote on every resolution placed before the company. His voting right on a poll is in proportion to his share of the paid-up equity capital of the company. The right of vote is an individual right in respect of which a member has a right to sue. He has a right to say, "whether I vote with the majority or with the minority, you shall record my vote: that is a right belonging to my interest in the company, and if you will not, I shall institute legal proceedings to compel you".

Preference shareholders' rights

A preference shareholder has a right to vote on those resolutions which directly affect his rights. Any resolution for winding up the company or for the repayment or reduction of its share capital is deemed directly to affect the rights of the preference shareholders. But holders of cumulative preference shares have a right to vote on all resolutions of the company at any meeting if their dividends remained unpaid for an aggregate period of at least 2 years preceding the date of commencement of meeting. In the case of non-cumulative preference shares, they have a right to vote on all resolutions of the company at any meeting, if their dividends remain unpaid for 2 financial years immediately preceding the meeting or for any 3 years during a period of 6 years ending with the financial year preceding the meeting.

Web links

- ebook.mca.gov.in/default.aspx
- <https://nptel.ac.in/courses/109105098/>
- https://nptel.ac.in/content/storage2/nptel_data3/html/mhrd/ict/text/109105098/lec12.pdf
- <https://www.classcentral.com/course/swayam-legal-compliance-for-incorporating-startup-5773>
- <https://www.simpletaxindia.net/2013/11/16-video-on-companies-act-2013-on-all.html>
- Classification of company: <https://www.udemy.com/course/basics-of-indian-companies-act-2013/>
- <http://www.freebookcentre.net/Law/Law-Books.html>

- <http://197.14.51.10:81/pmb/DROIT/1405899646.pdf>
- www.mooc-list.com/tags/business-law
- <https://www.mooc-list.com/course/business-law-wma>
- <http://cde.annauniv.edu/mbaqp/pdf/First%20Semester/DBA1607/MBA%201607.pdf>
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