
STUDY MATERIAL

EXECUTIVE PROGRAMME

COMPANY LAW

PAPER 1



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003
tel 011-4534 1000, 4150 4444 fax +91-11-2462 6727
email info@icsi.edu website www.icsi.edu

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Office Timings – 9.00 A.M. to 5.30 P.M.

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Phones

4150444, 45341000

Fax

011-24626727

Website

www.icsi.edu

E-mail

info@icsi.edu

EXECUTIVE PROGRAMME

COMPANY LAW

In view of increasing emphasis on adherence to norms of good corporate governance, Company Law assumes an added importance in the corporate legislative milieu, as it deals with structure, management, administration and conduct of affairs of Companies. A thorough study of various provisions of the Companies Act is a must for becoming a competent and efficient Company Secretary. In the light of this, the study material has been published to impart thorough knowledge to the students preparing for the Company Law paper of the CS Executive Programme.

The study material is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (including Amendments/clarifications/circulars issued there under upto June, 2014). In respect of sections of The Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with in the study.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of the study material may not be enough. Besides Company Secretaries Regulations, 1982 requires the students to be conversant with the amendments to the laws made upto six months preceding the date of examination. This study material may therefore be regarded as basic material and must be read along with the notified provisions of companies Act 2013 and rules made thereunder and the provisions of Companies Act 1956 which is still in force.

The amendments made upto June 2014 have been incorporated in this study material. However, it may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the bulletin 'Student Company Secretary' and ICSI Journal Chartered Secretary and other publications for updation of study material. In the event of any doubt, students may contact the Directorate of Academics at academics@icsi.edu.

Although due care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the e-bulletin' and Student Company Secretary'.

EXECUTIVE PROGRAMME**SYLLABUS
FOR****MODULE 1 - PAPER 1: COMPANY LAW (100 MARKS)****Level of Knowledge:** Expert Knowledge

Objective: *To acquire knowledge and develop understanding of the regulatory framework of companies with reference to various provisions of Companies Act and its schedules, rules, notifications, circulars, clarifications there under including case laws and Secretarial standards.*

Detailed Contents:**1. Introduction**

- Historical Development of Concept of Corporate Law in India
- Company – Definition, Meaning, Nature and its Characteristics
- Nature and Forms of Business
- Company vis-à-vis other Forms of Business
- Concept of Corporate Personality, Corporate Veil, Limited Liability and Citizenship

2. Incorporation and its Consequences

- Types of Companies and their incorporation
- Promoters – Meaning, Position, Duties, Rights, Responsibilities and Liabilities
- Formation of Companies – Procedural Aspects
- Memorandum of Association & Articles of Association and their Alteration
- Contracts and Conversion of Companies
- Commencement of Business
- Doctrine of Ultra-Vires, Constructive Notice, Indoor Management, Alter Ego

3. Financial Structure

- Concept of Capital and Financing of Companies– Sources of Capital; Classes and Types of Shares; Equity Shares with Differential Rights; Issue of Shares at Par, Premium and Discount; Forfeiture and Surrender of Shares; Bonus Issues; Rights Issues; Issue of Sweat Equity Shares; Employees Stock Option Scheme; Private Placement; preference shares and other forms of securities
- Alteration of Share Capital– Reduction of Capital; Buy–Back of Shares
- Prospectus– Definition; Abridged Prospectus; Red–Herring Prospectus; Shelf Prospectus; Information Memorandum; Contents, Registration; Misrepresentations and Penalties
- Debt Capital – Debentures, Debenture Stock, Bonds; Recent Trends and Dynamics of Corporate Debt Financing; Debenture Trust Deed and Trustees; Conversion of and Redemption of Debentures
- Securing of Debts:Charges ; Creation, Modification and Satisfaction of Charges
- Allotment and Certificates – General Principles and Statutory Provisions related to Allotment; Minimum Subscription; Irregular Allotment; Procedure of Issue of Share Certificates and Warrants

4. Membership in a Company

- Modes of Acquiring Membership
- Rights and Privileges of Members, Register of Members
- Dematerialisation and Rematerialisation of Securities
- Transfer and Transmission of Securities in Physical and Dematerialized forms
- Nomination

5. Management and Control of Companies

- Directors— Types, Director's Identification Number (DIN), Appointment/Reappointment, Qualifications, Disqualifications, Vacation of Office, Retirement, Resignation and Removal of Managing and Whole-Time Directors and Manager
- Role and Responsibilities of Directors
- Powers and Duties
- Loans to Directors
- Remuneration of Directors
- Office or Place of Profit
- Contracts in which Directors are Interested
- Board of Directors and its Committees
- Company Secretary – Appointment, Role and Responsibilities
- Company Secretary as a Key Managerial Personnel
- Meetings:
- Meetings of Board and Committees— Frequency, Convening, Proceedings, Video Conferencing of Board/Committee(s); Resolution by Circulation; Minutes and Evidence
- General Meetings – Kinds of Meetings; Law, Practice and Procedure Relating to Convening and Proceedings at General and Other Meetings; Notice, Quorum, Chairman, Proxy, Voting including Voting through Electronic Means; Resolutions, Circulation of Members' Resolution, etc.; Postal Ballot; Recording, Signing and Inspection of Minutes;
- Distribution of Powers of a Company – Division of Powers between Board and General Meetings; Acts by Directors in Excess of Authority; Monitoring and Management
- Sole Selling and Buying Agents – Meaning, Appointment and Reappointment, Removal; Powers of Central Government and Rules Framed for the Purpose

6. Investments, Loans and Deposits

- Law relating to making investments in and granting loans to other bodies corporate and giving guarantees and providing security
- Acceptance of Deposits, Renewal, Repayment, Default and Remedies

7. Accounts and Audit

- Books of Accounts
- Financial Statements
- Auditors – Appointment, Resignation and Removal; Qualification and Disqualification; Rights, Duties and Liabilities
- Audit and Auditor's Report
- Cost Audit and Special Audit

8. Dividends

- Profit and Ascertainment of Divisible Profits
- Declaration and Payment of Dividend
- Treatment of Unpaid and Unclaimed Dividend
- Transfer of Unpaid and Unclaimed Dividend to Investor Education and Protection Fund
- Board's Report and Disclosures Contents and Annexure to Board's Report
- Directors' Responsibility Statement – Preparation and Disclosures
- Compliance Certificate – Need and Objective; Issue and Signing by Practising Company Secretary
- Corporate Governance Report

9. Registers, Forms and Returns

- Statutory Books and Registers prescribed under various provisions of the Company Law– Maintenance, Authentication Place of Keeping and Inspection
- Filing of various Forms and Returns with the Authorities
- Procedure and Penalties for Delayed Filing
- Annual Return –Nature and Significance; Contents; and Certification by Practising Company Secretary

10. Inspection and Investigation

- Inspection of Documents
- Powers of the Inspector
- Seizure of Books And Documents
- Inspector's Report
- Power of the Registrar of Companies
- Investigation into Affairs of the Company

11. Majority Rule and Minority Rights

- Law relating to Majority Powers and Minority Rights
- Shareholder Remedies – Actions by Shareholders; Statutory Remedies; Personal Actions
- Prevention of Oppression and Mis-Management

12. Merger, De-merger, Amalgamation, Compromises and Arrangements – An Overview

13. Producer Companies

- Concept, Formation, Functioning and Dissolution

14. Limited Liability Partnerships

- Concept, Formation, Membership, Functioning and Dissolution

15. Application of Company Law to Different Sectors

- Banking
- Insurance
- Others

16. Offences and Penalties

- Introduction
- Officer in Default
- Penalties

17. Compounding of Offences

18. Winding up of Companies –An Overview

- Concept and Modes

19. Striking Off Name of Companies

20. An Introduction to E-Governance and XBRL



LIST OF RECOMMENDED BOOKS
MODULE I
PAPER 1 : COMPANY LAW

Readings:

1. Dr. Avtar Singh : Company Law; Eastern Book Company, 34, Lalbagh, Lucknow – 226 001
2. C.R. Datta : Datta on the Company Law; Lexis Nexis, Butterworths Wadhwa, Nagpur
3. A. Ramaiya : Guide to the Companies Act; Lexis Nexis, Butterworths Wadhwa, Nagpur
4. K.C. Garg, R.C. Chawla, Vijay Gupta : Company Law; Kalyani Publishers, 1/1, Rajinder Nagar, Civil Lines, Ludhiana – 141 001.
5. A.K. Mujumdar, Dr. G.K. Kapoor : Company Law and Practice; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
6. V.S. Datey : Guide to Tax and Corporate Laws; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
7. M.C. Kuchhal : Modern Indian Company Law; Shri Mahavir Book Depot, 2603, Nai Sarak, Delhi-110 006.
8. H.K. Saharay : Company Law; Universal Law Publishing Co., C-FF-1A, Dilkhush Industrial Estate, G.T. Karnal Road, Delhi. -110033.

References:

1. D.K. Jain : Company Law Ready Reckoner; Bharat Law House Pvt. Ltd.; T-1/95, Mangolpuri Industrial Area, Delhi-110083.
2. R. Suryanarayanan : Company Law Ready Reckoner; Commercial Law Publishers, 151, Rajinder Market, Opp. Tis Hazari Court, Delhi-110054.
3. Palmer : Company Law (Vol. 1); Stevens & Sons Ltd., London.
4. L.C.B. Gower : Principles of Modern Company Law; Stevens & Sons Ltd., London.
5. Taxmann's : Circulars & Clarifications on Company Law; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
6. Bare Act : Corporate Laws; Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
The Companies Act, 1956; Universal Law Publishing Co., C-FF-1A, Dilkhush Industrial Estate, G.T. Karnal Road, Delhi. -110 003.

Journals:

1. Chartered Secretary : ICSI, New Delhi
2. Student Company Secretary : ICSI, New Delhi
3. Corporate Law Adviser : Corporate Law Advisers, 613, Metro View Apt., Sector 13, Pocket B, Dwarka, New Delhi-110075.
4. Company Law Journal : Company Law Journal (India) Pvt. Ltd., 53/15, Old Rajinder Nagar, Post Box No. 2844, New Delhi-110060.

Note: The latest edition of all the books referred to above should be read.

ARRANGEMENT OF STUDY LESSONS**PAPER 1: COMPANY LAW (100 Marks)**

<i>Lesson No.</i>	<i>Subject</i>
1	INTRODUCTION
2	TYPES OF COMPANIES
3	PROMOTION AND INCORPORATION OF COMPANIES
4	MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION
5	CONTRACTS AND CONVERSIONS
6	CONCEPT OF CAPITAL AND FINANCING OF COMPANIES
7	ALTERATION OF SHARE CAPITAL
8	PRIVATE PLACEMENT AND PROSPECTUS
9	DEBT CAPITAL
10	CREATION AND REGISTRATION OF CHARGES
11	ALLOTMENT OF SECURITIES AND ISSUE OF CERTIFICATES
12	MEMBERSHIP IN A COMPANY
13	TRANSFER AND TRANSMISSION OF SECURITIES
14	INSTITUTION OF DIRECTORS
15	INDEPENDENT DIRECTORS
16	BOARD AND ITS POWERS
17	APPOINTMENT AND REMUNERATION OF KEY MANAGERIAL PERSONNEL
18	GENERALMEETINGS
19	LOANS AND INVESTMENTS BY COMPANY
20	DEPOSITS
21	ACCOUNTS AND AUDIT
22	DIVISIBLE PROFITS AND DIVIDENDS
23	BOARD'S REPORT AND DISCLOSURES
24	REGISTERS, FORMS AND RETURNS
25	INSPECTION AND INVESTIGATION
26	MAJORITY RULE AND MINORITY RIGHTS
27	MERGER, DE-MERGER, AMALGAMATION, COMPROMISE AND ARRANGEMENTS – AN OVERVIEW
28	PRODUCER COMPANIES
29	LIMITED LIABILITY PARTNERSHIPS
30	APPLICATION OF COMPANY LAW TO DIFFERENT SECTORS
31	OFFENCES, PENALTIES AND THEIR COMPOUNDING
32	WINDING UP OF COMPANIES
33	STRIKING OFF NAME OF COMPANIES
34	AN INTRODUCTION TO E-GOVERNANCE AND XBRL

TEST PAPERS

EXECUTIVE PROGRAMME

COMPANY LAW

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Lesson 1

Introduction

LESSON OUTLINE

- Company as a business medium
- Meaning and definition of term company
- Nature and characteristics of a company
- Historical Development of Concept of Corporate Law in India
- Development of Company Law in India and England
- Highlights of the Companies Act, 2013
- Companies vis-à-vis other Forms of business
- Concept of Corporate Personality
- Lifting of Corporate Veil
- Citizenship
- Personal liability of directors or members
- Illegal association

LEARNING OBJECTIVES

The concept of 'Company' or 'Corporation' in business is not new, but was dealt with, in 4th century BC itself during 'Arthashastra' days. Its' shape got revamped over a period of time according to the needs of business dynamics.

Company form of business has certain distinct advantages over other forms of businesses like Sole Proprietorship/Partnership etc. It includes features such as Limited Liability, Perpetual Succession etc.

After reading this lesson, you would be able to understand the historical development in evolution of corporate law in India and England, emerging regulatory aspects including Companies Act, 2013, besides dealing with basic characteristics of company and how it differs from other forms of businesses.

The great problem of having corporate citizens is that they aren't like the rest of us. As Baron Thurlow in England is supposed to have said, "They have no soul to save, and they have no body to incarcerate." — Robert Monks

COMPANY AS A BUSINESS MEDIUM

Meaning of a Company

The word 'company' is derived from the Latin word (Com=with or together; panis =bread), and it originally referred to an association of persons who took their meals together. In the leisurely past, merchants took advantage of festive gatherings, to discuss business matters. Nowadays, the business matters have become more complicated and cannot be discussed at festive gatherings. Therefore, the company form of organization has assumed greater importance. It denotes a joint stock enterprise in which the capital is contributed by several people. Thus, in popular parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law and clothing it with legal personality. The word 'corporation' is derived from the Latin term 'corpus' which means 'body'. Accordingly, 'corporation' is a legal person created by a process other than natural birth. It is, for this reason, sometimes called artificial legal person. As a legal person, a corporate is capable of enjoying many of the rights and incurring many of the liabilities of a natural person.

An incorporated company owes its existence either to a special Act of Parliament or to company law. Public corporations like Life Insurance Corporation of India, SBI etc., have been brought into existence through special Acts of Parliament, whereas companies like Tata Steel Ltd., Reliance Industries Limited have been formed under the Company law i.e. Companies Act, 1956 which is being replaced by the Companies Act, 2013.

Definition of Company

In the legal sense, a company is an association of both natural and artificial persons (and is incorporated under the existing law of a country). In terms of the Companies Act, 2013 (Act No. 18 of 2013) a "company" means a company incorporated under this Act or under any previous company law [Section 2(20)]. In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. However, an association formed not for profit also acquires a corporate character and falls within the meaning of a company by reason of a licence issued under Section 8(1) of the Act.

A company is not merely a legal institution. It is rather a legal device for the attainment of social and economic end. It is, therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organisation in the conduct of an enterprise". It is "an intricate, centralised, economic and administrative structure run by professional managers who hire capital from the investor(s)".

Lord Justice Lindley has defined a company as "an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his "share". The shares are always transferable although the right to transfer them may be restricted."

From the foregoing discussion it is clear that a company has its own corporate and legal personality distinct

which is separate from its members. A brief description of the various attributes is given here to explain the nature and characteristics of the company as a corporate body.

NATURE AND CHARACTERISTICS OF A COMPANY

Since a corporate body (i.e. a company) is the creation of law, it is not a human being, it is an artificial juridical person (i.e. created by law); it is clothed with many rights, obligations, powers and duties prescribed by law; it is called a 'person'. Being the creation of law, it possesses only the powers conferred upon it by its Memorandum of Association which is the charter of the company. Within the limits of powers conferred by the charter, it can do all acts as a natural person may do.

The most striking characteristics of a company are:

(i) Corporate personality

A company incorporated under the Act is vested with a corporate personality so it redundant bears its own name, acts under name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different 'person' from the members who compose it. Therefore it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners however they can be its creditors simultaneously. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital.

The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. Thus, 'incorporation' is the act of forming a legal corporation as a juristic person. A juristic person is in law also conferred with rights and obligations and is dealt with in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law [*Shiromani Gurdwara Prabandhak Committee v. Shri Sam Nath Dass AIR 2000 SCW 139*].

CASE EXAMPLE

The case of *Salomon v. Salomon and Co. Ltd.*, (1897) A.C. 22

The above case has clearly established the principle that once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member holds a large or small proportion of the shares, and whether he holds those shares as beneficially or as a mere trustee.

In the case, Salomon had, for some years, carried on a prosperous business as a leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed to 1 share each so that the actual cash paid as capital was £7. Salomon sold his business (which was perfectly solvent at that time), to the Company formed by him for the sum of £38,782. The company's nominal capital was £40,000 in £1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company's assets,

viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as a principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf.

Their Lordships of the House of Lords observed:

"...the company is a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not, in law, their agent or trustee. The statute enacts nothing as to the extent or degree of interest, which may, be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of company."

CASE EXAMPLE

The case of *Lee v. Lee's Air Farming Ltd.* (1961) A.C. 12 (P.C.),

The above case illustrates the application of the principles established in Salomon's case (*supra*). In this case, a company was formed for the purpose of aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company. He voted himself the managing director and got himself appointed by the articles as chief pilot at a salary. He was killed in an air crash while working for the company. His widow claimed compensation for the death of her husband in the course of his employment. The company opposed the claim on the ground that Lee was not a worker as the same person could not be the employer and the employee. The Privy Council held that Lee and his company were distinct legal persons which had entered into contractual relationships under which he became the chief pilot, a servant of the company. In his capacity of managing director he could, on behalf of the company, give himself orders in his other capacity of pilot, and the relationship between himself, as pilot and the company, was that of servant and master. Lee was a separate person from the company he formed and his widow was held entitled to get the compensation. In effect the magic of corporate personality enabled him (Lee) to be the master and servant at the same time and enjoy the advantages of both.

The decision of the Calcutta High Court in *Re. Kondoli Tea Co. Ltd.*, (1886) ILR 13 Cal. 43, recognised the principle of separate legal entity even much earlier than the decision in *Salomon v. Salomon & Co. Ltd.* case. Certain persons transferred a Tea Estate to a company and claimed exemptions from *ad valorem* duty on the ground that since they themselves were also the shareholders in the company, it was nothing but a transfer from them in one name to themselves under another name. While rejecting this Calcutta High Court observed: "The company was a separate person, a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons.

CASE EXAMPLE

New Horizons Ltd. v. Union of India, (AIR 1994, Delhi 126)

The experience of a shareholder of a company can be regarded as experience of a company. The tender of the company, New Horizons Ltd., for publication of telephone directory was not accepted by the Tender Evaluation Committee on the ground that the company had nothing on record to show that it had the technical experience required to be possessed to qualify for tender. On appeal the rejection of tender was upheld by the Delhi High Court.

The judgement of the Delhi High Court was reversed by the Supreme Court which observed as under:

"Once it is held that NHL (New Horizons Ltd.) is a joint venture, as claimed by it in the tender, the experience of its various constituents namely, TPI (Thomson Press India Ltd.), LMI (Living Media India Ltd.) and WML (World Media Ltd.) as well as IIPL (Integrated Information Pvt. Ltd.) had to be taken into consideration, if the Tender Evaluation Committee had adopted the approach of a prudent business man."

"Seeing through the veil covering the face of NHL, it will be found that as a result of re-organisation in 1992 the company is functioning as a joint venture wherein the Indian group (TPI, LMI and WML) and Mr. Aroon Purie hold 60% shares and the Singapore based company (IIPL) holds 40% shares. Both the groups have contributed towards the resources of the joint venture in the form of machines, equipment and expertise in the field. The company is in the nature of partnership between the Indian group of companies and Singapore based company who have jointly undertaken this commercial enterprise wherein they will contribute to the assets and share the risk. In respect of such a joint venture company, the experience of the company can only mean the experience of the constituents of the joint venture i.e. the Indian group of companies (TPI, LMI and WML) and the Singapore based company (IIPL) (*New Horizons Ltd. and another v. Union of India* (1995) 1 Comp. LJ 100 SC).

Company as a person

A Company is an artificial person created by law. It is not a human being but it acts through human beings. It is considered as a legal person which can enter into contracts, possess properties in its own name, sue and can be sued by others etc. It is called an artificial person since it is invisible, intangible, existing only in the contemplation of law. It is capable of enjoying rights and being subject to duties.

CASE EXAMPLE

Union Bank of India v. Khader International Construction and Other [(2001) 42 CLA 296 SC]

In this case, the question which arose before the Court was whether a company is entitled to sue as an indigent (poor) person under Order 33, Rule 1 of the Civil Procedure Code, 1908. The aforesaid Order permits persons to file suits under the Code as pauper/indigent persons if they are unable to bear the cost of litigation. The appellant in this case had objected to the contention of the company which had sought permission to sue as an indigent person. The point of contention was that, the appellant being a public limited company, it was not a 'person' within the purview of Order 33, Rule 1 of the Code and the 'person' referred to only a natural person and not to other juristic persons. The Supreme Court held that the word 'person' mentioned in Order 33, Rule 1 of the Civil Procedure Code, 1908, included any company as association or body of individuals, whether incorporated or not. The Court observed that the word 'person' had to be given its meaning in the context in which it was used and being a benevolent provision, it was to be given an extended meaning. Thus a company may also file a suit as an indigent person.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

A shareholder cannot be personally held liable for the acts of the company even if he holds virtually the entire share capital.

- True
- False

Correct Answer: True

(ii) Limited Liability

"The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organisation." The company, being a separate person, is the owner of its assets and bound by its liabilities. The liability of a member as shareholder, extends to the contribution to the capital of the company up to the nominal value of the shares held and not paid by him. Members, even as a whole, are neither the owners of the company's undertakings, nor liable for its debts. In other words, a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited. For example, if A holds shares of the total nominal value of ₹1,000 and has already paid ₹500/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than ₹ 500/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent. In the case of a company limited by guarantee, the liability of members is limited to a specified amount of the guarantee mentioned in the memorandum.

Buckley, J. in *Re. London and Globe Finance Corporation*, (1903) 1 Ch.D. 728 at 731, has observed: 'The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the commercial prosperity of the country. They have, to the advantage of the investor as well as of the public, allowed and encouraged aggregation of small sums into large capitals which have been employed in undertakings of "great public utility largely increasing the wealth of the country".

Exceptions to the principle of limited liability

- Where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members of such company shall be unlimited. [Section 7(7)(b)(Section 7(7) is yet to be notified)]
- Further under section 339(1), where in the course of winding up it appears that any business of the company has been carried on with an intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the Tribunal may declare the persons who were knowingly parties to the carrying on of the business in the manner aforesaid as personally liable, without limitation of liability, for all or any of the debts/liabilities of the company.[Section 339 is yet to be notified]
- When the company is incorporated as an Unlimited Company under Section 3(2)(c) of the Act
- Under Section 35(3), where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person who was a director at the time of issue of the prospectus or has been named as a director in the prospectus or every person who has authorised the issue of prospectus or every promoter or a person referred to as an expert in the prospectus shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.
- As per section 75(1), where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified or such further time as may be allowed by the Tribunal and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to other liabilities, also be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

- Section 224(5) states that where the report made by an inspector states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

(iii) Perpetual Succession

An incorporated company never dies, except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and it remains the same entity, despite total change in the membership. A company's life is determined by the terms of its Memorandum of Association. It may be perpetual, or it may continue for a specified time to carry on a task or object as laid down in the Memorandum of Association. Perpetual succession, therefore, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

The membership of an incorporated company may change either because one shareholder has sold/transferred his shares to another or his shares devolve on his legal representatives on his death or he ceases to be a member under some other provisions of the Companies Act. Thus, perpetual succession denotes the ability of a company to maintain its existence by the succession of new individuals who step into the shoes of those who cease to be members of the company. Professor L.C.B. Gower rightly mentions, "Members may come and go, but the company can go on forever. During the war all the members of one private company, while in general meeting, were killed by a bomb, but the company survived — not even a hydrogen bomb could have destroyed it".

(iv) Separate Property

A company being a legal person and entirely distinct from its members, is capable of owning, enjoying and disposing of property in its own name. The company is the real person in which all its property is vested, and by which it is controlled, managed and disposed off. Their Lordships of the Madras High Court in *R.F. Perumal v. H. John Deavin*, A.I.R. 1960 Mad. 43 held that "no member can claim himself to be the owner of the company's property during its existence or in its winding-up". A member does not even have an insurable interest in the property of the company.

CASE EXAMPLE

Mrs. Bacha F. Guzdar v. The Commissioner of Income Tax, Bombay, A.I.R. 1955 S.C. 74

The Supreme Court in this case held that, though the income of a tea company is entitled to be exempted from Income-tax up to 60% being partly agricultural, the same income when received by a shareholder in the form of dividend cannot be regarded as agricultural income for the assessment of income-tax. It was also observed by the Supreme Court that a shareholder does not, as is erroneously believed by some people, become the part owner of the company or its property; he is only given certain rights by law, e.g., to receive notice of or to attend or vote at the meetings of the shareholders. The court refused to identify the shareholders with the company and reiterated the distinct personality of the company.

(v) Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. When the joint stock companies were established, the object was that their shares

should be capable of being easily transferred, [In *Re. Balia and San Francisco Rly.*, (1968) L.R. 3 Q.B. 588]. Section 44 of the Companies Act, 2013 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles. If the articles do not provide anything for the transfer of shares and the Regulations contained in Table "F" in Schedule I to the Companies Act, 2013, are also expressly excluded, the transfer of shares will be governed by the general law relating to transfer of movable property.

A member may sell his shares in the open market and realise the money invested by him. This provides liquidity to a member (as he can freely sell his shares) and ensures stability to the company (as the member is not withdrawing his money from the company). The Stock Exchanges provide adequate facilities for the sale and purchase of shares.

Further, as of now, in most of the listed companies, the shares are also transferable through Electronic mode i.e. through Depository Participants in dematerialised form instead of physical transfers.

However there are restrictions with respect to transferability of shares of a Private Limited Company which are dealt in chapter 2.

(vi) Common Seal

Upon incorporation, a company becomes a legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all contracts entered into by its agents must be under the seal of the company. The Common Seal acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company, when the resolution passed by the Board, for its execution requires the common seal to be affixed is not authentic and shall have no legal force behind it. However, a person duly authorised to execute documents pursuant to a power of attorney granted in his favour under the common seal of the company may execute such documents and it is not necessary for the common seal to be affixed to such documents.

The person, authorised to use the seal, should ensure that it is kept under his personal custody and is used very carefully because any deed, instrument or a document to which seal is improperly or fraudulently affixed will involve the company in legal action and litigation.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A common seal acts as the official signature of a company.

- True
- False

Correct Answer: True

(vii) Capacity to Sue and Be Sued

A company being a body corporate, can sue and be sued in its own name. To sue, means to institute legal proceedings against (a person) or to bring a suit in a court of law. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name. A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be [*Floating Services Ltd. v. MV San Fransceco Dipaloa* (2004) 52 SCL 762 (Guj)]. A company, as a person distinct from its members, may even sue one of its own members.

A company has a right to seek damages where a defamatory material published about it, affects its business. Where video cassettes were prepared by the workmen of a company showing, their struggle against the company's management, it was held to be not actionable unless shown that the contents of the cassette would be defamatory. The court did not restrain the exhibition of the cassette. [*TVS Employees Federation v. TVS and Sons Ltd.*, (1996) 87 Com Cases 37]. The company is not liable for contempt committed by its officer. [*Lalit Surajmal Kanodia v. Office Tiger Database Systems India (P) Ltd.*, (2006) 129 Com Cases 192 Mad].

(viii) Contractual Rights

A company, being a legal entity different from its members, can enter into contracts for the conduct of the business in its own name. A shareholder cannot enforce a contract made by his company; he is neither a party to the contract, nor be entitled to the benefit derived from it, as a company is not a trustee for its shareholders. Likewise, a shareholder cannot be sued on contracts made by his company. The distinction between a company and its members is not confined to the rules of privity but permeates the whole law of contract. Thus, if a director fails to disclose a breach of his duties towards his company, and in consequence a shareholder is induced to enter into a contract with the director on behalf of the company which he would not have entered into had there been disclosure, the shareholder cannot rescind the contract.

Similarly, a member of a company cannot sue in respect of torts committed against the company, nor can he be sued for torts committed by the company. [British Thomson-Houston Company v. Sterling Accessories Ltd., (1924) 2 Ch. 33]. Therefore, the company as a legal person can take action to enforce its legal rights or be sued for breach of its legal duties. Its rights and duties are distinct from those of its constituent members.

(ix) Limitation of Action

A company cannot go beyond the power stated in its Memorandum of Association. The Memorandum of Association of the company regulates the powers and fixes the objects of the company and provides the edifice upon which the entire structure of the company rests. The actions and objects of the company are limited within the scope of its Memorandum of Association. In order to enable it to carry out its actions without such restrictions and limitations in most cases, sufficient powers are granted in the Memorandum of Association. But once the powers have been laid down, it cannot go beyond such powers unless the Memorandum of Association, itself altered prior to doing so.

(x) Separate Management

As already noted, the members may derive profits without being burdened with the management of the company. They do not have effective and intimate control over its working and they elect their representatives as Directors on the Board of Directors of the company to conduct corporate functions through managerial personnel employed by them. In other words, the company is administered and managed by its managerial personnel.

(xi) Voluntary Association for Profit

A company is a voluntary association for profit. It is formed for the accomplishment of some stated goals and whatsoever profit is gained is divided among its shareholders or saved for the future expansion of the company. Only a Section 8 company can be formed with no profit motive.

(xii) Termination of Existence

A company, being an artificial juridical person, does not die a natural death. It is created by law, carries on its affairs according to law throughout its life and ultimately is effaced by law. Generally, the existence of a company is terminated by means of winding up. However, to avoid winding up, sometimes companies adopt strategies like reorganisation, reconstruction and amalgamation.

To sum up, "a company is a voluntary association for profit with capital divisible into transferable shares with limited liability, having a distinct corporate entity and a common seal with perpetual succession".

HISTORICAL DEVELOPMENT OF CONCEPT OF CORPORATE LAW IN INDIA

The laws are developed by the common consciousness of the people, and corporate laws are no exception to it. Business people of the Indian subcontinent utilized the corporate form from a very early period. Corporations as such were not unknown to India as is clear from Kautilya's Arthashastra (4th Century BC).

"Regulations concerning trade and industry in the Arthashastra have a surprisingly modern look. The trade and industry of the period were characterized by a highly developed organization. The institution called 'Sreni' was a corporation of men following the same trade, art, or craft, and resembled the guilds of Medieval Europe. Almost every important industry had its guilds, which laid down rules and regulations for the conduct of its members, with a view to safeguarding their interests. These rules and regulations were recognized by the law of the land. Each guild had a definite constitution, with a President or a Headman, and a small Executive Council. Sometimes the guilds attained great power and prestige, and in all cases the head of the guild was an important personage in Court. The guilds sometimes maintained armies and helped the King in times of need, though at times, there were quarrels and fights between different guilds which taxed the power of the authority to its utmost. One of the most important functions of these guilds was to serve as local banks. People kept deposits of money with them with a direction that the interest accruing therefrom was to be devoted to specific purposes, every year, so as the Sun and Moon endure. This is the best proof of the efficient organization of these bodies, for people would hardly trust them with permanent endowments if they were not satisfied with their working. Sometimes the guilds proved to be centres of learning and culture, and, on the whole, they were remarkable institutions of ancient India.

There were also other types of corporate organizations besides guilds. Trade was carried on the joint-stock principles; there was Traders' League, and sometimes we hear even of 'Corner' or 'Trust', viz., the Union of Traders with a view to cause rise and fall in the value of the articles and make profits cent per cent."¹

There is evidence to suggest that traders would often organize into a partnership form for the purposes of engaging in longer distance travel and trade over sea and land. Usually these would be entered into by two or more people and they would appoint a leader. The entity would be bound by the activity of the partners and the entity appeared to have the ability to own assets separately from its owners. These two features provide the entities with the imprimatur of a contracting entity.

There were also fairly detailed rules developed over the years for the division of assets and liabilities. The rules for sharing assets and liabilities could be determined by agreement or, failing that, by the laws existing at that time that would divide assets and liabilities equally or sometimes by the relative contributions (skill, labour and capital) invested in the entity by members. The latter was more common in partnerships amongst craft people.

There also appear to have been obligations that mirrored the duty of care and duty of loyalty that are such a common feature of today's fiduciary duties. For a cause of action based on a partner negligently causing harm to the partnership the partners sat in judgment on their co-partner and decided whether such negligence in fact occurred. If the partner was found negligent he had to make good the losses. This bears some similarity to today's duty of care. Moreover, if the allegation was fraud then the accused partner would face some kind of ordeal or oath. If the partner failed then he would have to make good the losses to the

¹ R C Majumdar, "Ancient India", p. 215-216.

partnership, forfeit his profits and be removed from the partnership. This bears some similarity (except for the method of proof) to today's duty of loyalty.

These early partnerships also regulated other matters. First, the interest a partner had in a partnership could be bequeathed to his children. Second, the various written sources provide guidance and, in some respects, rules about who should enter partnerships. The general pattern was that "learned" people with similar socio-economic status and financial wherewithal were encouraged to enter these partnerships. Part of the explanation for this is that it makes monitoring of behavior easier and less costly when the partners are relatively similar, have roughly equivalent assets, and understand each other. Further, requiring partners to have assets means that they have something at stake in the partnership and this should induce them to exercise care in partnership matters. For example, a partner in a trading caravan with no goods to sell is likely to exercise less care and diligence than a partner with goods at stake. The Ancient Indians were clearly cognizant of some of the incentives that might inhabit this organizational form.

This advance and prosperity was the very undoing by way of successive invasion and occupation of India and the ruthless strafing of its institutions by foreign hands including the saga of the East India Company, till Independence.

Do you know?

Corporations were in existence in 4th Century B.C. itself.

DEVELOPMENT OF COMPANY LAW IN INDIA AND ENGLAND

The history and development of Modern Company Law in India is closely linked with that of England and for that reason it becomes essential to have a brief account of the history of English Company law for proper appreciation of our law.

Brief History of Company Law in England

The British came to India in 1600 as traders in the form of The East India Company. Attracted by the stories of the fabulous wealth of India and forfeited by the adventurous maritime activity of the Elizabethan era, Englishmen were eager to establish commercial contacts with the East. To facilitate such a venture, some of the enterprising merchants of London formed themselves into a company. They secured for it a Charter from Queen Elizabeth in December, 1600, which settled its constituents, the powers and privileges.

The concept of corporate form was brought in for the first time in United Kingdom wherein the body corporate could be brought into existence either by a Royal Charter or by a special Act of Parliament. Both these methods were very expensive and dilatory. Consequently, to meet the growing commercial needs of the nation, large unincorporated partnerships came into existence and started trading in corporate form. The memberships of each such concern being very large, the management of business was left to a few trustees resulting in separation of ownership from management. Rules of law were not being developed by that time which gave a chance to fraudulent promoters to exploit the public money. As a result, many spurious companies were created which were formed only to disappear resulting in loss to the investing public. The English Parliament, therefore, passed an act known as the Bubbles Act of 1720, which, instead of prohibiting the formation of fraudulent companies, made the very business of companies illegal. This Act made no attempt to put joint stock companies on a proper basis so as to promote the interest of the industry and trade and also to protect the investors. An almost frenetic boom in company floatations, which led to the famous South Sea Bubble, marked the first and second decades of the eighteenth century. Most company promoters were not particularly fussy about whether they obtained charters (an expensive and dilatory process). Those who felt it desirable to give their projects this hallmark of respectability found it simpler and cheaper to acquire charters from moribund companies, which were able to do a brisk trade therein.

The history of modern company law in England begins in 1825 when the Bubble Act was repealed by the Bubble Companies Act. After this the commercial need for general admission of joint stock enterprise became pressing, and it became clear that if the legislature did not act, the future development of companies would be an evolution of the unincorporated company, with its cumbrous/cumbersome constitution, its confused legal status and the great disadvantage of merely contractual limitation of liability of members. In 1844, as a result of Gladstone's initiative as President of Board of Trade, Parliament passed the Joint Stock Companies Act. The Act provided for the first time that a company could be incorporated by registration without obtaining a Royal Charter or sanction by a special Act of Parliament. The office of the Registrar of Joint Stock Companies was also created. But the Act denied to the members the facility of limited liability. The English Parliament in 1855 passed the Limited Liability Act providing for limited liability to the members of a registered company. The Act of 1844 was superseded by a comprehensive Act of 1855, which marked the beginning of a new era in company law in England. This Act introduced the modern mode of creating companies by means of memorandum and articles of associations.

The first enactment to bear the title of Companies Act was the Companies Act, 1862. By these Acts, some of the modern provisions of the company were clearly laid down. First of all, two documents, namely, (a) the memorandum of association, and (b) articles of association; formed the integral part for the formation of a limited liability company. Secondly, a company could be formed with liability limited by guarantee. Thirdly, any alteration in the object clause of the memorandum of association was prohibited. Lastly provisions for winding up was also introduced. Thus, the basic structure of the company as we know had taken shape. Palmer described this Act as the "Magna Carta of co-operative enterprises". But the Companies (Memorandum of Association) Act, 1890 made relaxation with regard to change in the object clause under the leave of the court obtained on the basis of special resolution passed by the members in general meeting. Then the liability of the directors of a company was introduced by the Directors' Liability Act, 1890 and the compulsory audit of the company's accounts was enforced under the Companies Act, 1900.

The concept of a private company was introduced for the first time in the Companies Act, 1908 (the earlier ones were called public companies). Two subsequent acts were passed in 1908 and 1929 to consolidate the earlier Acts. The Companies Act 1948, which was the Principal Act in force in England was based on the report of a committee under Lord Cohen.

The outstanding feature of the 1948 Act was the emphasis on the public accountability of the company. Generally recognised principles of accountancy were given statutory force and had to be applied in the preparation of the balance sheet and profit and loss account. Further, the 1948 legislation extended the protection of the minority (Section 210) and the powers of the Board of Trade to order an investigation of the company's affairs (Sections 164—175); and for the first time the shareholders in general meeting were given power to remove a director before the expiry of his period of office. The independence of auditors vis-a-vis the directors was strengthened.

The 1948 Act was amended by the Companies (Amendment) Act, 1967. The Amending Act was based upon the report and recommendations of the Jenkins Committee presented in 1962.

The 1967 Act adopted and considerably extended in some respects, the recommendations of the Committee as to disclosure. The Act abolished the exempt private company, and required all limited companies to file accounts. More stringent provisions were imposed in relation to director's interests in the company and disclosure thereof.

The Companies Act, 1976 attempted to remedy a variety of defects which had become evident in the application of the Acts of 1948 and 1967. The 1976 Act further strengthened the requirements of public accountability and those relating to the disclosure of interests in the shares of the company.

The Companies Act, 1980 was a major measure of company law reform in England as insider dealing was made a criminal offence. The shareholders were given a right of pre-emption in the case of new issues of shares in specified circumstances. Dealings between the directors and their companies became greatly restricted and maximum financial limits were introduced for such dealings. The protection to the minority shareholders was extended by enabling them to file petition for relief, if their position was unfairly prejudiced.

The Companies Act, 1981 introduced other important changes. For the purposes of accounting and disclosure, companies were divided into small, medium-sized and other companies and their disclosure requirements were differentiated accordingly. The law relating to the names of companies was simplified by the abolition, in principle, of the approval of the name by the Department of Trade. The company was authorised, subject to certain conditions, to issue redeemable equity shares and to purchase its own shares. The 1981 Act further abolished the register of business names which had to be kept under the Registration of Business Names Act, 1916.

Effective steps were taken to prepare consolidating measures relating to the Companies Acts 1948 to 1981. In November, 1981, the Department of Trade published a consultative document entitled "Consolidation of Companies Acts". In this document the various methods of consolidation and their relative advantages for the practice were discussed.

The whole of the existing statute relating exclusively to companies was consolidated in the Companies Act, 1985, and the Companies Acts 1948 and 1983 replaced by introduction of the Companies Consolidation (Consequential Provisions) Act, 1985. At the same time two minor consolidating enactments, the Business Names Act, 1985 and the Company Securities (Insider Dealing) Act, 1985, were passed to consolidate certain provisions of the Companies Acts 1980 and 1981, which affected sole traders, partnerships and persons other than companies as well as companies regulated by the Companies Act, 1985. The whole of the present statute, therefore, was contained in the Companies Act, 1985 and the two minor consolidating enactments together with the temporary and transitional provisions of the Companies Consolidation (Consequential Provisions) Act, 1985, all of which have come into force from 1st July, 1985.

The U.K. company law has further been amended and has been substituted by U.K. Companies Act, 2006 (which received Royal Assent on November 8, 2006). The Act has been brought into force in stages and circumscribes enhanced duties of directors, simpler regime for private companies, increased use of e-communication, enhanced auditor liabilities etc.

Development of Indian Company Law

Company Law in India, as indicated earlier, is the cherished child of the English parents. Our various Companies Acts have been modelled on the English Acts. Following the enactment of the Joint Stock Companies Act, 1844 in England, the first Companies Act was passed in India in 1850. It provided for the registration of the companies and transferability of shares. The Amending Act of 1857 conferred the right of registration with or without limited liability. Subsequently this right was granted to banking and insurance companies by an Act of 1860 following the similar principle in Britain. The Companies Act of 1856 repealed all the previous Acts. That Act provided inter alia for incorporation, regulation and winding up of companies and other associations. This Act was recast in 1882, embodying the amendments which were made in the Company Law in England upto that time. In 1913 a consolidating Act was passed, and major amendments were made to the consolidated Act in 1936. In the meantime England passed a comprehensive Companies Act in 1948. In 1951, the Indian Government promulgated the Indian Companies (Amendment) Ordinance under which the Central Government and the Court assumed extensive powers to intervene directly in the affairs of the company and to take necessary action in the interest of the company. The ordinance was replaced by an Amending Act of 1951.

The Companies Act, 1956 – Based on Bhabha Committee Recommendations

The Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations. The Act came into force on 1st April, 1956. This Companies Act was based largely on the recommendations of the Company Law Committee (Bhabha Committee) which submitted its report in March, 1952. This Act was the longest piece of legislation ever passed by our Parliament. Amendments have been made in this Act periodically. The Companies Act, 1956 consisted of 658 Sections and 15 Schedules.

Full and fair disclosure of various matters in prospectus; detailed information of the financial affairs of company to be disclosed in its account; provision for intervention and investigation by the Government into the affairs of a company; restrictions on the powers of managerial personnel; enforcement of proper performance of their duties by company management; and protection of minority shareholders were some of the main features of the Companies Act, 1956.

The Companies Act, 1956 had undergone changes by amendments in 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1971, 1977, 1985, 1988, 1996, 1999, 2000, 2002 (Amendment), 2002 (Second Amendment), and 2006. The Companies Act, 1956 was also amended pursuant to the enactment of the Depositories Act, 1996.

Based on the recommendations of Shastri Committee, the Companies (Amendment) Act, 1960 introduced several new provisions relating to various aspects of company management which were overlooked in the 1956 Act.

The Companies (Amendment) Act, 1963 provided for the appointment of a Companies Tribunal and constitution of the Board of Company Law Administration. It also empowered the Central Government to remove managerial personnel involved in cases of fraud, etc.

Based on the recommendations of the Vivian Bose Commission, the Companies (Amendment) Act, 1965 introduced some major changes, such as clear definition of the main and subsidiary objects of a company in its Memorandum of Association; Strengthening the provisions relating to investigation into the affairs of the company, etc. The Companies Act was further amended twice in 1966.

Two important changes were introduced by the Companies (Amendment) Act, 1969. The institutions of managing agents and secretaries and treasurers were abolished with effect from April 3, 1970. Secondly, contributions by companies to any political party or for any political purpose were prohibited.

The Companies (Amendment) Act, 1974 which came into force from February 1, 1975 had introduced some important and major changes in the Companies Act, 1956. The object of the Amendment Act was to inject an element of public interest in the working of the corporate sector.

The Companies (Amendment) Act of 1977 brought about certain changes in Sections 58A, 220, 293, 620 and 634A of 1956 Act.

The Companies (Amendment) Act, 1985: The amending Act substituted Section 293A of Companies Act, 1956 with a new section permitting Non-Government companies to make political contributions, directly or indirectly.

With a view that legitimate dues of workers rank *pari passu* with secured creditors in the event of closure of the company and rank above even the dues to Government, Sections 529 and 530 of the Companies Act, 1956, were amended and a new Section 529A was introduced.

The Companies (Amendment) Act, 1988: Based on the recommendations made by the Expert Committee (Sachar Committee), the Companies (Amendment) Act, 1988 substantially amended the Companies Act, 1956 in order to streamline some of the existing provisions of the Companies Act, 1956 and to ensure better working and administration of the Act.

The important changes introduced by the Amendment Act of 1988 were:

Definition of Secretary brought in line with the definition of 'Company Secretary' in the Company Secretaries Act, 1980 and includes an individual possessing the prescribed qualifications.

The concept of company secretary in practice was introduced for the first time in the Companies Act. The Amended Act, among other things, also set up an independent Company Law Board to exercise such judicial and quasi-judicial functions, earlier being exercised either by the Court or the Central Government.

The Depositories Act, 1996 made the following major amendments to the Companies Act, 1956:-

- (1) Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.
- (2) Stamping of transfer instruments is not required where both the transferor and transferee are entered as beneficial owners in the records of a depository.
- (3) The securities of a company other than a private company have been made freely transferable. The transfer has to be effected immediately by the company/depository.
- (4) The register of members shall indicate the shares held by a member in demat mode but such shares need not be distinguished by a distinctive number.
- (5) Company to give in the offer document option to the investor to ask for issue of securities in demat mode.

The Companies (Amendment) Act, 1999 made the following major changes to the Companies Act, 1956:-

- Companies allowed to issue Sweat Equity shares and to buy-back their own securities.
- Facility for nomination provided for the benefit of share/debenture/deposit holders.
- An Investor Education and Protection Fund to be established.
- National Advisory Committee on Accounting Standards for companies to be established.
- Prior approval of Central Government not required for inter-corporate investment/lending proposals subject to certain conditions.

Further the Companies (Amendment) Act, 2000 made the following major amendments:

- (1) Private Companies and Public Companies to have a minimum paid-up capital of Rupees one lakh and five lakh respectively.
- (2) Change of place of registered office from the jurisdiction of one Registrar of Companies to another Registrar of Companies within the same state requires confirmation from the Regional Director.
- (3) Provisions relating to deemed public companies became inoperative and a new provision relating to conversion of a public company to a private company inserted in the Companies Act, 1956.
- (4) SEBI given powers regarding issue and transfer of securities and non-payment of dividend by listed public companies.
- (5) Certain measures included for protecting the interest of small deposit holders in a company.

- (6) Preferential offer/Private placement of securities to 50 (fifty) persons or more treated as public issue. This shall not apply to a preferential offer made by public financial institutions and NBFCs.
- (7) Provisions relating to shelf-prospectus and information memorandum, issue of equity share capital with differential rights as to dividend, voting or otherwise included.
- (8) Every listed company making initial public offer of any security for a sum of Rupees ten crores or more will have to issue the same only in a dematerialised form.

The Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002 made the following changes to the Companies Act, 1956:-

1. New Part IXA consisting of Section 581A to 581ZT relating to Producer Companies inserted .
2. The existing Company Law Board is proposed to be dissolved and in its place a National Company Law Tribunal (Tribunal) is to be constituted.
3. Appeals against the orders of the Tribunal can be filed with the Appellate Tribunal. Further appeal against the orders of the Appellate Tribunal would lie to the Supreme Court.
4. The Board for Industrial and Financial Reconstruction is to be abolished and SICA will be repealed.
5. Transfer of all the powers from the BIFR to the Tribunal.
6. Transfer of certain powers of the High Court to the Tribunal.
7. Greater role for professionals in the administration of Company Law.
8. Transfer of powers relating to winding up, mergers and amalgamations from Court to the Tribunal.

The Companies (Amendment) Act, 2006 inserted new Sections 610B, 610C, 610D and 610E and also certain sections pertaining to Director Identification Number (DIN). Salient features of the provisions of Companies (Amendment) Act, 2006 are as follows:

- DIN to be obtained by all existing directors and every other person, intending to become a director.
- The applications, balance sheet, prospectus, return, declaration, memorandum and articles of association, particulars of charges or any other particulars or document required to be filed or delivered, are to be filed in electronic form .
- The document, notice, any communication or intimation, required to be served or delivered under the Act to the Registrar of Companies, should be served or delivered through electronic form .
- Applications, balance sheet, prospectus, return, register, MOA and AOA, particulars of charges or any other document and return filed shall be maintained by Registrar in electronic form .
- Central Government may provide such value added services through the electronic form .
- All the provisions of Information Technology Act, 2000 relating to the electronic records, in so far as they are not inconsistent with the Companies Act, shall apply to the records in electronic form.

EVOLUTION OF THE COMPANIES ACT 2013

The Companies Act, 1956 was enacted with the object to amend and consolidate the law relating to companies. This Act provided the legal framework for corporate entities in India and was a mammoth legislation. As the corporate sector grew in numbers and size of operations, the need for streamlining this Act was felt and as many as 24 amendments had taken place since then. Major amendments were made through the Companies (Amendment) Act, 1988 after considering the recommendations of the Sachar Committee, and then again in 1998, 2000 and in 2002 through the Companies (Second Amendment) Act,

2002. Unsuccessful attempts were made in 1993 and 1997 to replace the present Act with a new law. Companies (Amendment) Bill, 2003 containing important provisions relating to Corporate Governance and aimed at achieving competitive advantage was also introduced.

Till some time back Companies Act, 1956, was the principal legislation governing the corporate sector in India. However, several changes had taken place in the national and international economic environment after the enactment of this Act during the last two to three decades. Thus, modernization of company law governing setting up and functioning of enterprises, structures for sharing risk and reward, governance and accountability to the investors and other stakeholders and structural changes in the law commensurate with global standards had become critical for governing and guiding a vibrant corporate sector and business environment.

To frame a law that enables companies to achieve global competitiveness in a fast changing economy, the Government had taken up a fresh exercise for a comprehensive revision of the Companies Act, 1956, albeit through a consultative process. As the first step in this direction, a Concept Paper on Company Law drawn up in the legislative format was exposed for public viewing on the electronic media so that all interested parties may not only express their opinions on the concepts involved but may also suggest formulations on various aspects of Company Law.

The response to the concept paper on Company Law was tremendous. The Government, therefore, felt it appropriate that the proposals contained in the Concept Paper and suggestions received thereon be put to merited evaluation by an independent Expert Committee. A Committee was constituted on 2nd December, 2004 under the Chairmanship of Dr. J J Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable the adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. The Committee submitted its report to the Government on 31st May 2005.

DR. J J IRANI COMMITTEE REPORT

Dr. J J Irani Expert Committee on Company Law had submitted its report charting out the road map for a flexible, dynamic and user-friendly new company law. The Committee had taken a pragmatic approach keeping in view the ground realities, and had sought to address the concerns of all the stakeholders to enable adoption of internationally accepted best practices. As one wades through the report, one finds an arduous zeal to ensure that flexibility is coupled with accountability and transparency. Be it the role of directors in the management of the company or the role of promoters at the time of incorporation or the responsibility of professionals in ensuring better governance, the report had made very dynamic and balanced recommendations. The Report of the Committee had also sought to bring in multifarious progressive and visionary concepts and endeavored to recommend a significant shift from the "Government Approval Regime" to a "Shareholder Approval and Disclosure Regime".

The Expert Committee had recommended that private and small companies need to be given flexibilities and freedom of operations and compliance at a low cost. Companies with higher public interest which access capital from public need to be subjected to a stricter regime of Corporate Governance. Further, Government companies and public financial institutions should be subject to similar parameters with respect to disclosures and Corporate Governance as other companies are subjected to.

To attune the Indian Company Law with the global reforms taking place in the arena, the Report of the Committee had sought to bring in multifarious visionary concepts, which if accepted and acted upon would really simplify the voluminous and cumbersome Companies Act in the country.

Companies Bill, 2012

The Government considered the recommendations of Irani Committee and also had detailed discussions and deliberations with various stakeholders viz Industry Chambers, Professional Institutes, Government Departments, Legal Experts and Professionals etc. Thereafter, the Companies Bill, 2009 was introduced in the Lok Sabha on 3rd August, 2009. The Bill laid greater emphasis on self regulation and minimization of regulatory approvals in managing the affairs of the company. The Bill promised greater shareholder democracy, vesting the shareholders with greater powers, containing stricter corporate governance norms and requiring greater disclosures.

The objectives of the Bill were:

- (i) Revising and modifying the Act in consonance with the changes in the National and International economy,
- (ii) Bringing about compactness of company law by deleting the provisions that had become redundant and by re-grouping the scattered provisions,
- (iii) Re-writing of various provisions of the Act to facilitate easy interpretation,
- (iv) Delinking the procedural aspects from the substantive law and provide greater flexibility in rule making to enable adoption to the changing economic and technical environment.
- (v) Enabling the corporate sector to operate in a regulatory environment of best international practices that fosters entrepreneurship, investment and growth.

The Companies Bill, 2009 after introduction in Parliament was referred to the Parliamentary Standing Committee on Finance for examination which submitted its report to Parliament on 31st August, 2010. Certain amendments were introduced in the Bill in the light of the report of the Committee and a revised Companies Bill, 2011 was introduced. This version was also referred to the Hon'ble Committee, which suggested certain further amendments. The amended Bill was passed by the Lok Sabha on 18th December, 2012 and by the Rajya Sabha on 8th August, 2013. The Bill was retitled as Companies Bill, 2012.

Companies Act 2013

The Companies Bill, 2012 was assented to by the President of India on 29.08.2013 and notified in the Gazette of India on 30.08.2013. It finally became the Companies Act, 2013.

Highlights of the Companies Act, 2013

Passed in Lok sabha	December 18, 2012
Passed in Rajya Sabha	August 08, 2013
President's assent	August 29, 2013
Total number of sections	470
Total number of chapters	29
Total number of schedules	7
Number of sections notifies (282)	Section 1 on August 29, 2013 98 sections on September 12, 2013 183 sections on April 01, 2014
Total number of rules notified	Rules under 21 chapters notified

THE NEW CONCEPTS INTRODUCED

The Companies Act 2013 has introduced new concepts supporting enhanced disclosure, accountability, better board governance, better facilitation of business and so on. It includes the following aspects:-

- Associate company
- One person company
- Small company
- Dormant company
- Independent director
- Women director
- Resident director
- Special court
- Secretarial standards
- Secretarial audit
- Class action
- Registered valuers
- Rotation of auditors
- Vigil mechanism
- Corporate social responsibility
- Cross border mergers
- Prohibition of insider trading
- Global depositories receipts

COMPANY VIS-A-VIS OTHER FORMS OF BUSINESS

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs, a limited company is distinguished from a partnership firm, a Hindu Undivided Family (HUF) business and a registered society.

Distinction between Company and Partnership

The principal points of distinction between a company and a partnership firm are as follows:

- (1) A company is a distinct legal person. A partnership firm is not distinct from the several persons who form the partnership.
- (2) In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals who are its members.
- (3) Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.
- (4) Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business. A member of a company has no such power.
- (5) A partner cannot contract with his firm, whereas a member of a company can.
- (6) A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.

- (7) Restrictions on a partner's authority contained in the partnership contract do not bind outsiders whereas such restrictions incorporated in the Articles are effective, because the public are bound to acquaint themselves with them.
- (8) A partner's liability is always unlimited whereas that of shareholder may be limited either by shares or a guarantee.
- (9) A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.
- (10) A company may have any number of members except in the case of a private company which cannot have more than 200 members (excluding past and present employee members). In a public company there must not be less than seven persons in a private company not less than two. Further, a new concept of one person company has been introduced which may be incorporated with only one person.
- (11) A company is required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.
- (12) A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement among the partners.

Distinction between Company and Hindu Undivided Family Business

1. A company consists of heterogeneous (varied or diverse) members, whereas a Hindu Undivided Family Business consists of homogenous (unvarying) members since it consists of members of the joint family itself.
2. In a Hindu Undivided Family business the *Karta* (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
3. A person becomes a member of a Hindu Undivided Family business by virtue of birth. There is no provision to that effect in the company.
4. No registration is compulsory for carrying on business for gain by a Hindu Undivided Family even if the number of members exceeds twenty [*Shyamla Roy v. Madhusudan Roy*, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

Distinction between company and Limited Liability Partnership (LLP)

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.

Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.

Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity.

Since LLP contains elements of both ‘a corporate structure’ as well as ‘a partnership firm structure’ LLP is called a hybrid between a company and a partnership.

LLP is a body corporate and a legal entity separate from its partners, having perpetual succession. LLP form is a form of business model which : (i) is organized and operates on the basis of an agreement. (ii) provides flexibility without imposing detailed legal and procedural requirements (iii) enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.

A basic difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act) whereas for an LLP it would be by a contractual agreement between partners.

The management-ownership divide inherent in a company is not there in a limited liability partnership. LLP have more flexibility as compared to a company. LLP have lesser compliance requirements as compared to a company.

DOCTRINE OF LIFTING OF OR PIERCING THE CORPORATE VEIL

The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle/doctrine of what is called as “lifting of or piercing the corporate veil”. The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. *[BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai [1996] 86 Com Cases 371 (Bom).]*

However, the shareholders cannot ask for the lifting of the veil for their purposes. This was held in *Premlata Bhatia v. Union of India (2004) 58 CL 217 (Delhi)* wherein the premises of a shop were allotted on a licence to the individual licensee. She set up a wholly owned private company and transferred the premises to that company without Government consent. She could not remove the illegality by saying that she and her company were virtually the same person.

Statutory Recognition of Lifting of Corporate Veil

The Companies Act, 2013 itself contains some provisions [Sections 7(7), 251(1) and 339] which lift the corporate veil to reach the real forces of action. Section 7(7) deals with punishment for incorporation of company by furnishing false information; Section 251(1) deals with liability for making fraudulent application for removal of name of company from the register of companies and Section 339 deals with liability for fraudulent conduct of business during the course of winding up.

Lifting of Corporate Veil under Judicial Interpretation

Ever since the decision in *Salomon v. Salomon & Co. Ltd.*, (1897) A.C. 22, normally Courts are reluctant or at least very cautious to lift the veil of corporate personality to see the real persons behind it. Nevertheless, Courts have found it necessary to disregard the separate personality of a company in the following situations:

- (a) **Where the corporate veil has been used for commission of fraud or improper conduct. In such a situation, Courts have lifted the veil and looked at the realities of the situation.**

CASE EXAMPLE

In Jones v. Lipman, (1962) I. W.L.R. 832

A agreed to sell certain land to B. Pending completion of formalities of the said deal, A sold and transferred the land to a company which he had incorporated with a nominal capital of £100 and of which he and a clerk were the only shareholders and directors. This was done in order to escape a decree for specific performance in a suit brought by B. The Court held that the company was the creature of A and a mask to avoid recognition and that in the eyes of equity A must complete the contract, since he had the full control of the limited company in which the property was vested, and was in a position to cause the contract in question to be fulfilled.

(b) Where a corporate facade is really only an agency instrumentality.

CASE EXAMPLE

In Re. R.G. Films Ltd. (1953) 1 All E.R. 615

An American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American company which financed the production of the film. Board of Trade refused to register the film as a British film which stated that English company acted merely as the nominee of the American corporation.

(c) Where the conduct conflicts with public policy, courts lifted the corporate veil for protecting the public policy.

CASE EXAMPLE

In Connors Bros. v. Connors (1940) 4 All E.R. 179

The principle was applied against the managing director who made use of his position contrary to public policy. In this case the House of Lords determined the character of the company as "enemy" company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".

(d) Further, In *Daimler Co. Ltd. v. Continental Tyre & Rubber Co.*, (1916) 2 A.C. 307, it was held that a company will be regarded as having enemy character, if the persons having de facto control of its affairs are resident in an enemy country or, wherever they may be, are acting under instructions from or on behalf of the enemy.

(e) Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity and make the individuals concerned liable to pay the taxes which they would have paid but for the formation of the company.

CASE EXAMPLE

Re. Sir Dinshaw Manakjee Petit, A.I.R. 1927 Bombay 371

The facts of the case are that the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability.

But it was held “the company was formed by the assessee purely and simply as a means of avoiding super-tax and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the assessee as pretended loans”. The Court decided to disregard the corporate entity as it was being used for tax evasion.

- (f) **Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same and, therefore, where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction.**

CASE EXAMPLE

The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and another, A.I.R. 1986 SC 1.

The facts of the case were that a new company was created wholly by the principal company with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company i.e. only for the purpose of splitting the profits into two hands and thereby reducing the obligation to pay bonus. The Supreme Court of India held that the new company was formed as a device to reduce the gross profits of the principal company and thereby reduce the amount to be paid by way of bonus to workmen. The amount of dividends received by the new company should, therefore, be taken into account in assessing the gross profit of the principal company.

- (g) **Another instance of corporate veil arrived at by the Court arose in *Kapila Hingorani v. State of Bihar*.**

CASE EXAMPLE

Kapila Hingorani v. State of Bihar, 2003(4) Scale 712

In this case, the petitioner had alleged that the State of Bihar had not paid salaries to its employees in PSUs etc. for long periods resulting in starvation deaths. But the respondent took the stand that most of the undertakings were incorporated under the provisions of the Companies Act, 1956, hence the rights etc. of the shareholders should be governed by the provisions of the Companies Act and the liabilities of the PSUs should not be passed on to the State Government by resorting to the doctrine of lifting the corporate veil. The Court observed that the State may not be liable in relation to the day-to-day functioning of the PSUs but its liability would arise on its failure to perform the constitutional duties and the functions of these undertakings. It is so because, “life means something more than mere ordinal existence. The inhibition against deprivation of life extends to all those limits and faculties by which life is enjoyed”.

- (h) **Where it is found that a company has abused its corporate personality for an unjust and inequitable purpose, the court would not hesitate to lift the corporate veil. Further, the corporate veil could be lifted when acts of a corporation are allegedly opposed to justice, convenience and interests of revenue or workmen or are against public interest.**

Thus, in appropriate cases, the Courts disregard the separate corporate personality and look behind the legal person or lift the corporate veil.

Lifting the Corporate Veil of Small Scale Industry

Where small scale industries were given certain exemptions and the company owning an industry was controlled by some group of persons or companies, it was held that it was permissible to lift the veil of the

company to see whether it was the subsidiary of another company and, therefore, not entitled to the proposed exemptions. [*Inalsa Ltd. v. Union of India*, (1996) 87 Com Cases 599 (Delhi).]

Use of Corporate Veil for Hiding Criminal Activities

Where the defendant used the corporate structure as a device or facade to conceal his criminal activities (evasion of customs and excise duties payable by the company), the Court could lift the corporate veil and treat the assets of the company as the realisable property of the shareholder.

For example, in a case, there was a *prima facie* case that the defendants controlled the two companies, the companies had been used for the fraudulent evasion of excise duty on a large scale, the defendant regarded the companies as carrying on a family business and that they had benefited from companies' cash in substantial amounts and further no useful purpose would have been served by involving the companies in the criminal proceedings. In all these circumstances it was therefore appropriate to lift the corporate veil and treat the stock in the companies' warehouses and the companies' motor vehicles as realisable property held by the defendants. The court said that the excise department is not to be criticized for not charging the companies. The more complex commercial activities become, the more vital it is for prosecuting authorities to be selective in whom and what they charge, so that issues can be presented in as clear and short form as possible. In the present case, it seemed that no useful purpose would have been served by initiating criminal proceedings. [*H. and Others (Restraint Order : Realisable Property), Re*, (1996) 2 BCLC 500 at 511, 512 (CA).]

REVIEW QUESTIONS



Under which of the following circumstances does the Court permit the lifting of the corporate veil?

- (a) Where the company has abused its corporate personality for an unjust and inequitable purpose.
- (b) Where the veil has been used for evasion of taxes.
- (c) Where the Corporate Veil conflicts with public policy.
- (d) Avoidance of welfare legislation by the company

Correct answer: All

CITIZENSHIP

The term 'corporate citizenship' has been in use for some decades, but it rose to prominence only during the 2000s. There is considerable confusion over what exactly is meant by the term. *Matten and Crane* (2005) distinguish three views of corporate citizenship:

Limited View – where corporate citizenship is used to denote corporate philanthropy in the local community, such as being a 'good citizen' in donating money for charity or helping out a local sports or arts institution.

Equivalent View – where corporate citizenship is used to refer to corporate social responsibility. Matten and Crane refer here to a paper by Archie Carroll who described the "four faces of corporate citizenship" exactly the same as he had previously defined the four levels of CSR – as economic, legal, ethical, and philanthropic responsibilities. Many authors, companies, and consultancies adopt a similar approach. It is also evident in annual rankings of the "top corporate citizens", such as those by CRO Magazine and Corporate Knights

Extended View – where corporate citizenship is seen in terms of its distinctly political connotations, such as corporate claims to citizenship entitlements, firms' participation in global governance, or corporate involvement in the administration of individuals' social, civil and political rights. Some authors refer to this as

"political CSR" or a "beyond CSR" perspective.

All three approaches can be seen in practice, but in the business world the first two views are predominant, whilst in academia the extended view has started to gain greater prominence.

Corporations as citizens

Although it is generally accepted that corporations are not citizens in the same way that "real" citizens are - they cannot hold passports or vote in elections, for example - it has been recognized that they do share in some of the same or similar practices, such as paying taxes, engaging in free speech, and expecting certain protections from the state. There is concern, however, that extending the scope of citizenship to incorporated corporations may infringe upon democracy and equality given their access to substantial power and resources.

Is Company a Citizen?

The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India. In *State Trading Corporation of India Ltd. v. C.T.O.*, A.I.R. 1963 S.C. 1811, the Supreme Court held that the State Trading Corporation though a legal person, was not a citizen and can act only through natural persons. Nevertheless, it is to be noted that certain fundamental rights enshrined in the Constitution for protection of "person", e.g., right to equality (Article 14) etc. are also available to company. Section 2(f) of Citizenship Act, 1955 expressly excludes a company or association or body of individuals from citizenship.

CASE EXAMPLE

In R.C. Cooper v. Union of India, AIR 1970 SC 564

In this case, the Supreme Court held that where the legislative measures directly touch the company of which the petitioner is a shareholder, he can petition on behalf of the company, if by the impugned action, his rights are also infringed. In that case, the court entertained the petition under Article 32 of the Constitution at the instance of a director as shareholder of a company and granted relief. It is, therefore, to be noted that an individual's right is not lost by reason of the fact that he is a shareholder of the company.

CASE EXAMPLE

Bennet Coleman Co. v. Union of India, AIR 1973 SC 106

In this case, the Supreme Court stated that:

"It is now clear that the Fundamental Rights of shareholders as citizens are not lost when they associate to form a company. When their Fundamental Rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders' rights are equally and necessarily affected if the rights of the company are affected."

Nationality and Residence of a Company

Though it is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence. In *Gasque v. Inland Revenue Commissioners*, (1940) 2 K.B. 88, Macnaghten. J. held that a limited company is capable of having a domicile and its domicile is the place of its registration and that domicile clings to it throughout its existence. He observed in this case:

"It was suggested that a body corporate has no domicile. It is quite true that a body corporate cannot have a domicile in the same sense as an individual. But by analogy with a natural person the attributes of residence,

domicile and nationality can be given to a body corporate."

In *Tulika v. Parry and Co.*, (1903) I.L.R. 27 Mad. 315, Kelly C.B. observed:

"A joint stock company resides where its place of incorporation is, where the meetings of the whole company or those who represent it are held and where its governing body meets in bodily presence for the purposes of the company and exercises the powers conferred upon it by statute and by the Articles of Association."

Do you know?

Though the company cannot be considered as citizen, it has nationality, domicile and residence.

ILLEGAL ASSOCIATION

In order to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them did not know with whom they were contracting, the law has put a ceiling on the number of persons constituting an association or partnership. An unincorporated company, association or partnership consisting of large number of persons has been declared illegal. Rule 10 of Companies(Miscellaneous) Rules, 2014 prescribes 50 persons in this regard.

By virtue of section 464 of the Companies Act, 2013, no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. The number of persons which may be prescribed under this section shall not exceed 100.

Section 464 of the Act does not apply to the case of a Hindu undivided family carrying on any business whatever may be the number of its members. However, this section is also not applicable to an association or partnership, if it is formed by professionals who are governed by special Acts.

Since, the law does not recognize it, an illegal association:

- (i) cannot enter into any contract;
- (ii) cannot sue any member, or outsider, not even if the company is subsequently registered;
- (iii) cannot be sued by a member, or an outsider for recovery of any debts;
- (iv) cannot be wound up by an order of the Court. In fact, the Court cannot entertain a petition for its winding up as an unregistered company, for if it did, it would be indirectly according recognition to the illegal association (*Raghubar Dayal v. Sarafa Chamber A.I.R. 1954 All. 555*).

However, an illegal association is liable to be taxed [*Kumara Swamy Chattiar v. Income Tax Officer* (1957) I.T.R. 457].

The members of an illegal association are individually liable in respect of all acts or contracts made on behalf of the association; they cannot either individually or collectively, bring an action to enforce any contract so made, or to recover any debt due to the association [*Wilkinson v. Levison* (1925) 42 T.L.R. 97].

Under sub-section (3) of section 464, every member of an illegal association shall be punishable with fine which may extend to one lakh rupees and shall also be personally liable for all liabilities incurred in such business.

Applicability of Section 464 to LLPs

This section will not be applicable to LLPs as they are incorporated as bodies corporate under LLP Act.

REVIEW QUESTIONS

Which of the following activities are barred to an association that is considered illegal?

- Entering into any contract.
- Suing any member or an outsider by a company.
- Sued by a member or an outsider against the company.
- Liable to be taxed.

Correct answer: (a), (b) and (c)

LESSON ROUND-UP

- The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together.
- In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. A company has a separate legal entity from the persons constituting it.
- The main characteristics of a company are corporate personality, limited liability, perpetual succession, separate property, transferability of shares, common seal, capacity to sue and be sued, contractual rights, limitation of action, separate management, termination of existence etc.
- Company Law in India has been modelled on the English Company Law.
- In India after independence, the Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations.
- Companies Act, 2013 was passed by the Lok Sabha and Rajya Sabha on 18th December and 8th August, 2013 respectively. It received the assent of the Hon'ble President of India on 29th August, 2013 and was notified in the Gazette of India on 30th August, 2013. The Companies Act, 2013 has replaced the Companies Act, 1956.
- Major amendments to Companies Act, 1956 had been made by the Depositories Act, 1996, the Companies (Amendment) Acts, 1988, 1999, 2000, 2002 & 2006 apart from various other Amendments Acts.
- Business enterprises can be divided into two broad categories, namely, one which is non-corporate in form and the other which has a corporate character. Enterprises which fall in the former category are sole proprietorship, partnerships and Hindu Undivided Family and business organization which fall in the latter category are companies and co-operative undertakings.
- As compared to other types of business associations, an incorporated company has the advantage of corporate personality, limited liability, perpetual succession, transferable shares, separate property, capacity to sue, flexibility and autonomy.
- There are, however, certain disadvantages and inconveniences in incorporation. Some of these disadvantages are formalities and expenses, corporate disclosures, separation of control from ownership, greater social responsibility, greater tax burden in certain cases, cumbersome winding-up procedure.
- Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court may break through the corporate shell and apply the principle of what is known as "lifting of or piercing the corporate veil".
- In order to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them do not know with whom they were contracting, the law has put a ceiling on the number of persons constituting an association or partnership. If the ceiling exceeds 100, then such association or partnership has to register itself either under the Companies Act, 2013 or some other Indian Statute.

- The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India. Though it has established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.

GLOSSARY

Incorporate	It refers to the legal act of creating a company.
Liability	A person or business deemed liable is subject to a legal obligation.
Limited liability	Usually refers to limited companies where the shareholders' liability to pay the debts of the company is limited to the value of their shares.
Perpetual Succession	An incorporated company never dies except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and remains the same entity, despite total change in the membership.
<i>ipso facto</i>	by that very fact or act
Partnership	When two or more persons join together to carry on a business.
Limited Liability Partnership	Limited Liability partnership combines the advantages of both the company form and partnership form into a single form of organization; this is an important difference from that of an unlimited partnership.
Corporation	An organization formed under state law for the purpose of carrying on a business enterprise is such a manner as to make the enterprise distinct from its owners.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

- Answer on the following:
 - Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?
 - The members of a private limited company consist of 'A' and 'B' who are also its directors. On 4th August, 2012 'A' left India for a foreign business tour and on 28th August, 2012 he died abroad. On 1st September, 2012 'B' purchased on credit ₹ 10,000 worth of goods from 'C' on behalf of the company. 'C' now proposes to make 'B' personally liable for the payment of the debt. Is 'B' liable?
- (a) What types of associations are prohibited by the Companies Act, and what are the disabilities of such associations?
 - "Members of a Limited Company may nevertheless have unlimited liability." Comment.
 - What do you understand by corporate veil and when is it disregarded?
- State the consequences in each of the following cases giving reasons for your answers:
 - A Private Company has 210 members in total of which 10 are the employees of the company. 5 of these employees leave the employment of the company.
 - A private firm has 20 partners, including a private company which is having 30 shareholders.
- "The fundamental attribute of corporate personality is that the company is a legal entity distinct from the members." Elucidate the above statement.
- Discuss briefly the history of Company Law in India. Also discuss how far Company Law in India

has been influenced by the English Company Law.

6. What are the advantages of an incorporated company compared to partnership firms and unincorporated companies?
 7. Write short notes on:
 - (a) Perpetual succession
 - (b) Transferability of shares
 - (c) Limited liability
 - (d) Corporate personality
 - (e) One man company.

8. A company transferred all the shares of another company held by it to its newly incorporated wholly-owned public limited subsidiary investment company.

During the year, the subsidiary company made no other investment or had no source of income. By the transfer of the above shares, the holding company's available surplus for payment of bonus to its workmen got reduced and consequently rate of bonus came down.

Are the workmen of the holding company entitled to get the dividend income of the subsidiary company included in the holding company's profit and loss account for the purpose of getting higher rate of bonus?

9. Examine the following and say whether they are correct or wrong:

 - (a) A company being an artificial person cannot own property and cannot sue or be sued.
 - (b) Members are the owners of the company's undertaking.
 - (c) The term "body corporate" connotes a wider meaning than the term "company".
 - (d) Every member of an illegal association shall be personally liable for all liabilities incurred in carrying on the business.
 - (e) A company is a juristic legal person.

Lesson 2

Types of Companies

LESSON OUTLINE

- Introduction and basis of classification.
- Private company, its privileges.
- One person company
- Small Company
- Public company.
- Limited company.
- Unlimited company.
- Association not for profit and its privileges.
- Government companies, its privileges.
- Holding/Subsidiary companies.
- Associate Companies
- Investment companies.
- Producer companies.
- Dormant Companies
- Public Financial Institutions.
Statutory Corporations.

LEARNING OBJECTIVES

Companies may be classified on the basis of their incorporation, number of members, size, basis of control and motive. On the basis of incorporation the companies may be classified into Charter Companies, Statutory Companies and Registered Companies. On the basis of liability, it may be Companies limited by shares/guarantee and unlimited liability companies. Further, on the basis of number of members, they may be classified into One Person Company, private company and public company. On the basis of size, they may be divided into small companies and other companies. On the basis of control, they may be classified into holding company, subsidiary company and associate company.

Besides, companies may be non profit companies licensed under Section 8, Government companies, foreign companies, holding/subsidiary companies, investment companies, producer companies etc.

After reading this lesson you would be able to understand the concepts of various types of companies, their legal basis, special provisions and privileges for some classes of companies, distinction between different types of companies etc.

INTRODUCTION

The Companies Act, 2013 provides for the kinds of companies that can be promoted and registered under the Act. The three basic types of companies which may be registered under the Act are:

- (a) Private Companies;
- (b) Public Companies; and
- (c) One Person Company (to be formed as Private Limited)..

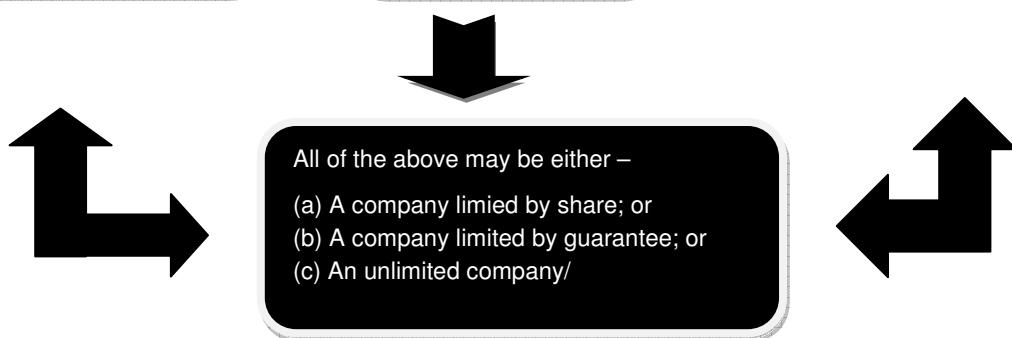
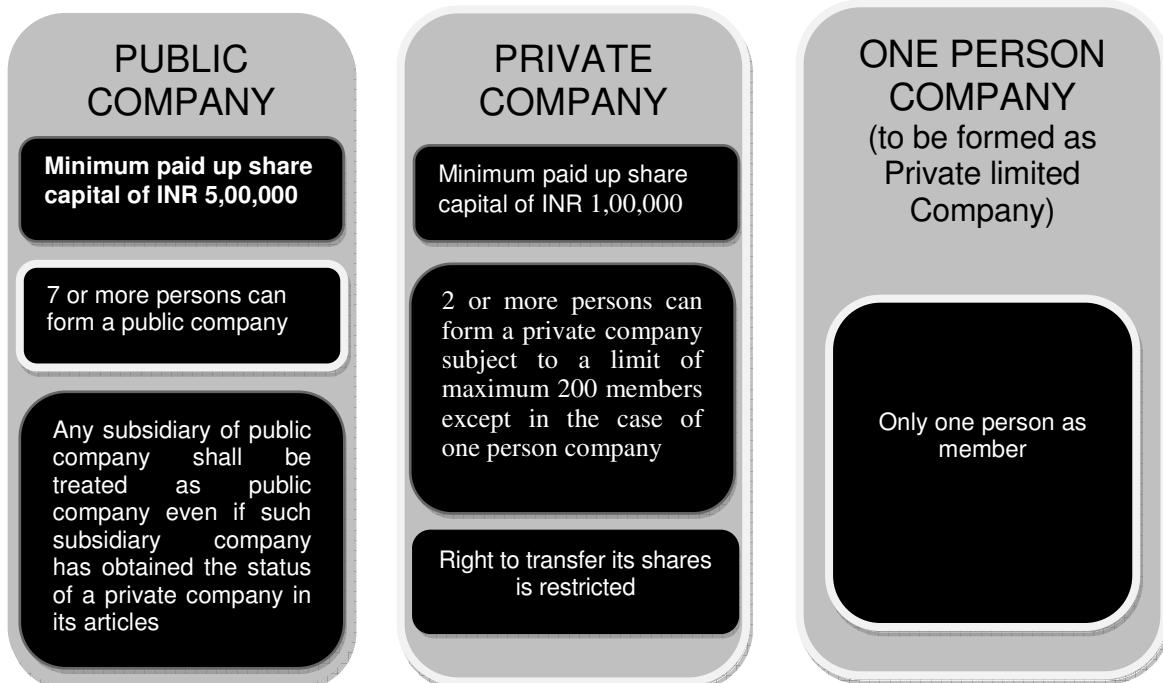
Section 3. (1) of the Companies Act 2013 states that a company may be formed for any lawful purpose by—

- (a) seven or more persons, where the company to be formed is to be a public company;
- (b) two or more persons, where the company to be formed is to be a private company; or
- (c) one person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration

(2) A company formed under sub-section (1) may be either—

- (a) a company limited by shares; or
- (b) a company limited by guarantee; or
- (c) an unlimited company.

Typs of Companies under the Companies Act, 2013



Classification of Companies

- (i) Classification on the basis of Incorporation: There are three ways in which companies may be incorporated.
 - (a) **Statutory Companies:** These are constituted by a special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.
 - (b) **Registered Companies:** The companies which are incorporated under the Companies Act, 2013 or under any previous company law, with ROC¹ fall under this category.
- (ii) Classification on the basis of Liability: Under this category there are three types of companies:
 - (a) **Unlimited Liability Companies:** In this type of company, the members are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited. Such companies may or may not have share capital. They may be either a public company or a private company.
 - (b) **Companies limited by guarantee:** A company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount.
 - (c) **Companies limited by shares:** A company that has the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. For example, a shareholder who has paid ₹75 on a share of face value ₹ 100 can be called upon to pay the balance of ₹25 only. Companies limited by shares are by far the most common and may be either public or private.

(iii) Other Forms of Companies

- (a) Associations not for profit having license under Section 8 of the Companies Act, 2013 or under any previous company law;
- (b) Government Companies;
- (c) Foreign Companies;
- (d) Holding and Subsidiary Companies;
- (e) Associate Companies/Joint Venture Companies
- (f) Investment Companies
- (g) Producer Companies.
- (h) Dormant Companies

PRIVATE COMPANY

As per Section 2(68) of the Companies Act, 2013, “private company” means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles,—

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

¹ ROC. Registrar of Companies

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member:

Provided further that the following persons shall not be included in the number of members;—

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

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, and

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

It must be noted that it is only the number of members that is limited to two hundred. A private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures is prohibited.

The aforesaid definition of private limited company specifies the restrictions, limitations and prohibitions, which must be expressly provided in the articles of association of a private limited company.

As per proviso to Section 14 (1), if a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, such company shall, as from the date of such alteration, cease to be a private company.

A private company can only accept deposit from its members in accordance with section 73 of the Companies Act, 2013.

The words ‘Private Limited’ must be added at the end of its name by a private limited company.

As per section 3 (1), a private company may be formed for any lawful purpose by two or more persons, by subscribing their names to a memorandum and complying with the requirements of this Act in respect of registration. Section 149(1) further lays down that a private company shall have a minimum number of two directors. The only two members may also be the two directors of the private company.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The number of members of a private company is limited to 200.

- True
- False

Correct answer: True

Privileges and Exemptions of Private Company

The Companies Act, 2013, confers certain privileges on private companies which are not subsidiaries of public companies. Such companies are also exempted from complying with quite a few provisions of the Act. The basic rationale behind this is that since private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies. Private limited companies lose the privileges and exemptions the moment they cease to be private companies.

Privileges of a Private Limited Company

Some privileges and exemptions enjoyed by a private company or its advantages over a public company include the following:

Section	Nature of exemptions/privileges
67(2)	Financial assistance can be given to its employees for purchase of or subscribing to its own shares or shares in its holding company
121(1)	Need not prepare a report on the Annual General Meeting.
134(3)(p)	Need not prepare a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.
149(1)	Private company need not have more than two directors.
149(4)	Need not appoint Independent directors on its Board.
152(6)	A proportion of directors need not retire every year.
164(3)	Additional grounds for disqualification for appointment as a director may be specified by the company in its articles.
165(1)	Restrictive provisions regarding total number of directorships which a person may hold in a public company do not include directorships held in a private company which is neither a holding or subsidiary company of a public company.
167(4)	Additional grounds for vacation of office of a director may be provided in the Articles.
190(4)	The provisions relating to contract of employment with managing or whole-time directors does not apply to a private company
197(1)	Total managerial remuneration payable by a private company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year may exceed eleven per cent. of the net profits

As per section 462 (1), the Central Government may in public interest, by notification, direct that any of the provisions of this Act, shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification.

Therefore, the Central Government may grant further privileges/exemptions to Private Companies by issuing a notification.

Special Obligations of a Private Company

In addition to the restrictions imposed on Private Companies as contained in Section 2(68) of the Companies Act, a private company owes certain special obligations as compared to a public company, which are as follows:

A private company, while filing its annual return with the Registrar of Companies as required by Section 92, must also send with this return, a certificate stating that:

- (i) The company has not, since the date of the closure of the last financial year with reference to which

- the last return was submitted or in the case of a first return since the date of the incorporation of the company, issued any invitation to the public to subscribe for any securities of the company;
- (ii) Where the annual return discloses the fact that the number of members, except in case of a one person company, of the company exceeds two hundred, the excess consists wholly of persons who under second proviso to clause (ii) of sub-section (68) of section 2 (i.e. the person who is or were in the employment of the Co.) of the Act are not to be included in reckoning the number of two hundred;
- (iii) The Company continued to be a Private Company during the financial year..

Consequences of Alteration of the Articles of Private Companies

As per proviso to section 14(1), where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under section 2(68), the company shall, as from the date of such alteration, cease to be a private company. In such a case, it shall be treated as a public company from the date of alteration of its articles.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

If a Private company alters its articles in such manner that they do not include the restrictions and limitations as laid down in section 2(68), it shall cease to a private company from the date on which such alteration took place.

- True
- False

Correct answer: True

FURTHER CLASSIFICATION OF PRIVATE COMPANY INTO ONE PERSON COMPANY AND SMALL COMPANY

The Dr. JJ Irani committee had recommended that “Company Law should therefore recognize a multiple classification of companies.” In line with the abovesaid recommendation, under the Companies Act, 2013, a private company can further be classified into a One Person Company and Small Company.

ONE PERSON COMPANY (OPC)

Background of OPC

With the implementation of the Companies Act, 2013, a single person could constitute a Company, under the One Person Company (OPC) concept.

The new Companies Act, 2013 has done away with redundant provisions of the previous Companies Act, 1956, and provides for a new entity in the form of one person company (OPC), while empowering the Central Government to provide a simpler compliance regime for small companies.

The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

In India, in the year 2005, the JJ Irani Expert Committee recommended the formation of OPC. It had suggested that such an entity may be provided with a simpler legal regime through exemptions so that the

small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliance.

OPC is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

Status of OPC In Other Countries

Even in other countries like UK, Australia, Singapore, Pakistan, etc; a single person can form a company.

Various countries permit this kind of a corporate entity (China introduced it in October 2005) in which the promoting individual is both the director and the shareholder.

The amended company law of Pakistan permits one person to form a single-member company by filing with the registrar, at the time of incorporation, a nomination in the prescribed form indicating at least two individuals to act as nominee director and alternate nominee director.

In US, several states permit the formation and operation of a single-member Limited Liability Company (LLC).

In China, one person is allowed to apply for opening a limited company with a minimum capital of 1, 00,000 Yuan. The amended law of China prescribes that the owner should pay the investment capital at one time and bars him from opening a second company of the same kind.

In most countries, the law governing companies enables a single-member company to have more than one director and grants exemptions to such companies from holding AGMs, though records and documents are to be maintained.

Difference between a Sole Proprietorship and an OPC

The fundamental difference between a sole proprietorship and an OPC is the way liability is treated in the latter.

A one-person company is different from a sole proprietorship because it is a separate legal entity that distinguishes between the promoter and the company.

The promoter's liability is limited in an OPC in the event of a default or legal issues. On the other hand, in sole proprietorships, the liability is not restricted and extends to the individual and his or her entire assets.

Position of OPC in India under the Companies Act, 2013

The Companies Act, 2013 classifies companies on the basis of their number of members into One Person Company, private company and public company. As stated above, a private company requires a minimum of 2 members. In other words, a One Person Company is a kind of private company having only one member.

As per section 2(62) of the Companies Act, 2013, "One Person Company" means a company which has only one person as a member.

Section 3(1)(c) lays down that a company may be formed for any lawful purpose by one person, where the company to be formed is to be One Person Company that is to say, a private company. In other words, one person company is a kind of private company.

A One person company shall have a minimum of one director. Therefore, a One Person Company will be registered as a private company with one member and one director.

By virtue of section 3(2), an OPC may be formed either as a company limited by shares or a company limited by guarantee; or an unlimited liability company.

Rule 3 of Companies (Incorporation) Rules, 2014 - One Person Company

- (1) Only a natural person who is an Indian citizen and resident in India-
- (a) shall be eligible to incorporate a One Person Company;
 - (b) shall be a nominee for the sole member of a One Person Company.

Explanation-For the purposes of this rule, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

- (2) No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.
- (3) Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in sub rule (2) within a period of one hundred and eighty days.
- (4) No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.
- (5) Such Company cannot be incorporated or converted into a company under section 8 of the Act.
- (6) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.
- (7) No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

Contract by One Person Company

Section 193 (1) provides that where One Person Company limited by shares or by guarantee enters into a contract with the sole member of the company who is also the director of the company, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are recorded in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract.

However, above said provision shall not apply to contracts entered into by the one person company in the ordinary course of its business.

As per section 193 (2), the company shall inform the Registrar about every contract entered into by the company and recorded in the minutes of the meeting of its Board of Directors under sub-section (1) within a period of fifteen days of the date of approval by the Board of Directors.

As per section 152 (1), in case of a One Person Company an individual being its member shall be deemed to be its first director until a director or directors are duly appointed by the member in accordance with the provisions of that section.

Privileges of a One Person Company

The privileges and exemptions enjoyed by a one person company or its advantages over other companies are as follows:

Section	Nature of exemptions/privileges
2(40)	The financial statement, with respect to One Person Company, may not include the cash flow statement;
67(2)	Financial assistance can be taken by the member from the OPC for purchase of or subscribing to its own shares
92(1)	The annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company. In other words it need not be signed by a company secretary in practice.
96(1)	Need not hold annual general meeting
121(1)	Need not prepare a report on Annual General Meeting
122(1)	The provisions of section 98 and sections 100 to 111 (both inclusive) of Chapter VII shall not apply to a One Person Company
122(3)	For any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of One Person Company, the resolution is communicated by the member to the company and entered in the minutes-book required to be maintained under section 118 and signed and dated by the member and such date shall be deemed to be the date of the meeting for all the purposes under this Act.
122(4)	Where there is only one director on the Board of Director of a One Person Company and any business is required to be transacted at the meeting of the Board of Directors of the company, it shall be sufficient if, in case of such One Person Company, the resolution by such director is entered in the minutes-book required to be maintained under section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all purposes under this Act.
134(1)	Financial statement and Board's report can be signed only by one director
134(3)(p)	Need not prepare a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
134(4)	In case of a One Person Company, Board's report shall mean only a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.
137(1)(Third proviso)	File a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year
149(1)	One person company need not to have more than one director on its Board.
149(4)	Need not to appoint Independent directors on its Board
152(6)	Retirement by rotation is not applicable.
164(3)	Additional grounds for disqualification for appointment as a director may be specified by way of articles.

Section	Nature of exemptions/privileges
165(1)	Restrictive provisions regarding total number of directorships which a person may hold in a public company do not include directorships held in One Person company which are neither holding nor subsidiary company of a public company.
167(4)	Additional grounds for vacation of office of a director may be provided in the Articles.
173 (5)	It is required to hold at least one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days. For an OPC having only 1 director, the provisions of section 173 (Meetings of board) and section 174 (Quorum for meetings of Board) will not apply.
190(4)	The provisions relating to contract of employment with managing or whole-time directors does not apply to a One Person Company
197(1)	Total managerial remuneration payable by a one person company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year may exceed eleven per cent. of the net profits.

As per section 462 (1), the Central Government may in public interest, by notification, direct that any of the provisions of this Act, shall not apply to such class or classes of companies; or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification.

Therefore, the Central Government may grant further privileges/exemptions to One Person Companies by issuing a notification.

Benefits of One Person Company

The concept of One person company is quite revolutionary. It gives the individual entrepreneurs all the benefits of a company, which means they will get credit, bank loans, access to market, limited liability, and legal protection available to companies.

Prior to the new Companies Act, 2013 coming into effect, at least two shareholders were required to start a company. But now the concept of One Person Company (OPC) would provide tremendous opportunities for small businessmen and traders, including those working in areas like handloom, handicrafts and pottery. Earlier they were working as artisans and weavers on their own, so they did not have a legal entity of a company. But now the OPC would help them do business as an enterprise and give them an opportunity to start their own ventures with a formal business structure,

Further, the amount of compliance by a one person company is much lesser in terms of filing returns, balance sheets, audit etc. Also, rather than the middlemen usurping profits, the one person company will have direct access to the market and the wholesale retailers. The new concept would also boost the confidence of small entrepreneurs.

SMALL COMPANY

As recommended by the Dr. JJ Irani Committee, the concept of small companies has been introduced in the Companies, Act, 2013. The recommendation of the Irani committee in this regard was as under:

"The Committee sees no reason why small companies should suffer the consequences of regulation that may be designed to ensure balancing of interests of stakeholders of large, widely held corporates. Company law should enable simplified decision making procedures by relieving such companies from select statutory

internal administrative procedures. Such companies should also be subjected to reduced financial reporting and audit requirements and simplified capital maintenance regimes. Essentially the regime for small companies should enable them to achieve transparency at a low cost through simplified requirements. Such a framework may be applied to small companies through exemptions, consolidated in the form of a Schedule to the Act."

Small company is a new form of private company under the Companies Act, 2013. A classification of a private company into a small company is based on its size i.e. paid up capital and turnover. In other words, such companies are small sized private companies.

As per section 2(85) "small company" means a company, other than a public company,—

- (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or
 - (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:
- Provided that nothing in this definition shall apply to—
- (A) a holding company or a subsidiary company;
 - (B) a company registered under section 8; or
 - (C) a company or body corporate governed by any special Act;

Privileges of a Small Company

The privileges and exemptions enjoyed by a small company or its advantages over other companies are as follows:

Section	Nature of exemptions/privileges
2(40)	The financial statement, with respect to Small Company may not include the cash flow statement;
67(2)	Financial assistance can be given for purchase of or subscribing to its own shares or shares in its holding company
92(1)	The annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company. In other words it need not be signed by the company secretary in practice.
121(1)	Need not prepare a report on Annual General Meeting
134(3)(p)	Need not prepare a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
149(1)	Small company need not have more than two directors in its Board.
149(4)	Need not appoint Independent directors on its Board
152(6)	A proportion of directors need not to retire every year.
164(3)	Additional grounds for disqualification for appointment as a director may be specified in the articles.

Section	Nature of exemptions/privileges
165(1)	Restrictive provisions regarding total number of directorships which a person may hold in a public company do not include directorships held in small company which are neither holding nor subsidiary company of a public company.
167(4)	Additional grounds for vacation of office of a director may be provided in the Articles.
173 (5)	It is required to hold at least one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days.
190(4)	The provisions relating to contract of employment with managing or whole-time directors do not apply to a Small Company
197(1)	Total managerial remuneration payable by a small company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year may exceed eleven per cent. of the net profits

As per section 462 (1), the Central Government may in public interest, by notification, direct that any of the provisions of this Act, shall not apply to such class or classes of companies; or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification.

Therefore, the Central Government may grant further privileges/exemptions to small companies by issuing a notification.

PUBLIC COMPANY

By virtue of Section 2(71), a public company means a company which:

- (a) is not a private company;
- (b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles

As per section 3 (1) (a), a public company may be formed for any lawful purpose by seven or more persons, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

A public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange. The number of members is not limited to two hundred. It may be noted that in case of a public company, the articles do not contain the restrictions provided in Sections 2(68) of the Act.

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. However, any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.

The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of *Western Maharashtra Development Corpn. Ltd. V. Bajaj Auto Ltd* [2010] 154 Com Cases 593 (Bom). It was held that the Companies Act, makes a clear distinction in regard to the transferability of shares

relating to private and public companies. By definition, a "private company" is a company which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest therein, of a company, shall be freely transferable.

The provision contained in the law for the free transferability of shares in a public company is founded on the principle that members of the public must have the freedom to purchase and, every shareholder the freedom to transfer. The incorporation of a company in the public, as distinguished from the private, realm leads to specific consequences and the imposition of obligations envisaged in law. Those who promote and manage public companies assume those obligations. Corresponding to those obligations are rights, which the law recognizes as inherent in the members of the public who subscribe to shares.

LIMITED COMPANY

As per section 3(2), a company formed under this Act may be either (a) a company limited by shares; or (b) a company limited by guarantee or (c) an unlimited company.

The term 'Limited Company' means a company limited by shares or by guarantee.

The liability of the members, in the case of a limited company, may be limited with reference to the nominal value of the shares, respectively held by them or to the amount which they have respectively guaranteed to contribute in the event of winding up of the company. Accordingly, a limited company can be further classified into: (a) Company limited by shares, and (b) Company limited by guarantee.

Companies Limited by Shares

As per section 2(22), "company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them. Accordingly, no member of a company limited by shares, can be called upon to pay more than the nominal value of the shares held by him. If his shares are fully paid-up, he has nothing more to pay. But in the case of partly-paid shares, the unpaid portion is payable at any time during the existence of the company on a call being made, whether the company is a going concern or is being wound up. This is the essence of a company limited by shares and is the most common form in existence.

Companies Limited by Guarantee

As per section 2(21) "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Clubs, trade associations and societies for promoting different objects are examples of such a company. It should be noted that a special feature of this type of company is that the liability of members to pay their guaranteed amounts arises only when the company has gone into liquidation and not when it is a going concern.

A guarantee company may or may not have a share capital.

As regards the funds, a guarantee company without share capital obtains working capital from other sources, e.g. fees or grants. But a guarantee company having a share capital raises its initial capital from its members, while the normal working funds would be provided from other sources, such as fees, charges, subscriptions, etc.

The Memorandum of Association of every guarantee company must state that every member of the company undertakes to contribute to assets of the company in the event of its being wound up while he is a member for the payment of the debts and liabilities of the company contracted before he ceases to be a member, and of the charges, costs and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

The Memorandum of a company limited by guarantee must state the amount of guarantee. It may be of different denominations.

In case of a guarantee company having share capital the shareholders have two-fold liability: to pay the amount which remains unpaid on their shares, whenever called upon to pay, and secondly, to pay the amount payable under the guarantee when the company goes into liquidation. The voting power of a guarantee company having share capital is determined by the shareholding and not by the guarantee.

A guarantee company must include the word ‘limited’ or the words “private limited” as part of its name, and must register its articles, and it shall adopt the provisions of the Table ‘G’ and ‘H’ of Schedule I. It must also state the number of members with which it proposes to be registered, although the number can be increased by means of a resolution.

Section 4(7) states that any provision in the memorandum of articles, in the case of company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member shall be void.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The voting power of a guarantee company having share capital is determined by the guarantee.

- True
- False

Correct answer: False

UNLIMITED COMPANY

As per section 2(92), “unlimited company” means a company not having any limit on the liability of its members. Thus, the maximum liability of the member of such a company, in the event of its being wound up, might stretch up to the full extent of their assets to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the Liquidator can ask the members to contribute to the assets of the company which will be used in the discharge of the debts of the company.

An unlimited company may or may not have share capital.

Under Section 18, a company registered as an unlimited company may subsequently re-register itself as a limited company, by altering its memorandum and articles of the company in accordance with the provisions of Chapter II of the Companies Act subject to the provision that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The members of an unlimited company are not liable directly to the creditors of the company.

- True
- False

Correct answer: True

ASSOCIATION NOT FOR PROFIT

As per Section 4(1), the memorandum of a company shall state the name of the company with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company. However, Section 8(1) permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without being required to use the word "Limited" or the words 'Private Limited' after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if:

- (i) it is intended to form a company for promoting commerce, art, science, sports, education, research, social welfare, religion, charity protection of environment or any such other object; and
- (ii) the company prohibits payment of any dividend to its members but intends to apply its profits or other income in promotion of its objects.

Further under section 8(5) where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified above and with the restrictions and prohibitions as mentioned aforesaid, it may, by licence, allow the company to be registered under this section subject to such conditions as the Central Government deems fit and to change its name by omitting the word "Limited", or as the case may be, the words "Private Limited" from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company.

The company is registered without paying any stamp duty on its Memorandum and Articles. On registration, the Association enjoys all the privileges of a limited company, and is subject to all its obligations, except, those in respect of which exemption by a notification is granted by the Central Government. A licence may be granted by the Central Government under Section 8 of the Act on such conditions and subject to such regulations as it thinks fit and those conditions and regulations shall be binding on the body to which the licence is granted. The Central Government may direct that such conditions and regulations shall be inserted in the Memorandum, or in the Articles, or partly in the one and partly in the other.

A Company, which has been granted licence under Section 8 cannot alter the provisions of its Memorandum or articles except with the previous approval of the Central Government.

A firm may be a member of the company registered under this section.

A company registered under section 8 may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

An association registered under the Act, which has been granted a licence under Sub-section (1) Section 8 is subject to all the obligations under the Act, except in some cases where the Central Government has issued some notifications directing exemption, to such licensed companies from various provisions of the Act, as specified in those notifications. It covers aspects such as shorter notice of general meetings, publication of name under section 12 etc.

The Central Government may by order at any time revoke the licence whereupon the word "Limited" or "Private Limited" as the case may be, shall have to be used as part of its name and the company will lose the exemptions that might have been granted by the Central Government. However, the Central Government can do so only after providing such association an opportunity to be heard and the aggrieved association can

challenge the order of the Central Government under Article 226 of the Constitution. Further a copy of every such order has to be filed with the Registrar.

It is permissible for the Central Government to grant exemption to a class or classes of companies from one or more of the provisions of the Act under Sub-section (1) of Section 462.

Please refer to Lesson 3 for Rules relating to Licencing and other aspects.

GOVERNMENT COMPANIES

Section 2(45) defines a “Government Company” as any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Notwithstanding all the pervasive control of the Government, the Government company is neither a Government department nor a Government establishment [*Hindustan Steel Works Construction Co. Ltd. v. State of Kerala* (1998) 2 CLJ 383].

Since employees of Government companies are not Government servants, they have no legal right to claim that the Government should pay their salary or that the additional expenditure incurred on account of revision of their pay scales should be met by the Government. It is the responsibility of the company to pay them the salaries [*A.K. Bindal v. Union of India* (2003) 114 Com Cases 590 (SC)].

When the Government engages itself in trading ventures, particularly as Government companies under the company law, it does not do so as a State but it does so in essence as a company. A Government company is not a department of the Government.

CASE EXAMPLE

In *Andhra Pradesh Road Transport Corporation v. ITO* AIR 1964 SC 1486, the Andhra Pradesh State Road Transport Corporation claimed exemption from taxation by invoking Articles 289 of the Constitution of India according to which the property and income of the State are exempted from the Union taxation. The Supreme Court, while rejecting the Corporation's claim, held that though it was wholly controlled by the State Government, it had a separate entity and its income was not the income of the State Government.

The Court, observed that the companies which are incorporated under the Companies Act, have a corporate personality of their own, distinct from that of the Government of India. The land and buildings are vested in and owned by the companies, the Government of India only owns the share capital.

In *Hindustan Steel Works Construction Ltd. v. State of Kerala* [1998] 2 Comp LJ 383, it was held that in spite of all the control of the Government, the company is neither a Government department nor a Government establishment, it is just an agency of the Government, and hence not exempt from the purview of Kerala Construction Workers Welfare Funds Act.

The employees of a Government Company are not the employees of the Central or State Government. A Government Company may, in fact, be wound up like any other company registered under the Companies Act. It may become insolvent or be unable to pay its debts. That does not mean that the Government holding the shares, viz, Central or State, as the case may be, has become bankrupt.

FOREIGN COMPANIES

As per section 2(42), "foreign company" means any company or body corporate incorporated outside India which—

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (b) conducts any business activity in India in any other manner

Sections 379 to 393 of the Act deal with such companies.

Section 380 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies for registration:

- (a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;
- (b) the full address of the registered or principal office of the company;
- (c) a list of the directors and secretary of the company containing such particulars as may be prescribed;
- (d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;
- (e) the full address of the office of the company in India which is deemed to be its principal place of business in India;
- (f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;
- (g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
- (h) any other information as may be prescribed.

Every foreign company has to ensure that the name of the company, the country of incorporation, the fact of limited liability of members is exhibited in the specified places or documents as required under Section 382.

Section 381 requires a Foreign Company to maintain books of Account and file a copy of balance sheet and profit and loss account in prescribed form with ROC every calendar year. These accounts should be accompanied by list of place of business established by the foreign company in India.

Section 376 of the Companies Act, 2013 provides further that when a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Sections 375 to 378 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

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

As regards the applicability of the provisions of the Companies Act, 2013 to foreign companies the following provisions of section 384 are to be noted:

- (i) The provisions of section 71 relating to Debentures shall apply *mutatis mutandis* to a foreign company.
- (ii) The provisions of Section 92 regarding (filing of annual returns) shall, subject to such exceptions, modifications or adaptations as may be made therein by the rules made under the Act, apply to a foreign company as they apply to a company incorporated in India.
- (iii) The provisions of Section 128 relating to the (to the extent of requiring it to maintain at its principal place of business in India books of account with respect to moneys received and spent, sales and purchase made and assets and liabilities, in the course of or in relation to its business in India), Section 209A (inspection of accounts), Section 233A (Special audit), Section 233B (audit of cost accounts), Section 234-246 (investigations), so far as may be, apply only to the Indian business of a foreign company having an established place of business in India as they apply to a company incorporated in India.
- (iv) The provisions of Chapter VI (Registration of Charges) shall apply *mutatis mutandis* to charges on properties which are created or acquired by any foreign company.
- (v) The provisions of Chapter XIV (Inspection, Inquiry and Investigation) shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

As per Section 386(c), having a share transfer office or share registration office will constitute a place of business. In *Tovarishestvo Manufacture Liudvig Rabenek, Re* [1944] 2 All ER 556 it was held that where representatives of a company incorporated outside the country frequently stayed in a hotel in England for looking after matter of business, it was held that the company had a place of business in England.

In a certain case, it was held that mere holding of property cannot amount to having a place of business.

A representative of a foreign company in India was merely receiving orders from customers, it was held that it was not a "place of business" [*P.J. Johnson v. Astrofiel Armadorn* [1989] 3 Comp LJ 1].

The following activities are held as not constituting "carrying on of business":

- (1) carrying small transactions
- (2) conducting meetings of shareholders or even directors
- (3) operating bank accounts
- (4) transferring of shares or other securities
- (5) operating through independent contractors
- (6) procuring orders
- (7) creating or financing of debts, charges, etc. on property
- (8) securing or collecting debts or enforcing claims to property of any kind.

HOLDING, SUBSIDIARY COMPANIES AND ASSOCIATE COMPANIES

On the basis of control companies can be classified into holding, subsidiary and associate companies.

Holding company

As per Section 2 (46), holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary company

Section 2 (87) provides that subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit. (Proviso to be notified)

For the above purpose,—

- (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- (c) the expression "company" includes any body corporate;

Meaning of Control

According to section 2 (27), control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

The Companies (Specification of definitions details) Rules, 2014

As per 2(1)(r) "total Share Capital", for the purposes of sub- sections (6) and (87) of section 2, means aggregate of the:-

- (a) paid-up equity share capital and
- (b) convertible preference share capital.

Subsidiary company not to hold shares in its holding company [Section 19]

Section 19 (1) seeks to provide that subsidiary company shall not either by itself or through its nominees hold shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

The reference in this section to the shares of a holding company which is a company limited by guarantee or an unlimited company, not having a share capital, shall be construed as a reference to the interest of its members, whatever be the form of interest.

Therefore, no company shall hold any interest in its holding company.

Following are the circumstances, where a subsidiary can hold the shares of its holding company:

- (a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or
- (b) where the subsidiary company holds such shares as a trustee; or
- (c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company:

However, the subsidiary company referred above shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee, as referred to in item (a) or (b) aforesaid.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A subsidiary company can be a member of the holding company also.

- True
- False

Correct answer: False

Associate company

As per Section 2(6), “Associate company”, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation to section 2(6) provides that “significant influence” means control of at least twenty per cent. of total share capital, or of business decisions under an agreement.

To add more governance and transparency in the working of the company, the concept of associate company has been introduced. It will provide a more rational and objective framework of associate relationship between the companies.

Further, as per section 2 (76), Related party includes ‘Associate Company’. Hence, contract with Associate Company will require disclosure/approval/entry in statutory register as is applicable to contract with a related party.

INVESTMENT COMPANIES

As per explanation (a) to section 186, “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities.

An investment company is a company, the principal business of which consists in acquiring, holding and dealing in shares and securities. The word ‘investment’, no doubt, suggests only the acquisition and holding

of shares and securities and thereby earning income by way of interest or dividend etc. But investment companies in actual practice earn their income not only through the acquisition and holding but also by dealing in shares and securities i.e. to buy with a view to sell later on at higher prices and to sell with a view to buy later on at lower prices.

If a company is engaged in any other business to an appreciable extent, it will not be treated as an investment company. The following two sets of legal opinions are quoted below as to the meaning of an investment company:

- (i) According to one set of legal opinion, an "investment company" means company which acquires and holds shares and securities with an intent to earn income only from them by holding them. On the other hand, another school of legal opinion holds that "an Investment Company means a company, which acquires shares and securities for earning income by holding them as well as by dealing in such shares and other securities".
- (ii) According to Section 2(10A) of the Insurance Act, 1938, an investment company means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

PRODUCER COMPANIES

Section 465(1) of the Companies Act, 2013 provides that the Companies Act, 1956 and the Registration of Companies (Sikkim) Act, 1961 (hereafter in this section referred to as the repealed enactments) shall stand repealed.

However, proviso to section 465(1) provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

In view of the above provision, Producer Companies are still governed by the Companies Act, 1956.

Companies (Amendment) Act, 2002 had added a new Part IXA to the main Companies Act, 1956 consisting of 46 new Sections from 581A to 581ZT.

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

Objects of Producer Companies

In terms of Section 581B(1) of the Companies Act, 1956, the objects of a producer company registered under this Act may be all or any of the following matters:

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the members or import of goods or services for their benefit.
- (b) processing including preserving, drying, distilling, brewing, vinting, canning and packaging of the produce of its members.
- (c) manufacturing, sale or supply of machinery, equipment or consumables mainly to its members.
- (d) providing education on the mutual assistance principles to its members and others.
- (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its members.

- (f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce.
- (g) insurance of producers or their primary produce.
- (h) promoting techniques of mutuality and mutual assistance.
- (i) welfare measures or facilities for the benefit of the members as may be decided by the Board.
- (j) any other activity, ancillary or incidental to any of the activities referred to in clauses (a) to (i) above or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any other manner.
- (k) financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) above, which include extending of credit facilities or any other financial services to its members.

Further, under Section 581B(2) it has also been clarified that every producer company shall deal primarily with the produce of its active members for carrying out any of its objects specified above.

DORMANT COMPANIES

The Companies Act, 2013 has recognized a new set of companies called as dormant companies.

As per section 455 (1) where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

Explanation appended to section 455(1) says that for the purposes of this section,—

- (i) “inactive company” means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;
- (ii) “significant accounting transaction” means any transaction other than—
 - (a) payment of fees by a company to the Registrar;
 - (b) payments made by it to fulfil the requirements of this Act or any other law;
 - (c) allotment of shares to fulfil the requirements of this Act; and
 - (d) payments for maintenance of its office and records.

As per section 455(2), the Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect.

Section 455(3) provides that the Registrar shall maintain a register of dormant companies in such form as may be prescribed.

According to section 455(4), in case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

Further a dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed. [Section 455(5)]

The Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section. [Section 455(6)]

Privileges of a Dormant Company

The privileges and exemptions enjoyed by a dormant company or its advantages over other companies are as follows:

Section	Nature of exemptions/privileges
2(40)	The financial statement, with respect to a dormant company, may not include the cash flow statement;
173 (5)	It is required to hold at least one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days.

PUBLIC FINANCIAL INSTITUTIONS

According to Section 2 (72), "Public financial institution" means—

- (i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;
- (ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of sub-section (1) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;
- (iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- (iv) institutions notified by the Central Government under sub-section (2) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;
- (v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

However, no institution shall be so notified unless—

- (A) it has been established or constituted by or under any Central or State Act; or
- (B) not less than fifty-one per cent. of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

A BRIEF STUDY OF STATUTORY CORPORATIONS

A Company formed under an Act of Parliament or State Legislature is called a Statutory Company/Corporation. The special enactment contains its constitution, powers and scope of its activities. Change in its structure is possible only by a legislative amendment. Such companies are usually formed to carry on the work of some special public importance and for which the undertaking requires extraordinary powers, sanctions and privileges. A major objective for incorporating statutory corporations is to serve public interest. The need for establishing a statutory corporation is that the State wishes to enter a field of human activity which has traditionally been, or will in normal course be, undertaken by non-official persons and groups. Such companies do not use the word "limited" as part of their names, e.g., Reserve Bank of India, LIC, etc. However, in respect of Insurance, Banking, Electricity Supply or Electricity Generation companies and other

companies governed by any special Act which are incorporated and registered under the Companies Act, the provisions of Insurance Act, Banking Regulation Act, Electricity Act and such special Act will prevail, respectively, when they are inconsistent with the provisions of the Companies Act, 2013, applicable generally.

Principal Characteristics of Statutory Corporations

The principal characteristics of a statutory corporation are as discussed below:

- (i) It is owned by the State.
- (ii) It is created by a special law of Parliament or State Legislature defining its objects, powers and privileges and prescribing the form of management and its relationship with Government departments.
- (iii) Immunity from Parliamentary Scrutiny: A basic and fundamental characteristic of a statutory corporation is its immunity from Parliamentary enquiry into its day-to-day working, as distinct from matters of policy. As stated by Professor Robson, “It has long been recognised that while Parliament has a right to discuss and determine matters of major policy concerning the nationalised industries, the day-to-day conduct of their business by the public corporations should be immune from Parliamentary inquisition”.*
- (iv) Freedom in regard to personnel: Another distinguishing characteristic of a public corporation is that excluding the officers taken from the Government department on deputation, its employees are not civil servants and are not governed by Government regulations in respect of conditions of service. They are also not entitled to the protection of Article 311 of the Constitution of India. This applies to the members of the Board of directors and to other employees. Though the statutory corporations are empowered to regulate their personnel policies, many of them have borrowed wholly or partly civil service rules of promotion, seniority, dismissal etc. The corporations are also required to obtain prior approval of the Government for regulations regarding terms and conditions of service of their employees, and also publish these terms and conditions in the Gazette of India. For example, see Section 49(b) of the LIC Act, Section 45(2)(b) of the Air Corporation Act and Section 37(2) of the International Airports Authority Act. In the case of the ONGC, the Act empowers the Government to make rules even for travelling and daily allowances payable to employees [Section 31(2)(a)].
- (v) A body corporate: Each statutory corporation is a body corporate and can sue and be sued, enter into contracts and acquire property in its own name. For example, the ONGC Act states: “The commission shall be a body corporate, having perpetual succession and a common seal with power to acquire, hold and dispose of property and to contract and shall by the said name sue and be sued” [Section 3(2)]. After laying down the composition of the Commission, the Act states the various functions of the Commission. This is the standard formula for all the statutory corporations. The corporations are given full powers necessary for carrying out their functions, with some exceptions like approval for capital expenditure beyond prescribed limits, and employment of categories of persons.
- (vi) Distinct relation with the Government: The most important provision which regulate the relationship of public corporation and Government is the latter's power to issue directions. The ONGC Act, for e.g. provides, “In the discharge of its functions under this Act, the Commission shall be bound by such directions as the Central Government may, for reasons to be stated in writing give it from time to time” [Section 14(3)]. For the LIC the scope of Government directions is restricted because these

* Robson W.A., Nationalised Industry and Public Ownership, Aller & Unwinc, London, 1960, p.28.

should relate to “matter of policy involving public interest” [Section 21 of the LIC Act]. More or less the same approach has been adopted by the Acts of other corporations.

- (vii) Independent Finances: A major plank of autonomy of a statutory corporation is its independence in respect of its finances. Except for appropriations to provide capital or to cover losses, it is usually independent in its finances. It obtains funds by borrowing either from the Government or, in some cases, from the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenue.
- (viii) Commercial Audit: Except in the case of the banks, the financial institutions and the LIC, where chartered accountants are auditors, in all the other corporations, the audit has been entrusted to the Comptroller and Auditor General of India (CAG). In brief, a statutory corporation is ordinarily not subject to the budget, accounting and audit laws and procedure applicable to Government departments.
- (ix) Operation on business principles: In case of some corporations, the Acts lay down that “In the discharge of its functions the corporations shall act as far as may be on business principles” [Section 6(3) of the LIC Act]. Similar provisions exist in the International Airports Authority Act (Section 11), and the Air Corporations Act (Section 9). However, the practical implications of these clauses are not clear.

WHICH CORPORATIONS ARE “STATE”?

The Courts in India until *Raman Dayaram Shetty v. International Airport Authority*, A.I.R. 1979 S.C. 1628 considered the statutory character of the corporation as a definitive criterion to identify it with “STATE” within the meaning of Article 12 of the Constitution of India. In the case of *Rajasthan State Electricity Board v. Mohan Lal*, A.I.R. 1967 S.C. 1857, the Electricity Board of Rajasthan constituted under the Electricity Supply Act, 1948 was held to be ‘other authority’ to which the provisions of Part III (Fundamental Rights) of the Constitution were applicable. The Supreme Court in this case held that the expression “Other authorities” will include Constitutional or statutory authorities on whom powers are conferred by law.

But from *International Airport Authority* (*ibid*) case onwards there has been a departure from the above trend. From this case onwards, the position has been adopted that, how the corporation was born is not a relevant criterion, and it is immaterial whether the corporation is statutory or is formed under the Companies Act, Societies Registration Act, Co-operative Societies Act or any other Act. The relevant criteria, according to the judgement delivered by Bhagwati J. in the *International Airport Authority* case and later accepted in other cases including in *Som Prakash* case are —

- (1) the source of the share capital,
- (2) the extent of state control over the corporation, and whether it is “deep and pervasive”.
- (3) whether the corporation has monopoly status,
- (4) whether functions of the corporation are of public importance and closely related to Governmental functions, and
- (5) whether what belonged to a department of government formerly was transferred to the corporation.

Neither of these is a conclusive test, nor is an exhaustive list of operational indices. There may be other indices as well. The Court should use all the relevant factors to draw an inference whether the corporation is an “agency or instrumentality” of the State.

In *International Airport Authority* case (*ibid*), the International Airport Authority was held to be “other authority” for the purpose of Article 12 and therefore “State and for that reason was required to observe the principle of

equality in its contractual dealings. In *Som Prakash v. Union of India* A.I.R. 1981 S.C. 212, the Bharat Petroleum Corporation was held to be a “State” and therefore amendable to the writ jurisdiction of the Supreme Court for a breach of a fundamental right. In *Ajay Hasia v. Khalid Mujib*, A.I.R. 1981 S.C. 487, the Regional Engineering College, Srinagar, was considered to be “State” and bound by the principles of equality in the matter of selection of students for admission.

LESSON ROUND-UP

- From the point of view of incorporation, companies can be classified as chartered companies, statutory companies and registered companies. Companies can be categorized as unlimited companies, companies limited by guarantee and companies limited by shares. Companies can also be classified as public companies, private companies, one person companies, small companies, associations not for profit having licence under Section 8 of the Act, Government companies, foreign companies, holding companies, subsidiary companies, associate companies, investment companies and Producer Companies.
- A private company has been defined under Section 2(68) of the Companies Act, 2013 as a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as prescribed, and by its articles restricts the right to transfer its shares, limits the number of its members to two hundred, and prohibits any invitation to the public to subscribe for any securities of the company...
- The Companies Act, 2013 confers certain privileges on private companies. A private company also owes certain special obligations as compared to a public company.
- Where a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included therein under section 2(68), the company shall, as from the date of such alteration, cease to be a private company.
- A private company can be further classified into a One Person Company and Small Company.
- “One Person Company” means a company which has only one person as a member.
- ‘Small company’ means a company, other than a public company, (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.
- Above definition of small company is not applicable to a holding company or a subsidiary company; or a company registered under section 8; or a company or body corporate governed by any special Act.
- A public company is a company which (a) is not a private company (b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed.
- A limited company is a company limited by shares or by guarantee. An unlimited company is a company not having any limit on the liability of its members.
- Associations not for profit with limited liability are permitted to be registered under a licence granted by the Central Government without using the word(s) ‘Limited’ or ‘Private Limited’.
- Section 2(45) defines a Government company as a company in which not less than fifty one per cent of the paid-up share capital is held by Central or State Government or governments or partly by one and partly by others.
- Auditor of a government company shall be appointed or reappointed by the Comptroller and Auditor General of India (C.A.G.).
- Foreign Company means any company or body corporate incorporated outside India which (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner
- Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.

- A Producer Company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. Section 581B(1) of the Companies Act, 1956 provides the objects for which a producer company may be registered under the Act.
- A company formed under an Act of Parliament or State Legislature is called a Statutory Company/ Corporation.
- Principal characteristics of Statutory Corporation are State ownership, creation by special law, immunity from Parliamentary scrutiny, freedom in regard to personnel, body corporate features, distinct relation with the Government, independent finances, commercial audit and operation on business principles.

GLOSSARY

Chartered Companies	A company created by the grant of a charter by the Crown is called a Chartered Company and is regulated by that Charter.
Statutory Companies	These are constituted by special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.
Registered Companies	The companies which are incorporated under the Companies Act, 2013 by getting themselves registered with ROC fall under this category.
Public Company	The company which is not the private company.
Government Company	A Government company as any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments
Investment Company	Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.
Producer Company	A producer company is a body corporate having objects or activities specified in Section 581B of Companies Act, 1956 and which is registered as such under the provisions of the Act.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
2. Define a private company and state the special privileges which it enjoys under the Companies Act, 2013.
3. Discuss in brief disadvantages and obligations of a private company.
4. Define a public company and distinguish it from a private company.
5. What is a Government Company? Summarise the special provisions of the Companies Act relating to Government Companies.
6. Write short notes on:
 - (a) Holding and Subsidiary companies.
 - (b) Associate Companies
 - (c) Investment Companies
 - (d) Finance Companies.

- (e) Unlimited Companies.
 - (f) Small Companies
 - (g) One Person Companies

7. Discuss in brief the law relating to statutory corporations.

8. What is a foreign company? Summarise the provisions of the Companies Act relating to foreign companies.

Lesson 3

Promotion and Incorporation of Companies

LESSON OUTLINE

- Definition of the word 'promoter'.
- Promoters' contract and the ratification thereof.
- Promoter's legal position.
- Duties of a promoter
- Promoter's duties under Indian Contract Act, 1872 and the termination of their duties.
- Remedies available to the company against the promoter.
- Liabilities of promoters.
- Rights of promoters.
- Remuneration of promoters.
- Procedural Aspects in the formation of companies.
- Certificate of incorporation as conclusive evidence.
- Incorporation of one person company and Companies with Charitable objectives.

LEARNING OBJECTIVES

Promoters are persons who conceive the idea of forming a company and take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire for it business or property, which it is to manage.

The relationship between the promoter and the company that he has floated is a fiduciary relationship from the day on which he started the work of floating and it continues till he hands over the same to the directors.

After reading this lesson you would be able to understand the concept of promoters, their legal position, duties, liabilities and their remuneration. It also enumerates the important steps which are to be followed while forming a company such as application for name availability with the Registrar of Companies, preparation of Memorandum of Association, Articles of Association and other legal documents etc., including formation procedures as to one person companies and companies with charitable objects, etc..

A. PROMOTERS

DEFINITION OF THE WORD PROMOTER

Section 2 (69) of the Companies Act, 2013 defines the term 'promoter' as under:-

"Promoter" means a person—

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

Provided that sub-clause (c) shall not apply to a person who is acting merely in a professional capacity.

By virtue of above definition, persons in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act are also treated as promoters. However, if a person is merely acting in a professional capacity i.e. giving only professional advice to the Board of directors, he shall not be treated as a promoter.

Further, according to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, "promoter" includes:

- (i) the person or persons who are in control of the issuer;
- (ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public;
- (iii) the person or persons named in the offer document as promoters.

Is a director/officer/employee of the issuer a promoter?

A director/officer/employee who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise is considered as a promoter. As per section 2 (27), control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

However, a director or officer or employee of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter.

Certain attempts have also been made by the judiciary to define the term 'promoter'

CASE LAW

It was held in *Twycross v. Grant*, (1877) 2. C.P.D. 469 that promoter is "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".

In *Whaley Bridge Calico Printing Co. v. Green* (1880) 5 Q.B.D. 109, Bowen, L.J. held that the term

"promoter" is a term not of law but of business usually summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence".

But a person may be a promoter even if he has undertaken a lesser active role in the formation of a company. Any person who becomes a director, places shares or negotiates preliminary agreements, may be covered by this term. Who constitutes a promoter in a particular case , has to be seen in the light of a clear legislative definition provided under section 2(69) the Companies Act, 2013. A company may have several promoters. A promoter may be a natural person or a company.

It is clear from the foregoing that the word "promoter" is used in common parlance to denote any individual, corporate, syndicate, association or partnership which has taken all the necessary steps to create and mould a company and set it going. The promoter originates the scheme for the formation of a company; gets together the subscribers to the memorandum, gets the Memorandum and Articles prepared, executed and registered, finds the bankers, brokers and legal advisers, finds the first directors, settles the terms of preliminary contracts with vendors and agreement with underwriters, and makes arrangement for preparation, advertisement and circulation of the prospectus and placement of the capital. But a person who merely acts in a professional capacity on behalf of the promoter, such as a solicitor who draws up an agreement or articles, an accountant or valuer who prepares figures or valuation on behalf of a promoter, and who is paid for the same, is not a promoter.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

The person who takes lesser role in the formation of company cannot be a promoter.

- True
- False

Correct answer: False

PROMOTERS' CONTRACT — RATIFICATION THEREOF

As regards ratification of promoters' contracts, the view taken in *Kelner v. Baxter LR* (1886) 2 CP 174 was that the company could not ratify contract made by a promoter before its incorporation. Specific performance of a contract may be enforced against a company in respect of contracts entered into by promoters on behalf of the company, if such a contract is warranted by the terms of incorporation and the company has accepted the contract and communicated the acceptance to the other party. (Section 15 of the Specific Relief Act, 1963). Section 19 of the same Act provides that the other party can also enforce the contract if the company has adopted it after incorporation and the contract is within the terms of incorporation.

As long as the company does not ratify, as required by the Specific Relief Act, 1963 the position remains the same as under the common law.

CASE LAW

In *D.R. Patil v. A.S. Dimilov* AIR 1961 MP 4 AT 5, it was held that a promoter is personally liable to third parties upon all contracts made on behalf of the intended company, until with their consent, the company takes over this liability.

If the promoter commits a breach of duties, the company can either rescind the contract or can compel him to account for any secret profits that he has made.

LEGAL POSITION OF A PROMOTER

While the accurate description of a promoter may be difficult, his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires to make full disclosure of the relevant facts, including any profit made by him as held by Lord Cairns in *Erlanger v. New Sombrero Phosphate Co.* (39 LT 269).

CASE LAW

Lindley L.J. in Lydney and Wigpool Iron Ore Co. v. Bird, (1866) 33 Ch. D. 85, described the position of a promoter as follows:

"Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is well settled that a promoter of a company is accountable to it for all money secretly obtained by him from it just as the relationship of the principal and agent or the trustee and *cestui que* trust had really existed between him and the company when the money was obtained".

Similarly, it was observed in *Lagunas Nitrate Co. v. Lagunas Syndicate*, (1899) 2 Ch. 392 that "promoters" stand in a fiduciary relation to the company they promote and to those persons whom they induce to become shareholders in it".

The promoters undoubtedly stand in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begin to act [As per Lord Cairns in *Erlanger v. New Sombrero Phosphate Co.*, (1873) 3 App. Case 1218-1236].

In a series of similar cases under the English Law it has been held that the promoters, being in a fiduciary position, may not make, either directly or indirectly, any profit at the expense of the company and that if he does make a profit in disregard of this rule, the company can compel him to account for it.

The promoters can be compelled to surrender the secret profits [*Emma Silver Mining Co. v. Grant*, (1879) 11 Ch. D. and *Erlanger v. New Sombrero Phosphate Co.*, (supra)].

DUTIES OF A PROMOTER

The Companies Act, 2013, contains some provisions regarding the duties of promoters. The fiduciary duties of a promoter includes:

(a) As per section 102(4), where as a result of the non-disclosure or insufficient disclosure in any explanatory statement annexed to the notice of a general meeting , by a promoter, director, manager, if any, or other key managerial personnel, any benefit accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

In the case of default in complying with above provisions, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to 50,000 rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more. [Sub-section (5) of Section 102]

The above provision is based on the principle that a promoter cannot make either directly or indirectly,

any profit at the expense of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it. In relation to disclosure it may be noted that part disclosure will also attract the same consequences. A promoter is not forbidden to make profit but he is barred from making any secret profit. He may make a profit out of promotion with the consent of the company in the same way as an agent may retain a profit obtained through his agency with his principal's consent.

CASE LAW

In *Gluckstein v. Barnes*, (1900) A.C. 240 it was held that where a promoter makes some profits in connection with a transaction to which company is a party and does not make full disclosure of his profits; the company has the right to affirm the contracts and promoter should handover his profits to the company.

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

CASE LAW

In *Erlanger v. New Sombrero Phosphate Co.*, (1878) 3 A.C. 1218, a syndicate of which E was the head purchased an island containing mines of phosphate for £ 5,000. E then formed a company to buy this island. A contract was made between X a nominee of the syndicate and the company for its purchase at £ 1,10,000. The details of the sale were not disclosed to the shareholders or to the independent Board of directors. The company now sought to rescind the contract of sale. It was held that as there had been no disclosure by the promoters of the profit they were making, the company was entitled to rescind the contract.

In case, therefore, the promoter wishes to sell his own property to the company, he should either disclose the fact:

- (a) to an independent Board of directors; or
- (b) in the articles of association of the company; or
- (c) in the prospectus; or
- (d) to the existing and intended shareholders directly.

In addition to disclosing secret profits, a promoter has the duty to disclose to the company any interest he has in a transaction entered into by him.

(c) As per section 13(8), a company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

(d) As per section 27(2), the dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

(e) As per section 167(3), where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

(f) As per section 168(3), where all the directors of a company resign from their offices, or vacate their offices under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting.

(g) As per section 284(1)^{*}, the promoters, directors, officers and employees, who are or have been in employment of the company or acting or associated with the company shall extend full cooperation to the Company Liquidator in discharge of his functions and duties during winding up by the Tribunal.

Promoter's duties under the Indian Contract Act

Promoters' duties cannot depend on a contract because at the time the promotion begins, the company is not incorporated, and so cannot contract with its promoters.

The promoter's duties must be the same as that of a person acting on behalf of another individual without a contract of employment. If he does make any misrepresentation in a prospectus he may be held guilty of fraud under Section 17 of the Indian Contract Act, 1872 and would be held liable for damages.

Termination of Promoters' Duties

It is a general opinion that a promoter completes his duty the moment the company, that he promotes, is incorporated or when the Board of directors is appointed. But, in reality it continues until the company has acquired the property for which it was formed to manage and has raised its initial share capital, [*Lagunas Nitrate Co. v. Lagunas Syndicate Ltd. (Supra)*] and the Board takes over the management of the affairs of the company from the promoters.

REMEDIES AVAILABLE TO THE COMPANY AGAINST THE PROMOTER

If a promoter makes a secret profit or does not disclose it, the company has got a remedy against him. This varies according to the circumstances, which can be divided into two possible situations.

1. Where the promoter was not in a fiduciary position when he acquired the property which he is selling to the company, but only when he sold it to the company.

If a person acquires property or has had it before he takes any active steps in the promotion of a company and sells it to the company at a profit, he is entitled to retain that profit. Here the promoter, as in Salomon's case, has had the property for a period of time. He can hardly be said to be in a fiduciary relation to the company. As long as he makes a full disclosure of the fact that the property is his and he is the real vendor, he may sell it to the company at a profit. If, however, he fails to disclose this fact the company is entitled either to rescind the contract or claim damages for breach of duty of disclosure.

2. Where the promoter was in fiduciary position when he acquired the property and when he sold it to the company.

This may happen in any of the following circumstances:

- (a) Where the promoter bought property with a view to sell it to the company which he intends to promote, he occupies fiduciary position *vis-a-vis* the company. He must disclose all the facts to the company.
- (b) Where the promoter resells property to the company at an increased price, the property which he purchased after he has commenced to act in the capacity of a promoter, he cannot retain the profit which he has not disclosed to the company.

* Provision yet to be notified.

- (c) Where a person is a promoter for acquiring the property for the company, the rules of agency will apply, so that any profit he makes will belong to the company.
3. Where, the promoter bought the property with a view to sell it to the company he promotes, the company may either—
- (a) rescind the contract and if he has made a profit on some ancillary transaction that may also be recovered; or
 - (b) retain the property, paying no more for it than what the promoter has paid, depriving him of his profit; or
 - (c) where the above remedies would be inappropriate, such as when the property has been altered so as to render recession impossible and the promoter has already received his inflated price, the company may sue him for misfeasance (breach of duty to disclose). The measure of damages will be the difference between the market value of the property and the contract price.

LIABILITIES OF PROMOTERS

A promoter is subject to the following liabilities under the various provisions of the Companies Act, 2013:-

1. Incorporation of company by furnishing false information:- As per section 7(6), where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration shall be liable for fraud under section 447.

2. Section 26 of the Act lays down matters to be stated and reports to be set out in the prospectus. The promoter(s) may be held liable for the non-compliance of the provisions of this Section. Further, as per section 26(1)(a)(xiv) prescribed disclosures about sources of promoter's contribution has to be made in prospectus.

3. Civil Liability for misstatements in prospectus:- A promoter is liable for any misleading statement in the prospectus to a person who has subscribed for any securities of the company on the faith of the prospectus. By virtue of section 35(1), where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and certain persons as mentioned in the said section, including a promoter of the company shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage. No promoter shall be liable under this section, if he proves

(a) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

4. Punishment for fraudulently inducing persons to invest money:- As per section 36, any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into, (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or (b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or (c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution, shall be liable for punishment for fraud under section 447.

5. *Contravention of provisions relating to private placement:* If a company makes an offer or accepts monies in contravention of the provisions of private placement as stated in section 42, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty. [Section 42(10)]

6. *Liability during Revival and Rehabilitation of companies (Yet to be notified)*

- (i) As per section 257(3), the interim administrator may direct any promoter, director or any key managerial personnel to attend any meeting of the committee of creditors and to furnish such information as may be considered necessary by the interim administrator.
- (ii) As per 266 (2), if the Tribunal is satisfied on the basis of the information and evidence in its possession with respect to any person who is or was a director or an officer or other employee of the sick company, that such person by himself or along with others had diverted the funds or other property of such company for any purpose other than the purposes of the company or had managed the affairs of the company in a manner highly detrimental to the interests of the company, the Tribunal shall, by order, direct the public financial institutions, scheduled banks and State level institutions not to provide, for a maximum period of ten years from the date of the order, any financial assistance to such person or any firm of which such person is a partner or any company or other body corporate of which such person is a director, by whatever name called, or to disqualify the said director, promoter, manager from being appointed as a director in any company registered under this Act for a maximum period of six years.

7. *Failure to cooperate with Company Liquidator during winding up:* As per section 284 (2), where any promoter, without reasonable cause, fails to cooperate with the Company Liquidator during winding up, he shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both. (*Yet to be notified*)

8. A promoter may be liable to public examination like any other director or officer of the company if the Tribunal so directs on a Company Liquidator's report alleging fraud in the promotion or formation business or conduct of affairs of the company since its formation [Section 300(1)]. (*Yet to be notified*)

9. A company may proceed against a promoter on action for deceit or breach of duty under Section 340*, where the promoter has misappropriated or retained any money or property of the company or is guilty of misfeasance or breach of trust in relation to the company.

10. *Criminal Liability for misstatement in prospectus:* Besides civil liability, the promoters are criminally liable under Section 34 for the issue of prospectus containing untrue or misleading statements in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead. Section 447 imposes severe punishment for fraud on promoters who make untrue or misleading statements in prospectus with a view to obtaining capital. The punishment prescribed is imprisonment for a term which shall not be less than six months but which may extend to ten years and also a fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Further, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. A promoter can, however, escape the punishment if he proves:

- (i) that the statement or omission was immaterial; or
- (ii) that he had reasonable grounds to believe, and did, up to the time of the issue of prospectus, believe that statement was true or the inclusion or omission was necessary.

* Yet to be notified.

The following are some of the remedies available to the subscriber who is deceived by any misleading statement or the inclusion or omission of any matter in the prospectus:—

- (1) As per section 37, a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.
- (2) He may take proceedings to repudiate the contract and require repayment of his money with interest.
- (3) He may, in respect of any misleading statement or the inclusion or omission of any matter in the prospectus, bring an action against the directors and promoters for the recovery of compensation.
- (4) He may, bring an action for damages against the directors and other persons responsible for failure to disclose matters in a prospectus.
- (5) He may, in respect of any misleading statement or the inclusion or omission of any matter in the prospectus, bring an action against directors or those who are responsible for the prospectus.

In addition to directors and promoters the liability under the section also attaches to person who have authorised the issue of the prospectus. However, the words cannot reasonably be held to apply to such persons as bankers, brokers, accountants, solicitors and engineers who merely consent to their names appearing as such in the prospectus.

Misrepresentation of facts: A promoter will be responsible for any misstatement as to an existing fact. A calculation of future profits is not a statement of fact [*Bentley v. Black*, (1893) 9 TLR 580 (CA)]. But a misstatement as to purposes for which the money to be raised and is to be applied is a misrepresentation of a present fact. [*Edgington v. Fitzmaurice*, (1885) 29 Ch D 459; (1991-5) All ER Rep 59 (CA)].

Misstatements of Names of directors: If a director's name is misstated in the prospectus, it is an important misrepresentation and the promoter can be held to be liable, [*Metropolitan Coal Consumer's Association Ltd., Karberg's case*, (1892) 3 Ch 1 (CA)].

Representation true only at time of issue: Sometimes representations which were true when the prospectus was issued, become false before the allotment is made. In such cases, the fact ought to be communicated to the applicant otherwise the applicant will not be able to rescind the contract. A promoter/director who knows that a statement has become false is under a duty to disclose the truth and if he abstains, he may be guilty of fraud. [*Brownliey v. Campbell*, (1880) 5 App. Cas 925; *Rajagopala Iyer v. The South Indian Rubber Works*, AIR 1942 Mad 656; (1942) 12 Com Cases 203].

RIGHTS OF PROMOTERS

Right to receive preliminary Expenses

A promoter has no legal right to claim promotional expenses for his services unless there is a valid contract. Without such a contract he is not even entitled to recover his preliminary expenses. [*Re. English & Colonial Produce Company* (1906) 2 Ch. 435 CA].

The promoters are entitled to receive all the expenses incurred for in setting up and registering the company, from Board of Directors. The articles will have provision for payment of preliminary expenses to the promoters. The company may pay the expenses to the promoters even after its formation, but such payments should not be *Ultra Vires* the articles of the company. The Articles may have provision regarding payment of fixed sum to the promoters.

Right to recover proportionate amount from the Co-promoters

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

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A promoter has no legal right to claim promotional expenses for his/her services unless there is a valid contract.

- True
- False

Correct answer: True

B. FORMATION OF COMPANIES

Section 3(1) states that a company may be formed for any lawful purpose by—

- (a) seven or more persons, where the company to be formed is to be a public company;
- (b) two or more persons, where the company to be formed is to be a private company; or
- (c) one person, where the company to be formed is to be One Person Company that is to say, a private company

by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration:

INCORPORATION OF COMPANIES - PROCEDURAL ASPECTS

(a) Application for Availability of Name of company

As per section 4(4) a person may make an application, in such form and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as—

- (a) the name of the proposed company; or
- (b) the name to which the company proposes to change its name.

As per *Rule 9 of Companies (incorporation) Rules 2014*, an application for the reservation of a name shall be made in Form No. INC.1 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

According to section 4(2), the name stated in the memorandum of association shall not—

- (a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or
- (b) be such that its use by the company—

- (i) will constitute an offence under any law for the time being in force; or
- (ii) is undesirable in the opinion of the Central Government.

Section 4(3) provides that without prejudice to the provisions of section 4(2), a company shall not be registered with a name which contains—

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

unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

Section 4(5)(i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 60 days from the date of the application.

Rule 8 of Companies (Incorporation) Rules, 2014 states that in determining whether a proposed name is identical with another, the differences on account of certain aspects may be disregarded, the details of the same is stated in that rule. Rule 8 of Companies (Incorporation) Rules 2014 is annexed at Annexure 3.1 of this lesson.

REVIEW QUESTIONS



Choose the correct answer

What is the maximum allowable period for the adoption of the name by the promoters when the registrar informs the promoters of the company that the name is available for use?

- (a) 30 days from the date the name is allowed
- (b) 60 days from the date the name is allowed
- (c) 90 days from the date the name is allowed
- (d) 180 days from the date the name is allowed

Correct answer: (b)

(b) Preparation of Memorandum and Articles of Association

The Memorandum of Association is the charter of a company. It is a document, which amongst other things, defines the area within which the company can operate.

Section 4(1) states that the memorandum of a company shall state—

- (a) the name of the company with the last word “Limited” in the case of a public limited company, or the last words “Private Limited” in the case of a private limited company
- (b) the State in which the registered office of the company is to be situated;
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

- (d) the liability of members of the company, whether limited or unlimited, and also state,— (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute— (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
- (e) in the case of a company having a share capital,— (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;
- (f) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Section 5(1) states that the articles of a company shall contain the regulations for management of the company.

The details of conditions as to Memorandum and Articles of Association is contained in chapter 4 of this study.

FILING OF DOCUMENTS WITH REGISTRAR OF COMPANIES

Section 7(1) states that there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the following documents and information for registration, namely:—

- (a) Application for Incorporation of Companies: Rule 12 of Companies (Incorporation) Rules 2014 states that an application for incorporation shall be filed with ROC in form INC-2 (in case of one person company or INC-7 in case of other companies).

Memorandum and Articles of Association of the company duly signed

- (b) Section 7(1)(a) the filing of the memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;

Rule 13 of Companies (Incorporation) Rules 2014 states that

The Memorandum and Articles of Association of the company shall be signed in the following manner, namely:-

(1) The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address, description and occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any and the witness shall state that "I witness to subscriber/subscriber(s), who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in"

(2) Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which

shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

(3) Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

(4) Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate and where the subscriber is a Limited Liability Partnership, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership:

Provided that in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.

(5) Where subscriber to the memorandum is a foreign national residing outside India-

- (a) in a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.
- (b) in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary (Public) of the country of his origin and be duly apostillised in accordance with the said Hague Convention.
- (c) in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948) or, where there is no such officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889 (52 and 53 Vic.C.10), or in any Act amending the same;
- (d) visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa.

Explanation.- For the purposes of this clause, it is hereby clarified that, in case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

(c) Declaration from the professional

Section 7(1)((b) requires filing of a declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;

Rule 14 of The Companies(Iincorporation) Rules 2014 states that for the purposes of clause (b) of sub-section (1) of section 7, the declaration by an advocate, a Chartered Accountant, Cost accountant or Company Secretary in practice shall be in Form No. INC.8.

Explanation (i) "chartered accountant" means a chartered accountant as defined in clause (b) of sub section

(1) of section 2 of the Chartered Accountants Act, 1949 (ii) "Cost Accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and (iii) "company secretary" means a "company secretary" or "secretary" means as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980.

(d) Affidavit from the subscribers to the Memorandum

Section 7(1)(c) requires the filing of an affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

Rule 15 of The Companies (Incorporation) Rules 2014 states that

For the purposes of clause (c) of sub-section (1) of section 7, the affidavit shall be submitted by each of the subscribers to the memorandum and each of the first directors named in the articles in Form No.INC.9

(e) Furnishing verification of Registered Office

Under Section 12, a company shall, on and from the 15th day of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it. The company can furnish to the registrar verification of registered office with in 30 days of incorporation in the manner prescribed. As per rule 25(1) of Companies (Incorporation) Rules 2014, the verification of registered office shall be filed in Form no INC 22.

Where the location of the registered office is finalised prior to Incorporation of a company by the promoters, the promoters can also file along with the Memorandum and Articles, the verification of its Registered office in Form no INC 22.

(f) Particulars of subscribers

Section 7(1)(e) requires the filing of the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;

Rule 16 of Companies (Incorporation) Rules states that

Particulars of every subscriber to be filed with the Registrar at the time of incorporation.

- (1) The following particulars of every subscriber to the memorandum shall be filed with the Registrar-
 - (a) Name (including surname or family name) and recent Photograph affixed and scan with MOA and AOA:
 - (b) Father's/Mother's name:
 - (c) Nationality:
 - (d) Date of Birth:
 - (e) Place of Birth (District and State):

- (f) Educational qualification:
- (g) Occupation:
- (h) Income-tax permanent account number: (i) Permanent residential address and also Present address (Time since residing at present address and address of previous residence address (es) if stay of present address is less than one year) similarly the office/business addresses :
- (j) Email id of Subscriber;
- (k) Phone No. of Subscriber;
- (l) Fax no. of Subscriber (optional)

Explanation.- information related to (i) to (l) shall be of the individual subscriber and not of the professional engaged in the incorporation of the company;

- (m) Proof of Identity:

For Indian Nationals:

- PAN Card (mandatory) and any one of the following
- Voter's identity card
- Passport copy
- Driving License copy
- Unique Identification Number (UIN)

For Foreign nationals and Non Resident Indians

- Passport

It was clarified by MCA vide Circular No. 16/2014 that, a declaration from foreign national in the prescribed format shall be furnished as an attachment of INC 7 (Application for Incorporation), in case if he does not have a PAN.

- (n) Residential proof such as Bank Statement, Electricity Bill, Telephone / Mobile Bill:

Provided that Bank statement Electricity bill, Telephone or Mobile bill shall not be more than two months old;

- (o) Proof of nationality in case the subscriber is a foreign national.

- (p) If the subscriber is already a director or promoter of a company(s), the particulars relating to-

- (i) Name of the company;
- (ii) Corporate Identity Number;
- (iii) Whether interested as a director or promoter;

- (q) the specimen signature and latest photograph duly verified by the banker or notary shall be in the prescribed Form No.INC.10.

(2) Where the subscriber to the memorandum is a body corporate, then the following particulars shall be filed with the Registrar-

- (a) Corporate Identity Number of the Company or Registration number of the body corporate, if any
- (b) GLN, if any;
- (c) the name of the body corporate
- (d) the registered office address or principal place of business;
- (e) E-mail Id;

- (f) if the body corporate is a company, certified true copy of the board resolution specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed by the body corporate, and the name, address and designation of the person authorized to subscribe to the Memorandum;
- (g) if the body corporate is a limited liability partnership or partnership firm, certified true copy of the resolution agreed to by all the partners specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed in the body corporate, and the name of the partner authorized to subscribe to the Memorandum;
- (h) the particulars as specified above for subscribers in terms of clause (e) of sub- section (1) of section 7 for the person subscribing for body corporate;
 - (i) in case of foreign bodies corporate, the details relating to-
 - (i) the copy of certificate of incorporation of the foreign body corporate; and
 - (ii) the registered office address.

(g) Particulars of first directors along with their consent to act as directors

Section 7(1)(f) requires filing of the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

Section 7(1)(g) states that the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Rule 17 of Companies (Incorporation) Rules 2014 states that

The particulars of each person mentioned in the articles as first director of the company and his interest in other firms or bodies corporate along with his consent to act as director of the company shall be filed in Form No.DIR.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

As per section 152 (3), no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154. Section 152(4) provides that every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number. By virtue of section 153, every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number in Form no Dir 3. Any individual who intends to be a director of a company will have to mandatorily apply for DIN first. DIN has to be obtained by the directors of the company before commencing the procedure for incorporation of a company.

(h) Power of Attorney

With a view to fulfilling the various formalities that are required for incorporation of a company, the promoters may appoint an attorney empowering him to carry out the instructions/requirements stipulated by the Registrar. This requires execution of a Power of Attorney on a non-judicial stamp paper of a value prescribed in the respective State Stamp Laws.

Issue of Certificate of Incorporation by Registrar

Section 7(2) states that the Registrar on the basis of documents and information filed under sub-section (1) of section 7, shall register all the documents and information referred to in that sub- section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name. (Section 9). The subscribers would become the members of the company.

Conclusive Evidence

A Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein with rights and liabilities of a natural person, competent to enter into contracts [*Jubilee Cotton Mills Ltd. v. Lewis*, (1924) (A.C. 958)]. The validity of the registration cannot be questioned after the issue of the certificate.

In *Moosa v. Ebrahim ILR* (1913) 40 Cal. 1 (P.C.) the Memorandum of Association of a company was signed by two adults and by a guardian of the other 5 subscribers, who were minors. The Registrar, however, registered the company and issued under his hand a Certificate of Incorporation. It was contended that this Certificate of Incorporation should be declared void. Lord Macnaughten said: "Their Lordships will assume that the conditions of registration prescribed by the Indian Companies Act were not duly complied with; that there were no seven subscribers to the Memorandum and that the Registrar ought not to have granted the certificate. But the certificate is conclusive for all purpose. Thus, the certificate prevents anyone from alleging that the company does not exist".

It is for the purpose of incorporation only that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of a company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose, [*Performing Right Society Ltd. v. London Theatre of Varieties* (1992) 2 KB 433].

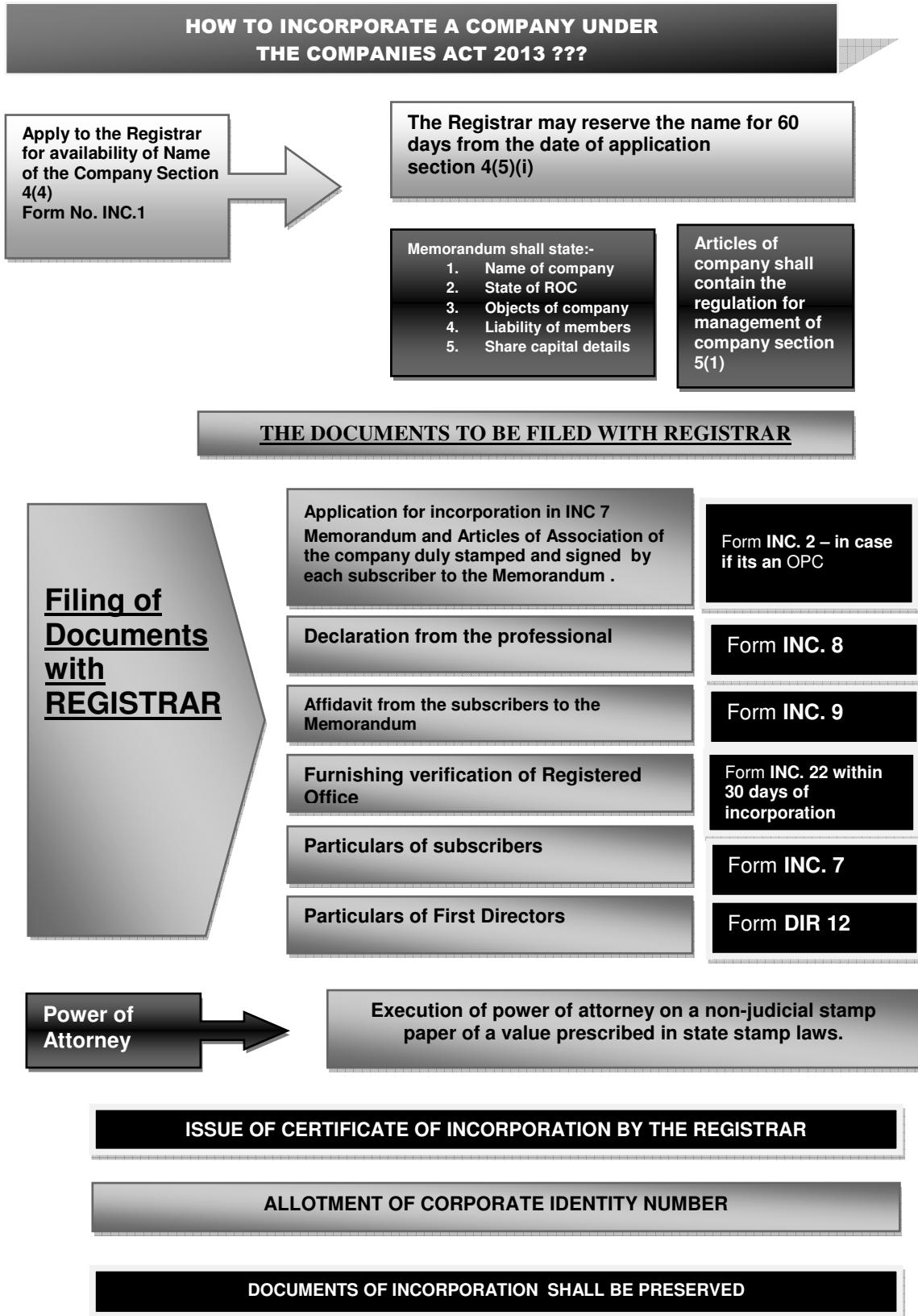
Allotment of Corporate identity number

Section 7(3) states that on and from the date mentioned in the certificate of incorporation issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

Documents of incorporation to be preserved

Section 7(4) states that the company shall maintain and preserve at its registered office copies of all documents and information as originally filed under sub-section (1) till its dissolution under this Act.

The Procedural aspects involved in incorporation of companies is briefly given below:



Punishment for furnishing false or incorrect information at the time of incorporation

The Companies Act, 2013 imposes severe punishment for incorporation of a company by furnishing false or incorrect information. The persons furnishing false or incorrect information shall be liable for following punishment:-

- (i) If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be punishable for fraud under section 447. [Section 7(5)]
- (ii) Without prejudice to the above liability, where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under section 7(1)(b) shall each be punishable for fraud under section 447. [Section 7(6)]

Powers of the Tribunal in case of incorporation of a company by furnishing false or incorrect information*

As per Section 7(7), where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants:-

- (a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or
- (b) direct that liability of the members shall be unlimited; or
- (c) direct removal of the name of the company from the register of companies; or
- (d) pass an order for the winding up of the company; or
- (e) pass such other orders as it may deem fit:

Provided that before making any order under this sub-section,—

- (i) the company shall be given a reasonable opportunity of being heard in the matter; and
- (ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

PROVISIONS SPECIFICALLY RELATING TO INCORPORATION OF

(A) ONE PERSON COMPANY

Nomination by the subscriber or member of One Person Company

According to the first proviso to section 3(1), the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form (INC-3), who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

* Section 7(7) is yet to be notified.

Rule 4(2) of Companies (Incorporation) Rules, 2014 states that subscriber of memorandum of one person company shall nominate such person in form INC 2 and the nominee's consent is to be obtained in INC 3.

Such other person may withdraw his consent in such manner as may be prescribed [Second proviso to section 3(1)]

Rule 4(3) of Companies (Incorporation) Rules 2014 states that the person nominated by the subscriber or member of a One Person Company may, withdraw his consent by giving a notice in writing to such sole member and to the One Person Company:

The sole member shall nominate another person as nominee within fifteen days of the receipt of the notice of withdrawal and shall send an intimation of such nomination in writing to the Company, along with the written consent of such other person so nominated in Form No.INC.3.

Rule 4(4) of the said rules states that the company shall within thirty days of receipt of the notice of withdrawal of consent under sub-rule (3) file with the Registrar, a notice of such withdrawal of consent and the intimation of the name of another person nominated by the sole member in Form No INC.4 along with fee as provided in the Companies (Registration offices and fees) Rules, 2014 and the written consent of such another person so nominated in Form No.INC.3.

The member of a One Person Company may at any time change the name of such other person by giving notice in such manner as may be prescribed [Third proviso to section 3(1)].

Further it shall be the duty of the member of One Person Company to intimate the company about the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed, and the company shall intimate the Registrar of any such change within such time and in such manner as may be prescribed [Fourth proviso to section 3(1)]

Any such change in the name of the person shall not be deemed to be an alteration of the memorandum. [Fifth proviso to section 3(1)]

Rule 4 (5) of Companies (Incorporation) Rules 2014 states that the subscriber or member of a One Person Company may, by intimation in writing to the company, change the name of the person nominated by him at any time for any reason including in case of death or incapacity to contract of nominee and nominate another person after obtaining the prior consent of such another person in Form No INC.3: The company shall, on the receipt of such intimation, file with the Registrar, a notice of such change in Form No INC.4 along with fee as provided in the Companies (Registration offices and fees) Rules, 2014 and with the written consent of the new nominee in Form No.INC.3 within thirty days of receipt of intimation of the change.

As per section 4 (1) (f), the memorandum of a company shall state in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Rule 4(6) of Companies (Incorporation) Rules 2014 states that if the sole member of One Person Company ceases to be the member in the event of death or incapacity to contract and his nominee becomes the member of such One Person Company, such new member shall nominate within fifteen days of becoming member, a person who shall in the event of his death or his incapacity to contract become the member of such company, and the company shall file with the Registrar an intimation of such cessation and nomination in Form No INC.4 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 within thirty days of the change in membership and with the prior written consent of the person so nominated in Form No.INC.3.

As per second proviso to section 12(3) relating to painting, affixing of details of name, Registered office etc. out side every office or place of business, states that the words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

Companies (Incorporation) Rules, 2014

The provisions of Section 8 of Companies Act 2013 is covered under Lesson 2. Following Rules provide for licensing provisions.

Companies with charitable objects under Section 8

Rule 19-20 of Companies (Incorporation) Rules, 2014.

Rule 19. License under section 8 for new companies with charitable objects etc.-

- (1) A person or an association of persons (hereinafter referred to in this rule as "the proposed company"), desirous of incorporating a company with limited liability under sub-section (1) of section 8 without the addition to its name of the word "Limited", or as the case may be, the words "Private Limited", shall make an application in Form No.INC.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 to the Registrar for a license under sub-section (1) of section 8.
- (2) The memorandum of association of the proposed company shall be in Form No.INC.13.
- (3) The application under sub-rule (1) shall be accompanied by the following documents, namely:—
 - (a) the draft memorandum and articles of association of the proposed company;
 - (b) the declaration in Form No.INC.14 by an Advocate, a Chartered Accountant, Cost Accountant or Company Secretary in practice, that the draft memorandum and articles of association have been drawn up in conformity with the provisions of section 8 and rules made thereunder and that all the requirements of the Act and the rules made thereunder relating to registration of the company under section 8 and matters incidental or supplemental thereto have been complied with;
 - (c) an estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and the objects of the expenditure;
 - (d) the declaration by each of the persons making the application in Form No. INC.15.

Rule 20 -License for existing companies.-

(1) A limited company registered under this Act or under any previous company law, with any of the objects specified in clause (a) of sub-section (1) of section 8 and the restrictions and prohibitions as mentioned respectively in clause (b) and (c) of that sub-section, and which is desirous of being registered under section 8, without the addition to its name of the word "Limited" or as the case may be, the words "Private Limited", shall make an application in Form No.INC.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 to the Registrar for a licence under sub-section (5) of section 8.

(2) The application under sub-rule (1), shall be accompanied by the following documents, namely:-

- (a) the memorandum and articles of association of the company;
- (b) the declaration as given in Form No.INC.14 by an Advocate, a Chartered accountant, Cost Accountant or Company Secretary in Practice, that the memorandum and articles of association have been drawn up in conformity with the provisions of section 8 and rules made there under and that all the requirements of the Act and the rules made there under relating to registration of the

- company under section 8 and matters incidental or supplemental thereto have been complied with;
- (c) For each of the two financial years immediately preceding the date of the application, or when the company has functioned only for one financial year, for such year (i) the financial statements, (ii) the Board's reports, and (iii) the audit reports, relating to existing companies;
 - (d) a statement showing in detail the assets (with the values thereof), and the liabilities of the company, as on the date of the application or within thirty days preceding that date;
 - (e) an estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and the objects of the expenditure;
 - (f) the certified copy of the resolutions passed in general/ board meetings approving registration of the company under section 8; and
 - (g) a declaration by each of the persons making the application in Form No.INC.15.
- (3) The company shall, within a week from the date of making the application to the Registrar, publish a notice at his own expense, and a copy of the notice, as published, shall be sent forthwith to the Registrar and the said notice shall be in Form No. INC.26 and shall be published-
- (a) at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the proposed company is to be situated or is situated, and circulating in that district, and at least once in English language in an English newspaper circulating in that district; and
 - (b) on the websites as may be notified by the Central Government.
- (4) The Registrar may require the applicant to furnish the approval or concurrence of any appropriate authority, regulatory body, department or Ministry of the Central Government or the State Government(s).
- (5) The Registrar shall, after considering the objections, if any, received by it within thirty days from the date of publication of notice, and after consulting any authority, regulatory body, Department or Ministry of the Central Government or the State Government(s), as it may, in its discretion, decide whether the license should or should not be granted.
- (6) The licence shall be in Form No.INC.16. or Form No.INC.17, as the case may be, and the Registrar shall have power to include in the licence such other conditions as may be deemed necessary by him.
- (7) The Registrar may direct the company to insert in its memorandum, or in its articles, or partly in one and partly in the other, such conditions of the license as may be specified by the Registrar in this behalf.

Rule 6 Companies (Incorporation) Rules, 2014

Annexure 3.1

- (1) In determining whether a proposed name is identical with another, the differences on account of the following shall be disregarded-
- (a) the words like Private, Pvt, Pvt., (P), Limited, Ltd, Ltd., LLP, Limited Liability Partnership;
 - (b) words appearing at the end of the names – company, and company, co., co, corporation, corp, corpn, corp.;
 - (c) plural version of any of the words appearing in the name;
 - (d) type and case of letters, spacing between letters and punctuation marks;
 - (e) joining words together or separating the words does not make a name distinguishable from a name

that uses the similar, separated or joined words;

- (f) use of a different tense or number of the same word does not distinguish one name from another;
 - (g) using different phonetic spellings or spelling variations shall not be considered as distinguishing one name from another. Illustration (For example, P.Q. Industries limited is existing then P and Q Industries or Pee Que Industries or P n Q Industries or P & Q Industries shall not be allowed and similarly if a name contains numeric character like 3, resemblance shall be checked with 'Three' also);
 - (h) misspelled words, whether intentionally misspelled or not, do not conflict with the similar, properly spelled words;
 - (i) the addition of an internet related designation, such as .com, .net, .edu, .gov, .org, .in does not make a name distinguishable from another, even where (.) is written as 'dot';
 - (j) the addition of words like New, Modern, Nav, Shri, Sri, Shree, Sree, Om, Jai, Sai, The, etc. does not make a name distinguishable from an existing name and similarly, if it is different from the name of the existing company only to the extent of adding the name of the place, the same shall not be allowed; such names may be allowed only if no objection from the existing company by way of Board resolution is submitted;
 - (k) different combination of the same words does not make a name distinguishable from an existing name, e.g., if there is a company in existence by the name of "Builders and Contractors Limited", the name "Contractors and Builders Limited" shall not be allowed unless it is change of name of existing company;
 - (l) if the proposed name is the Hindi or English translation or transliteration of the name of an existing company or limited liability partnership in English or Hindi, as the case may be.
- (2) (a) The name shall be considered undesirable, if-
- (i) it attracts the provisions of section 3 of the Emblems and Names (Prevention and Improper Use) Act, 1950 (12 of 1950);
 - (ii) it includes the name of a registered trade mark or a trade mark which is subject of an application for registration, unless the consent of the owner or applicant for registration, of the trade mark, as the case may be, has been obtained and produced by the promoters;
 - (iii) it includes any word or words which are offensive to any section of the people;
- (b) The name shall also be considered undesirable, if-
- (i) the proposed name is identical with or too nearly resembles the name of a limited liability partnership;
 - (ii) it is not in consonance with the principal objects of the company as set out in the memorandum of association;
- Provided that every name need not be necessarily indicative of the objects of the company, but when there is some indication of objects in the name, then it shall be in conformity with the objects mentioned in the memorandum;
- (iii) the company's main business is financing, leasing, chit fund, investments, securities or combination thereof, such name shall not be allowed unless the name is indicative of such related financial activities, viz., Chit Fund or Investment or Loan, etc.;
 - (iv) it resembles closely the popular or abbreviated description of an existing company or limited liability partnership;

- (v) the proposed name is identical with or too nearly resembles the name of a company or limited liability partnership incorporated outside India and reserved by such company or limited liability partnership with the Registrar:

Provided that if a foreign company is incorporating its subsidiary company in India, then the original name of the holding company as it is may be allowed with the addition of word India or name of any Indian state or city, if otherwise available;

- (vi) any part of the proposed name includes the words indicative of a separate type of business constitution or legal person or any connotation thereof e.g. co-operative, sehkari, trust, LLP, partnership, society, proprietor, HUF, firm, Inc., PLC, GmbH, SA, PTE, Sdn, AG etc.;

Explanation.- For the purposes of this sub-clause, it is hereby clarified that the name including phrase 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT):

Provided that name application is accompanied with an affidavit to the effect that the name to be obtained shall be only for the purpose of registration of companies under Electoral Trust Scheme as notified by the Central Board of Direct Taxes;

- (vii) the proposed name contains the words 'British India';

- (viii) the proposed name implies association or connection with embassy or consulate or a foreign government;

- (ix) the proposed name includes or implies association or connection with or patronage of a national hero or any person held in high esteem or important personages who occupied or are occupying important positions in Government;

- (x) the proposed name is vague or an abbreviated name such as 'ABC limited' or '23K limited' or 'DJMO' Ltd: abbreviated name based on the name of the promoters will not be allowed. For example:- BMCD Limited representing first alphabet of the name of the promoter like Bharat, Mahesh, Chandan and David:

Provided that existing company may use its abbreviated name as part of the name for formation of a new company as subsidiary or joint venture or associate company but such joint venture or associated company shall not have an abbreviated name only e.g. Delhi Paper Mills Limited can get a joint venture or associated company as DPM Papers Limited and not as DPM Limited:

Provided further that the companies well known in their respective field by abbreviated names are allowed to change their names to abbreviation of their existing name after following the requirements of the Act;

- (xi) the proposed name is identical to the name of a company dissolved as a result of liquidation proceeding and a period of two years have not elapsed from the date of such dissolution:

Provided that if the proposed name is identical with the name of a company which is struck off in pursuance of action under section 248 of the Act, then the same shall not be allowed before the expiry of twenty years from the publication in the Official Gazette being so struck off;

- (xii) it is identical with or too nearly resembles the name of a limited liability partnership in liquidation or the name of a limited liability partnership which is struck off up to a period of five years;

- (xiii) the proposed name include words such as 'Insurance', 'Bank', 'Stock Exchange', 'Venture Capital', 'Asset Management', 'Nidhi', 'Mutual fund' etc., unless a declaration is submitted by the applicant that the requirements mandated by the respective regulator, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;

- (xiv) the proposed name includes the word "State", the same shall be allowed only in case the company is a government company;
- (xv) the proposed name is containing only the name of a continent, country, state, city such as Asia limited, Germany Limited, Haryana Limited, Mysore Limited;
- (xvi) the name is only a general one, like Cotton Textile Mills Ltd. or Silk Manufacturing Ltd., and not Lakshmi Silk Manufacturing Co. Ltd;
- (xvii) it is intended or likely to produce a misleading impression regarding the scope or scale of its activities which would be beyond the resources at its disposal;
- (xviii) the proposed name includes name of any foreign country or any city in a foreign country, the same shall be allowed if the applicant produces any proof of significance of business relations with such foreign country like Memorandum Of Understanding with a company of such country:
Provided that the name combining the name of a foreign country with the use of India like India Japan or Japan India shall be allowed if, there is a government to government participation or patronage and no company shall be incorporated using the name of an enemy country.
Explanation.- For the purposes of this clause, enemy country means so declared by the Central Government from time to time.

(3) If any company has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities after complying with all the provisions as applicable to change of name.

(4) In case the key word used in the name proposed is the name of a person other than the name(s) of the promoters or their close blood relatives, No objection from such other person(s) shall be attached with the application for name. In case the name includes the name of relatives, the proof of relation shall be attached and it shall be mandatory to furnish the significance and proof thereof for use of coined words made out of the name of the promoters or their relatives.

(5) The applicant shall declare in affirmative or negative (to affirm or deny) whether they are using or have been using in the last five years , the name applied for incorporation of company or LLP in any other business constitution like Sole proprietor or Partnership or any other incorporated or unincorporated entity and if, yes details thereof and No Objection Certificate from other partners and associates for use of such name by the proposed Company or LLP, as the case may be, and also a declaration as to whether such other business shall be taken over by the proposed company or LLP or not .

(6) The following words and combinations thereof shall not be used in the name of a company in English or any of the languages depicting the same meaning unless the previous approval of the Central Government has been obtained for the use of any such word or expression-

- (a) Board;
- (b) Commission;
- (c) Authority;
- (d) Undertaking;
- (e) National;
- (f) Union;
- (g) Central;
- (h) Federal;
- (i) Republic;

- (j) President;
- (k) Rashtrapati;
- (l) Small Scale Industries;
- (m) Khadi and Village Industries Corporation;
- (n) Financial, Corporation and the like;
- (o) Municipal;
- (p) Panchayat;
- (q) Development Authority;
- (r) Prime Minister or Chief Minister;
- (s) Minister;
- (t) Nation;
- (u) Forest corporation;
- (v) Development Scheme;
- (w) Statute or Statutory;
- (x) Court or Judiciary;
- (y) Governor;
- (z) the use of word Scheme with the name of Government (s) , State , India, Bharat or any government authority or in any manner resembling with the schemes launched by Central, state or local Governments and authorities; and
- (za) Bureau

(7) For the Companies under section 8 of the Act, the name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, Council, Electoral trust and the like etc. Every company incorporated as a "Nidhi" shall have the last word 'Nidhi Limited' as part of its name.

(8) The names released on change of name by any company shall remain in data base and shall not be allowed to be taken by any other company including the group company of the company who has changed the name for a period of three years from the date of change subject to specific direction from the competent authority in the course of compromise, arrangement and amalgamation.

LESSON ROUND-UP

- Promoters are the persons who conceive the idea of forming a company, and take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire the business or property which it is to manage.
- A promoter is neither an agent of, nor a trustee for the company. But he occupies a fiduciary position in relation to the company.
- A promoter is not forbidden to make profit but he should not make any secret profit.
- Disclosure by promoters to the company should be through the medium of the Board of Directors.
- Disclosures of sources of promoter's contribution have to be made in the prospectus.
- Civil as well as criminal liability may be imposed on a promoter for any misleading statement in the prospectus if loss or damage has been sustained by a person who has subscribed for any securities of the company on the faith of the prospectus.

- A promoter has no legal right to claim promotional expenses for his services unless there is a valid contract.
- The first few steps to be taken by a promoter in incorporating a company are to apply for availability of name of company, prepare the memorandum and articles of association and get them vetted, printed, stamped and signed. The promoter should then execute power of attorney and file additional documents as required under section 7. He should then file statutory declaration and pay the registration fees.
- The Registrar on the basis of documents and information filed above shall register all those documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.
- The certificate of incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein.
- Any person who furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, shall be punishable for fraud under section 447. In such a case, the Tribunal may also on an application made to it pass suitable orders.

GLOSSARY

Prospectus	Any document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any securities of a body corporate.
Preliminary Expenses	The expenses incurred at the time of incorporation of a company.
Certificate of Incorporation	A certificate issued by the Registrar of Companies of a State indicating that a company's memorandum of association and articles of association have been accepted for filing and that the company is incorporated.
Remuneration	It is a reward for the efforts in employment.
Power of Attorney	A written document in which one person (the principal) appoints another person to act as an agent on his or her behalf, thus conferring authority on the agent to perform certain acts or functions on behalf of the principal.
Vetting	Broadly, vetting is a process of examination and evaluation.
Conclusive Evidence	Preponderant evidence that may not be disputed and must be accepted by a Court as a definitive proof of a fact.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Who is a promoter? Write a note on the duties and liabilities of promoters.
2. What are the remedies available to the Company against a promoter?
3. What does 'conclusive evidence' mean in relation to certificate of incorporation? Discuss the same citing case laws?
4. "A promoter is not a trustee or agent for the company but he stands in a fiduciary position towards it." Discuss.

5. State the legal position of a promoter?
 6. What are the remedies available to the company against the promoter?
 7. What steps are required to be taken for the formation of a public limited company?
 8. What is the punishment for incorporation of companies by furnishing false or incorrect information?

Lesson 4

Memorandum of Association and Articles of Association

LESSON OUTLINE

- Memorandum of Association (MoA)
- Articles of Association (AoA)
- Purpose and Contents of MoA and AoA
- Printing and signing of MoA
- Name, situation, objects, liability, capital clauses in MoA
- Contents of AoA
- Doctrine of *ultra-vires*.
- Alteration of MoA and AoA
- Distinction between MoA and AoA
- Legal effect and interpretation of Memorandum and Articles of Association.
- Doctrine of indoor management and exceptions to it.
- Doctrine of Alter Ego

LEARNING OBJECTIVES

The memorandum and articles of association of a company are the most important documents for the formation of a company and for its functioning thereafter.

The memorandum of association contains the name, situation of registered office, objects, capital and liability clauses. The articles are its bye-laws or rules and regulations that govern the management and internal affairs and the conduct of its business. Both the documents are required to be registered with the Registrar of Companies during incorporation.

Before dealing with a company, it is advisable to read the memorandum and articles of the company to understand aspects, such as powers of Board, scope of company's activities etc. and its relationship with the outside world.

After reading this lesson, you would be able to understand the concept of Memorandum of Association and Articles of Association, their purpose, contents and registration. It also discusses the alterations that can be carried out in the Memorandum and Articles of Association and effect of such alterations. It also explains the legal effect of these documents. It also covers doctrine of indoor management and Alter Ego.

"To enable the shareholders, creditors and those who deal with the company to know what is the permitted range of enterprise"

— Lord Macmillan

MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world.

The first step in the formation of a company is to prepare a document called the memorandum of association. In fact memorandum is one of the most essential pre-requisites for incorporating any form of company under the Act. This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

To subscribe means to append one's signature or mark a document as an approval or attestation of its contents.

According to Section 2(56) of the Companies Act, 2013 "memorandum" means the memorandum of association of a company as originally framed and altered from time to time in pursuance of any previous company law or this Act.

Section 4 of the Act specifies in clear terms the contents of this important document which is the charter of the company. The memorandum of association of a company contains the objects to pursue which the company is formed. It not only shows the objects of formation but also determines the scope of its operations beyond which its actions cannot go. "THE MEMORANDUM OF ASSOCIATION", observed Palmer, "is a document of great importance in relation to the proposed company".

CASE LAW

In the celebrated case of *Ashbury Railway Carriage & Iron Co. Ltd. v. Riche*, (1875) L.R. 7 H.L. 653, Lord Cairn observed: "The memorandum of association of a company is its charter and defines the limitations of the powers of the company..... it contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and powers which by law are given to the corporation, and it states negatively, if it is necessary to state, that nothing shall be done beyond that ambit....." [*Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd.* (1931) A.C. 677]

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Memorandum determines the scope of operations of a company beyond which its' actions cannot go.

- True
- False

Correct answer: True

FORM OF MEMORANDUM OF ASSOCIATION

Section 4(6) of the Companies Act, 2013 provides that the memorandum of association should be in any one of the Forms specified in Tables A, B, C, D or E of Schedule I to the Act, as may be applicable in relation to the type of company proposed to be incorporated or in a Form as near thereto as the circumstances admit.

- (i) The Form in Table A is applicable in the case of companies limited by shares;
- (ii) the Form in Table B is applicable to companies limited by guarantee not having a share capital;
- (iii) the Form in Table C is applicable to the companies limited by guarantee having a share capital;
- (iv) the Form in Table D is applicable to unlimited companies not having a share capital;
- (v) the Form in Table E is applicable to unlimited companies having a share capital.

A company shall adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it.

CONTENTS OF MEMORANDUM

As per Section 4(1), the memorandum of a limited company must state the following:

- (a) the name of the company with "Limited" as its last word in the case of a public company; and "Private Limited" as its last words in the case of a private company; (*Name Clause*)
 - (b) the State in which the registered office of the company is to be situated; (*Situation Clause*)
 - (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof; (*objects clause*)
- Provided that nothing in this clause shall apply to a company registered under section 8;
- (d) the liability of members of the company, whether limited or unlimited, and also state,— (*Liability Clause*)
 - (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
 - (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute—
 - (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
 - (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
 - (e) in the case of a company having a share capital,— (*Capital Clause*)
 - (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share per subscriber; and
 - (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;
 - (f) in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

According to section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

The above clauses are compulsory and are designated as "conditions" prescribed by the Act, on the basis of which a company is incorporated.

It is to be noted that the Companies Act, 2013 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act (Section 6).

MEMORANDUM OF ASSOCIATION [SECTION 4 READ WITH SCHEDULE 1]



NAME CLAUSE	SITUATION CLAUSE	OBJECT CLAUSE	LIABILITY CLAUSE	CAPITAL CLAUSE	SUBSCRIPTION CLAUSE (STATED IN SCHEDULE 1)
<p>Application for name approval to be made in INC 1</p> <p>Name of the company to indicate private or public</p> <p>No use of name that will constitute an offence</p> <p>No undesirable name as specified in Rule 8 of Companies (Incorporation) Rules</p> <p>No identical name that resembles the name of an existing company.</p>	<p>This specifies the state in which the registered office is situated</p> <p>Companies to have registered office within 15 days of incorporation</p> <p>Registrar to be intimated about the details of registered office within 30 days of incorporation or 15 days of change if any as the case may be in Form INC. 22</p>	<p>Memorandum to state the object of the company proposed to be incorporated</p> <p>The bifurcation of main, ancillary and other objects as required under Companies Act 1956 has been dispensed within Companies Act 2013.</p>	<p>This states that liability of the members is limited or unlimited.</p> <p>In case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them (including premium if any) as against Companies Act 1956 where it was limited to the amount unpaid on the face value of the share.</p>	<p>This must state the amount of the capital with which the company is registered</p> <p>The shares into which the capital is divided must be of fixed amount and the no. of shares which the subscribers to the memorandum agree to subscribe to</p> <p>The capital is variously described as "Nominal", "Authorised"</p>	<p>Subscribers agree to subscribe the prescribed no. of shares stated against their name in the memorandum.</p> <p>The statutory requirements regarding subscription of memorandum are that:</p> <ul style="list-style-type: none"> ~Each subscriber must take at least 1 share ~Each subscriber must write opposite his name the no. of shares which he agreed to take

NAME CLAUSE

A company being a legal entity must have a name of its own to establish its separate identity. The name of the company is a symbol of its independent corporate existence. The first clause in the memorandum of association of the company states the name by which a company is to be known. The company may adopt any suitable name provided it is not undesirable.

According to section 4(2), the name stated in the memorandum shall not—

- (a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or
- (b) be such that its use by the company—
 - (i) will constitute an offence under any law for the time being in force; or
 - (ii) is undesirable in the opinion of the Central Government.

Section 4(3) provides that without prejudice to the provisions of section 4(2), a company shall not be registered with a name which contains—

- (a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or
- (b) such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

As per section 4(4) a person may make an application, in such form (Form INC1) and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as—

- (a) the name of the proposed company; or
- (b) the name to which the company proposes to change its name.

Section 4(5)(i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 60 days from the date of the application.

As stated above, section 4(2) provides that the name stated in the memorandum shall not be such that its use by the company, in the opinion of the Central Government, is undesirable. A name which is identical to or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable

The Registrar must make preliminary enquiries to ensure that the name allowed by him is not misleading or intended to deceive with reference to the Objects Clause of the memorandum [*Methodist Church v. Union of India*, (1985) 57 Com Cases 443 (Bombay)]. The Registrar is not, however, required to carry out any elaborate investigation at the time of registration of the company. Unless the purpose of the company appears to be unlawful *ex-facie* or is transparently illegal or prohibited by any statute, it cannot be regarded as an unlawful association [*T.V. Krishna v. Andhra Prabha (P) Ltd.*, (1960) 30 Com Cases 437 (AP)].

The object is to prevent the use of a name likely to mislead the public. For example, a company is not allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none.

CASE LAW

Thus, in *Ewing v. Buttercup Margarine Co. Ltd.* (1917) 2 Ch. 1, the plaintiff, who carried on business under the name of the Buttercup Dairy Co., obtained an injunction against the defendant (Buttercup Margarine Co. Ltd.), on the grounds that the public might think that the two businesses were connected, the word "Buttercup" being a fancy one.

The rule will apply also to foreign companies or traders, whose goods are imported into the country, as it was

applied in the case of *La Societe Anonyme Panchard at Levessor v. Panchard Levessor Motor Co. Ltd.*, (1901) 2 Ch. 513. The plaintiffs were a French company carrying on business in Paris as motor car manufacturers and were using the name "Panchard" in connection with motors of their manufacture. They objected to the use of the word "Panchard" in the name of the defendant company on the ground that the principal object of the defendants was to injure wrongfully and fraudulently the plaintiffs' business by passing off their goods as those of the plaintiffs' manufacture and succeed even though they had no agencies in England but had a market for their goods there.

Section 16 provides that if by inadvertence or otherwise a name has been registered which is identical to or too nearly resembles the name of an existing company whether registered under this Act or the previous company law, the Central Government may direct the company to change its name. The company shall change its name within a period of 3 months from the issue of the above direction after passing an ordinary resolution for the purpose. The Central Government is empowered to direct a company, at any point of time to rectify its name if by inadvertence it has been registered with a name similar to that of an existing company. If a company is so directed by the Central Government, it must change the name within 3 months of the direction after passing an ordinary resolution.

This section also gives enhanced power to the Central Government to order rectification of name where such name in its opinion constitutes an infringement of a registered trademark. The proprietor of the registered trade mark may make an application to the Central Government for an order for rectification of name because it is identical to or too nearly resembles the applicant's registered trademarks. Such application must be made within three years from the date of incorporation or the registration or change of name whether under this Act or previous company law. In such a case the Central Government may direct the company to change its name and the company shall change its name, within a period of six months from the issue of such direction, after passing an ordinary resolution for the purpose.

Where a company changes its name or obtains a new name, it shall within a period of fifteen days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum.

CASE LAW

In the case of *Atlas Cycles (Haryana) Ltd. v. Atlas Products Pvt. Ltd* [146 (2008) DLT 274 (DB)], use of the brand name as corporate name was settled. Both the plaintiff and the defendant companies belong to the same family. The Appellant-plaintiff was the proprietor of the trade mark in the name "Atlas". The Respondent-defendant company containing the name "Atlas" in its corporate name started dealing in bicycles. The plaintiff objected to the use of the name "Atlas" by the defendant company. The Defendants were restrained from using the word 'Atlas' in their corporate/trade name in respect of bicycles and bicycle parts.

Where a company is directed to change the name, the court cannot directly tell the Registrar to effect the change in the name of the company. The Court can only direct the company to do so. The company cannot simply file the Court order regarding the change but it will have to follow the prescribed procedure. [*Halifax Plc v. Halifax Repossessions Ltd.* (2004) 2 BCLC 455 (CA)].

But mere similarity of name is not in itself enough to give a right to an injunction. As held in *D.W. Boulay v. D.W. Boulay*, (1868) LR 2 (PC), the law does not give a person a right to prevent the use of a name by another person. In the case of companies, however, registration will be refused only if there is likelihood of deception or confusion.

A person cannot be permitted to name a company even after his personal name if that name resembles the

name of an existing company. [*K.G. Khosla Compressors Ltd. v. Khosla Extractions Ltd.*, (1986) 1 Comp LJ 211 : AIR 1986 Del 181]

In the case of incorporation of an Asset Management Company (AMC), the Memorandum and Articles of Association are required to be vetted and approved by the Securities and Exchange Board of India (SEBI) before these documents are registered by the Registrar of Companies.

Publication of Name

The name of the company and the address of its registered office must be painted or displayed outside every office or place at which its business is carried on, in a conspicuous position and in legible letters in English and in the language in general use in that locality. The name must also be engraved on the company's common seal. Further, the name of the company and the address of the registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any must be mentioned in legible characters in all business letters, in all its bill heads, letter papers and in all its notices and other official publications, as well as in all negotiable instruments and other prescribed documents (Section 12).

However, where a company has changed its name or names during the last two years, it shall paint or display or print, as the case may be, along with its name, the former name or names so changed during the last two years as required above.

Further in case of One Person Company, the words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

Ministry of Corporate Affairs (MCA) has clarified that display of its name in English in addition to the display in the local language will be a sufficient compliance with the requirements of the section.

The MCA has also clarified that a share certificate is not an official publication of a company within the meaning of Section 147 of the Act [Corresponds to section 12 of the Companies Act, 2013] [Circular No. 3/73/8/10(147)/ 72-CC-V dated 3.2.1973].

The words 'outside of every office' do not mean outside the premises in which the office is situated [*Dr. H.L. Batliwalla Sons & Company Ltd. v. Emperor* (1941) 11 Com Cases 154 : AIR 1941 (Bom.) 97]. Where office is situated within a compound, the display outside the office room, though inside the building, is sufficient.

The details of Companies (incorporation) Rules 2013 in this regard is dealt in detail in Lesson 3 of the Institute.

SITUATION CLAUSE

The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein. Within 15 days of its incorporation, and at all times thereafter, the company must have a registered office to which all communications and notices may be sent. The company must also furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation in such manner as may be prescribed.

Section 12(3) states that every company shall—

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

one of those languages;

- (b) have its name engraved in legible characters on its seal;
- (c) get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and
- (d) have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed:

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

OBJECTS CLAUSE

The third compulsory clause in the memorandum sets out the objects for which the company has been formed. Under section 4(1)(c) of the Companies Act, 2013, all companies must state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

The objects clause is of great importance because it determines the purpose and the capacity of the company. It indicates the purpose for which the company has been set up and its actual capability, besides its sphere of activities. It states affirmatively the ambit and extent of powers of the company and, stated negatively, that nothing should be done beyond that ambit and that no attempt shall be made to use the company for any other purpose than that which is specified. The purpose of the objects clause is to enable the persons dealing with the company to know its permitted range of activities. The acts beyond this ambit are *ultra vires* and hence void. Even the entire body of shareholders cannot ratify such acts.

Do you know?

The company shall furnish to the Registrar of Companies, the verification of its registered office within 30 days of incorporation in Form INC 22.

Although express powers are necessary, a company may do anything which is incidental to and consequential upon the powers specified, and the act will not be *ultra vires* [Attorney General v. G.E. Rly. Co., (1880) 5 A.C. 473]. Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange in the ordinary form, but a railway company cannot issue bills although it may borrow money.

The subscribers to the memorandum of association enjoy almost unrestricted freedom to choose the objects. The only restriction is that objects should not be illegal and against the provisions of the Companies Act, 2013.

It is on the basis of the main objects clause that the concerned Registrar of Companies enquires as to the objects intended to be pursued by the company either immediately or within a reasonable time after its incorporation. The Registrar must satisfy himself by reference to certain documents, information or explanations furnished by the company.

The memorandum of association of a company is its charter defining the objects of its existence and operations. As pointed out in *Cotman v. Brougham* 1918 AC 514, its purpose is 'to enable the shareholders, creditors and those dealing with the company to know what is the permitted range of the enterprise. The

objects clause or clauses in the memorandum are to be so construed as to confer on the company all powers reasonably required to the attainment of the objects.' 'A memorandum of association like any other document must be read fairly and its importance derived from a reasonable interpretation of the language which it employs' [*Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd.* AC 677: (1931) 1 Com Cases 285: AIR 1931 PC 182; 62 MLJ 163; *Deuchar v. Gas, Light and Coke Co.*, (1925) AC 691)]. The natural and ordinary meaning of the language used in several clauses should be taken into consideration for determining whether a particular transaction does or does not fall within the objects stated in the memorandum [*Bell Houses Ltd. v. City Wall Properties Ltd.* (1966) 36 Com Cases 779: (1966) 2 All ER 674 (CA)].

It is *ultra vires* for a company to act beyond the limits of its memorandum. Any attempted departure will be invalid and cannot be validated even if assented to by all the shareholders of the company. *Ultra vires* means an act or transaction of a company, which though it may not be illegal, is beyond the company's powers by reason of not being within the objects of the memorandum of association. The memorandum is, so to speak, the limit beyond which a company cannot travel. [*Ashbury Railway Carriage and Iron Company v. Riche*, (1875) LR 7 HL 653]. The Memorandum of Association is the 'Lakshman Rekha' for a company. An act beyond the objects mentioned in the memorandum is *ultra vires* and void and cannot be ratified [*Dr. Lakshmanaswami Mudaliar A. v. LIC* (1963) Comp LJ 248: 1963 33 Com Cases 420: AIR 1963 SC 1185]. Where no connection or nexus exists between the exercise of a power and the attainment of an object, exercise of power will be *ultra vires* [*Radha Cinema & Co. v. Chitralipi Films*, 1974 Tax LR 2180 (Cal)].

DOCTRINE OF ULTRA VIRES

In the case of a company whatever is not stated in the memorandum as the objects or powers is prohibited by the doctrine of *ultra vires*^{*}. As a result, an act which is *ultra vires* is void, and does not bind the company. Neither the company nor the contracting party can sue on it. Also, as stated earlier, the company cannot make it valid, even if every member assents to it.

The general rule is that an act which is *ultra vires* the company is incapable of ratification. An act which is *intra vires* the company but outside the authority of the directors may be ratified by the company in proper form [*Rajendra Nath Dutta v. Shilendra Nath Mukherjee*, (1982) 52 Com Cases 293 (Cal.)].

The rule is meant to protect shareholders and the creditors of the company. If the act is *ultra vires* (beyond the powers of) the directors only, the shareholders can ratify it. If it is *ultra vires* the articles of association, the company can alter its articles in the proper way.

REVIEW QUESTIONS



Can Shareholders ratify an act which is *ultra vires* the MoA?

Answer: No

CASE LAW

The doctrine of *ultra vires* was first enunciated by the House of Lords in a classic case, *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1878) L.R. 7 H.L. 653.

The memorandum of the company in the said case defined its objects thus: "The objects for which the

* The word 'ultra' means beyond and the word 'vires' means powers.

company is established are to make and sell, or lend or hire, railway plants..... to carry on the business of mechanical engineers and general contractors.....".

The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. On subsequent repudiation of this contract by the company on the ground of its being *ultra vires*, Riche brought a case for damages on the ground of breach of contract, as according to him the words "general contractors" in the objects clause gave power to the company to enter into such a contract and, therefore, it was within the powers of the company. More so because the contract was ratified by a majority of shareholders.

The House of Lords held that the contract was *ultra vires* the company and, therefore, *null and void*. The term "general contractor" was interpreted to indicate as the making generally of such contracts as are connected with the business of mechanical engineers. The Court held that if every shareholder of the company had been in the room and had said, "That is a contract which we desire to make, which we authorise the directors to make", still it would be *ultra vires*. The shareholders cannot ratify such a contract, as the contract was *ultra vires* the objects clause, which by Act of Parliament, they were prohibited from doing.

However, later on, the House of Lords held in other cases that the doctrine of *ultra vires* should be applied reasonably and unless it is expressly prohibited, a company may do an act which is necessary for or incidental to the attainment of its objects. Section 13(1)(d) of the Companies Act, 1956 [Corresponds to section 4(1)(c) of the Companies Act, 2013] provides that the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof be stated in the memorandum. However, even when the matters considered necessary in furtherance of the objects are not stated, they would be allowed by the principle of reasonable construction of the memorandum.

CASE LAW

Justice Shah (afterwards C.J.) in the case *A. Lakshmanaswami Mudaliar v. L.I.C.*, A.I.R. 1963 S.C. 1185, upheld the doctrine of *ultra vires*. In this case, the directors of the company were authorised "to make payments towards any charitable or any benevolent object or for any general public or useful object". In accordance with shareholders' resolution the directors paid ₹ 2 lacs to a trust formed for the purpose of promoting technical and business knowledge. The company's business having been taken over by L.I.C., it had no business left of its own.

The Supreme Court held that the payment was *ultra vires* the company. Directors could not spend company's money on any charitable or general objects. They could spend for the promotion of only such charitable objects as would be useful for the attainment of the company's own objects. It is pertinent to add that the powers vested in the Board of directors, e.g., power to borrow money, is not an object of the company. The powers must be exercised to promote the company's objects. Charity is allowed only to the extent to which it is necessary in the reasonable management of the affairs of the company. Justice Shah held: "There must be proximate connection between the gift and the company's business interest". Thus "gifts to foster research relevant to the company's activities" and "payments to widows of ex-employees on the footing that such payments encourage persons to enter the employment of the company" have been upheld as valid and *intra vires*.

A bank or any other person lending to a company, for purposes *ultra vires* the memorandum, cannot recover [*National Provincial Bank v. Introductions Ltd.*, (1969) 1 All. E.R. 887].

Further, in the case of *Bell Houses Ltd. v. City Wall Properties Limited* (1966) 36 Com Cases 779, the objects clause included a power to "carry on any other trade or business whatsoever which can, in the

opinion of the Board of directors, be advantageously carried on by the company." The Court has held the same to be in order.

Corporate bona fide charitable spending under Section 181 and ultra vires rule

Section 181 of the Companies Act, 2013 authorises the Board of directors to contribute to bona fide charitable and other funds. However, prior consent of the company in general meeting, has to be obtained in order to contribute for any *bona fide* charitable or other purpose any amount exceeding five per cent of the average net profits for the three immediately preceding financial years.

The power of the Board as regards contribution to funds, which do directly relate to business of the company is unrestricted. It should not be inferred from the language of the section that with the consent of the company in general meeting, the board of directors may contribute to charitable funds to an unlimited extent, unless MoA and AoA authorizes such expenditure. If it does not authorize so it will be *ultra vires* the powers of the company.

Loans, borrowings, guarantees and ultra vires rule

An *ultra vires* borrowing does not create a relationship of a debtor and creditor. In a case, a company had accepted deposits from outsiders which was outside the scope of the Memorandum. When the company was ordered to be wound up, a question was raised whether the depositors were creditors of the company and whether the contributors could be asked to contribute towards payment of deposits. The Court held that the relationship between the company and the depositors was not that of debtor and creditor. But if the lender had lent the amount for discharging lawful expenses, he may recover the amount.

Whether a transaction is *ultra vires* the company can be decided on the basis of the following:

- (1) if a transaction entered into by a company falls within the objects, it is not *ultra vires* and hence not void;
- (2) if a transaction is outside the capacity (objects) of the company, it is *ultra vires*;
- (3) if a transaction is in excess or abuse of the company's powers, such transaction will be set aside by the shareholders;

Implied Powers

The powers exercisable by a company are to be confined to the objects specified in the memorandum. While the objects are to be specified, the powers exercisable in respect of them may be express or implied and need not be specified.

Every company may necessarily possess certain powers which are implied, such as, a power to appoint and act through agents, and where it is a trading company, a power to borrow and give security for the purposes of its business, and also a power to sell. Such powers are incidental and can be inferred from the powers expressed in the memorandum. [Oakbank Oil Co. v. Crum (1882) 8 App Cas 65]. The principle underlying the exercise of such powers is that a company, in carrying on the business for which it is constituted, must be able to pursue those things which may be regarded as incidental to or consequential upon that business. [See Egyptian Salt and Soda Co. v. Port Said Salt Association].

Powers which are not implied

The following powers have been held not to be implied and it is, therefore, prudent to include them expressly in the objects clauses:

- (1) acquiring any business similar to the company's own business. [*Ernest v. Nicholls*, (1857) 6 HLC 40];
- (2) entering into an agreement with other persons or companies for carrying on business in partnership or for sharing profit, joint venture or other arrangements. Very clear powers are necessary to justify such transactions [*Re European Society Arbitration Act* (1878) 8 Ch 679];
- (3) taking shares in other companies having similar objects. [*Re Barned's Banking Co., ex parte and The Contract Corporation* (1867) 3 Ch. App. 105. *Re William Thomas & Co. Ltd.* (1915) 1 Ch 325];
- (4) taking shares of other companies where such investment authorises the doing indirectly that which will not be *intra vires* if done directly;
- (5) promoting other companies or helping them financially [*Joint Stock Discount Co. v. Brown*, (1869) LR 8 EQ 381];
- (6) a power to sell and dispose of the whole of a company's undertaking;
- (7) a power to use funds for political purposes;
- (8) a power to give gifts and make donations or contribution for charities not relating to the objects stated in the memorandum;
- (9) acting as a surety or as a guarantor.

Shareholder's right in respect of ultra vires acts

An *ultra vires* contract is as null and void as a contract with a minor [*Steel Equipment & Construction Co. (P) Ltd. Re* (1968) 38 Com Cases 82, (1967) 1 Comp LJ 172 (Cal)].

A shareholder can get back the money paid by him to the company under an *ultra vires* allotment of shares. A transferee of shares from him would not have been so allowed. [*Margarate Linz v. Electric Wire Co. of Salestine Ltd.* (1948) 18 Com Cases 201, 205 : AIR 1949 PC 51].

Effects of *ultra vires* Transactions

- (i) *Void ab initio* – The *ultra vires* acts are null and void *ab initio*. The company is not bound by these acts. Even the company cannot sue or be sued upon [*Ashbury Railway Carriage and Iron Company v. Riche*].
- (ii) *Injunction*: The members can get an injunction to restrain a company wherein *ultra vires* act has been or is about to be undertaken [*Attorney General v. Gr. Eastern Rly. Co.*, (1880) 5 A.C. 473].
- (iii) *Personal liability of Directors*: It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted to purposes alien to the company's memorandum, the directors will be personally liable to replace it. In *Jehangir R. Modi v. Shamji Ladha*, [(1866-67) 4 Bom. HCR (1855)], the Bombay High Court held, "A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit".

In case of deliberate misapplication, criminal action can also be taken for fraud.

However, a distinction must be drawn between transactions which are *ultra vires* the company and the transactions which are *ultra vires* the directors. Where the directors exceed their authority the same may be ratified by the general body of the shareholders. Provided the company has the

capacity to do that transaction as per its memorandum of association.

- (iv) Where a company's money has been used *ultra vires* to acquire some property, the company's right over such property is held secure and the company will be the right party to protect the property. This is because, though the property has been acquired for some *ultra vires* object, it represents the money of the company.
- (v) *Ultra vires* borrowing does not create the relationship of creditor and debtor [In *Re. Madras Native Permanent Fund Ltd.*, (1931) 1 Com Cases 256 (Mad.)].

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

If a transaction is outside the capacity of the company, it is *ultra vires*.

- True
- False

Correct answer: True

LIABILITY CLAUSE

Section 4 1(d) of the Companies Act, states that the liability of members of the company, whether limited or unlimited, and also state,—

- (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
- (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute—
 - (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
 - (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

CAPITAL CLAUSE

This is the fifth compulsory clause which must state the amount of the capital with which the company is registered. The shares into which the capital is divided must be of fixed value, which is commonly known as the nominal value of the share. The capital is variously described as “nominal”, “authorised” or “registered”.

The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects. The usual way to state the capital in the memorandum is: “The capital of the company is Rs. 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each”. This amount lays down the maximum limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 61 of the Companies Act, 2013.

If there are both equity and preference shares, then the division of the capital is to be shown under these two

heads. A company is not authorised to issue capital beyond its authorised/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorised capital, the amount received on excess number of shares should be returned.

Out of the issued capital, the total amount actually subscribed or agreed to be subscribed is known as subscribed capital, and this subscribed capital again may be wholly paid or partly paid, in which latter case the balance would be payable on future calls when made. The amount actually paid by the shareholders is called the paid-up capital.

According to Section 60 of the Act, if the amount of the authorised capital (nominal capital), of the company is stated in any notice, advertisement, official publication, business letter, bill head or letter paper, it shall also contain a statement in an equally prominent position and in equally conspicuous terms the amount of capital which has been subscribed and the amount paid-up.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A company is not authorised to issue capital beyond its registered capital.

- True
- False

Correct answer: True

DECLARATION FOR SUBSCRIPTION

The subscribers to the memorandum declare: "We, the several persons whose names and addresses are subscribed below, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names". Then follow the names, addresses, description, occupations of the subscribers, and the number of shares each subscriber has agreed to take and their signatures attested by a witness.(Refer to Form INC 13 of Companies (Incorporation) Rules 2013)

The statutory requirements regarding subscription of memorandum are that:

- each subscriber must take at least one share;
- each subscriber must write opposite his name the number of shares which he agrees to take. [Section 4(1)(e))]

SIGNING OF MEMORANDUM

Rule 13 Companies (Incorporation) Rules 2014

The Memorandum and Articles of Association of the company shall be signed in the following manner, namely:-

(1) The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address, description and occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any and the witness shall state that "I witness to subscriber/subscriber(s), who

has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in"

(2) Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

(3) Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

(4) Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate and where the subscriber is a Limited Liability Partnership, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership:

Provided that in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.

(5) Where subscriber to the memorandum is a foreign national residing outside India-

- (a) in a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.
- (b) in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary (Public) of the country of his origin and be duly apostillised in accordance with the said Hague Convention.
- (c) in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948) or, where there is no such officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889 (52 and 53 Vic.C.10), or in any Act amending the same;
- (d) visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa.

Explanation.- For the purposes of this clause, it is hereby clarified that, in case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

Subscription induced by misrepresentation

A subscriber to the memorandum cannot, after the issue of the certificate of incorporation, repudiate his subscription on the ground that he was induced to sign by misrepresentation [*Re Metal Constituents Ltd., Lord Lurgan's case - Re*, (1902) 1 Ch 707].

ALTERATION OF MEMORANDUM OF ASSOCIATION

Section 13(1) of the Companies Act, 2013 provides that save as provided in section 61 (Dealing with power

of limited company to alter its share capital), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. The memorandum of association of a company may be altered in the following respects:

- (1) By changing its name [Sections 13(2)].
- (2) By altering it in regard to the State in which the registered office is to be situated [Section 13(4) & (7)].
- (3) By altering its objects [Section 13 (1) & (9)].
- (4) By altering its share capital (Section 61).
- (5) By reorganising its share capital (Sections 230 to 237).
- (6) By reducing its capital (Section 66).

The provisions or conditions of the memorandum of association relating to the name clause, registered office clause, the objects clause, limited liability clause, subscriber's share clause as provided in Section 4 of the Companies Act, 2013 or any other specific provisions contained therein, can be altered by following the prescribed procedure laid down in the Act. Strict compliance of the prescribed procedure is demanded by law. Failure to comply with the express provisions made under the Act for the purpose of alteration of the provisions or conditions contained in the memorandum will be deemed as a nullity.

Further section 13(6) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).

Section 13(10) provides that no alteration made under this section shall have any effect until it has been registered in accordance with the provisions of the said section.

Further, any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void. [Section 13 (11)]

The procedure for the alteration of the compulsory clauses or conditions of the memorandum is discussed in detail in the following paragraphs.

ALTERATION OF NAME CLAUSE

The name of the company can be altered by a special resolution and with the approval of the Central Government in writing. Approval of the Central Government is not necessary if the change relates to the addition/deletion of the word 'Private' to the name of the company consequent to the conversion of a private company into a public company and *vice versa*. [Section 13(1) & (2)]

When any change in the name of a company is made under section 13(2), the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and the change in the name shall be complete and effective only on the issue of such a certificate [Section 13(3)].

Under Section 16 of the Act, rectification of the name of the company is required to be carried out if, through inadvertence or otherwise, a company (whether on its first registration or on its registration by a new name) is registered by a name which is identical to or too nearly resembles the name of a company already in existence. The rectification of the name must also be carried out if the Central Government so directs at any point of time after the registration of the company. The direction of the Central Government is required to be complied with by the company within a period of 3 months from the date of issue thereof. Further where a company changes its name or obtains a new name under section 16 (1), it shall within a period of fifteen

days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum. Any default in complying with the direction issued by the Central Government would render the company liable for punishment with fine which may extend to one thousand rupees for every day during which default continues and its officers in default shall be liable for fine which shall not be less than five thousand rupees but which may extend to one lakh rupees.

Rule 29 of Companies(incorporation) Rules 2014 states that

- (1) The change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any document due for filing with the Registrar or which has defaulted in repayment of matured deposits or debentures or interest on deposits or debentures.
- (2) An application shall be filed in Form No.INC.24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No.INC.25 shall be issued to the company consequent upon change of name.

Name change requirement under Clause 32 of Listing Agreement

If the company has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name.

Further, all listed companies which decide to change their names shall be required to comply with the following conditions:

1. A time period of atleast 1 year should have elapsed from the last name change.
2. At least 50% of its total revenue in the preceding 1 year period should have been accounted for by the new activity suggested by the new name, or, the amount invested in the new activity/project (Fixed Assets + Advances + Work in Progress) is at least 50% of the assets of the company. The 'advances' shall include only those extended to contractors and suppliers towards execution of project, specific to new activity as reflected in the new name. To confirm the compliance, the company would have to submit auditor's certificate to the stock exchange.
3. The new name along with the old name shall be disclosed through the web sites of the respective stock exchange/s where the company is listed for a continuous period of one year, from the date of the last name change.

EFFECT OF CHANGE

The change of name shall not affect any rights or obligations of the company, or render defective any legal proceedings by or against it, and any legal proceedings which might have been continued or commenced by or against the company in its former name may be continued by or against the company in its new name.

However, where a company changes its name and the new name has been registered by the Registrar, the commencing of legal proceedings in the former name is not valid [*Malhati Tea Syndicate Ltd. v. Revenue Officer*, (1973) 43 Com Cases 337]. In spite of a change in name the entity of the company continues. The company is not dissolved nor does any new company come into existence. If any legal proceeding is commenced, after change in the name, against the company in its old name, the company should be treated as if it is not in existence. It is not an incurable defect and the plaint can be amended to substitute the new

name [*Pioneer Protective Glass Fibre (P) Ltd. v. Fibre Glass Pilkington Ltd.*, (1986) 60 Com Cases 707 (Cal.)].

The courts have held that proceedings commenced by the company in its former name can be continued under its new name [*Solvex Oils and Fertilizers v. Bhandari Cross-Fields (P) Ltd.*, (1978) 48 Com Cases 260 (P & H)].

In *Economic Investment Corporation Ltd. v. CIT (WB)* AIR (1970) 40 Com Cases I (Cal.), it was held that by change of name, the constitution of the company is not changed, only the name changes. It is not similar to the reconstitution of a partnership which means creation of a new legal entity altogether.

ALTERATION OF REGISTERED OFFICE CLAUSE

(a) Change within the local limits of same town

Section 12(5) of the Act provides that except on the authority of a special resolution passed by a company, the registered office of the company shall not be changed,—

- (a) in the case of an existing company, outside the local limits of any city, town or village where such office is situated at the commencement of this Act or whereit may be situated later by virtue of a special resolution passed by the company; and
- (b) in the case of any other company, outside the local limits of any city, town or village where such office is first situated or where it may be situated later by virtue of a special resolution passed by the company:

No company shall change the place of its registered office from then jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State unless such change is confirmed by the Regional Director on an application made in this behalf by the company in the prescribed manner.

Thus according to Section 12(5), a company can change its registered office from one place to another within the local limits of the city, town or village, where it is situated, by merely passing a Board resolution. A notice of the change is required to be given to the Registrar in Form no INC 22, within 15 days of such change.(Section 12(4) read with rule 27 of Companies(incorporation) Rules, 2014. This does not involve alteration of memorandum.

(b) Change from one city to another within the same State

If the registered office is to be shifted from one city, town or village to another city, town or village within the same State, a special resolution has to be passed in the general meeting of the company. A notice of the change is required to be given to the Registrar in Form no INC 22, within 15 days of such change along with Form no MGT 14, as required under Section 117(1), towards special resolution passed...

(c) Change within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies

Proviso to Section 12(5) provides that confirmation by the Regional Director will be necessary for changing registered office of a company from one place to another if the change of registered office is from the jurisdiction of one Registrar to the jurisdiction of another within the same State.

Section 12(6) states that the Regional Director, after hearing the parties shall pass necessary orders within a period of thirty days from the date of the receipt of the application. Thereafter, the company concerned shall file a copy of the said order with the Registrar of Companies (ROC) within a period of sixty days from the

date of the confirmation order by Regional Director. The said ROC shall record the ordered changes in its records. The ROC of the state where the registered office of the company was previously situated, shall transfer all the documents and papers to the new ROC.

Rule 28 of Companies(Icorporation) Rules 2014 states that

- (1) An application seeking confirmation from the Regional Director for shifting the registered office within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies, shall be filed by the company with the Regional Director in **Form no. INC. 23** along with the fee.
- (2) The company shall, not less than one month before filing any application with the Regional Director for the change of registered office.-
 - (a) publish a notice, at least once in a daily newspaper published in English and in the principal language of that district in which the registered office of the company is situated and circulating in that district; and
 - (b) serve individual notice on each debenture holder, depositor and creditor of the company, clearly indicating the matter of application and stating that any person whose interest is likely to be affected by the proposed alteration of the memorandum may intimate his nature of interest and grounds of opposition to the Regional Director with a copy to the company within twenty one days of the date of publication of that notice;
 - (c) Additionally, Form no MGT.14 is to be filed with the Registrar towards special resolution.

Change of Registered office from one State to another

The change of registered office from one State to another State involves alteration of memorandum, and the change can be effected by a special resolution of the company which must be confirmed by the Central Government on an application made to it [Section 13(4)].

According to Section 13(1), a company may, by special resolution and after complying with the procedure specified alter the provisions of its memorandum

Further, the alteration of the provisions of the memorandum relating to the change of the place of its registered office from one State to another shall not take effect unless it is confirmed by the Central Government on an application made to it in the prescribed form and manner [Section 13(4)].

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

A company shall, in relation to any alteration of its memorandum involving change of registered office from one State to another, file with the Registrar the special resolution passed by it in MGT 14 [Section 13(6)].

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

Rule 30-31 of Companies (Incorporation) Rules 2014

Rule 30 states that

(1) An application under sub-section (4) of section 13, for the purpose of seeking approval for alteration of memorandum with regard to the change of place of the registered office from one State Government or Union territory to another, shall be filed with the Central Government in **Form No. INC.23** along with the fee and shall be accompanied by the following documents, namely:-

- (a) a copy of the memorandum and articles of association;
- (b) a copy of the notice convening the general meeting along with relevant Explanatory Statement;
- (c) a copy of the special resolution sanctioning the alteration by the members of the company;
- (d) a copy of the minutes of the general meeting at which the resolution authorizing such alteration was passed, giving details of the number of votes cast in favor or against the resolution;
- (e) an affidavit verifying the application;
- (f) the list of creditors and debenture holders entitled to object to the application;
- (g) an affidavit verifying the list of creditors;
- (h) the document relating to payment of application fee;
- (i) a copy of board resolution or Power of Attorney or the executed Vakalatnama, as the case may be.

(2) There shall be attached to the application, a list of creditors and debenture holders, drawn up to the latest practicable date preceding the date of filing of application by not more than one month, setting forth the following details, namely:-

- (a) the names and address of every creditor and debenture holder of the company;
- (b) the nature and respective amounts due to them in respect of debts, claims or liabilities:

Provided that the applicant company shall file an affidavit, signed by the Company Secretary of the company, if any and not less than two directors of the company, one of whom shall be a managing director, where there is one, to the effect that they have made a full enquiry into the affairs of the company and, having done so, have formed an opinion that the list of creditors is correct, and that the estimated value as given in the list of the debts or claims payable on a contingency or not ascertained are proper estimates of the values of such debts and claims and that there are no other debts or claims against the company to their knowledge.

(3) There shall also be attached to the application an affidavit from the directors of the company that no employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory

(4) A duly authenticated copy of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of a sum not exceeding ten rupees per page to the company.

(5) There shall also be attached to the application a copy of the acknowledgment of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

(6) The company shall at least fourteen days before the date of hearing-

- (a) advertise the application in the Form No.INC.26 in a vernacular newspaper in the principal

vernacular language in the district in which the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district;

- (b) serve, by registered post with acknowledgement due, individual notice(s), to the effect set out in clause (a) on each debenture-holder and creditor of the company; and
- (c) serve, by registered post with acknowledgement due, a notice together with the copy of the application to the Registrar and to the Securities and Exchange Board of India, in the case of listed companies and to the regulatory body, if the company is regulated under any special Act or law for the time being in force.

(7) Where any objection of any person whose interest is likely to be affected by the proposed application has been received by the applicant, it shall serve a copy thereof to the Central Government on or before the date of hearing.

(8) Where no objection has been received from any of the parties, who have been duly served, the application may be put up for orders without hearing.

(9) Before confirming the alteration, the Central Government shall ensure that, with respect to every creditor and debenture holder who, in the opinion of the Central government, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Central government, either his consent to the alteration has been obtained or his debt or claim has been discharged or has determined, or has been secured to the satisfaction of the Central Government.

(10) The Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper:

Provided that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

Rule 31. The certified copy of the order of the Central Government, approving the alteration of the memorandum for transfer of registered office of the company from one State to another, shall be filed in Form No.INC.28 along with the fee as with the Registrar of the State within thirty days from the date of receipt of certified copy of the order. Cases under the erstwhile Companies Act 1956

No notice of the petition is required to be served on the State, but in view of the wider language of Section 17 [Corresponds to section 13 of the Companies Act, 2013] Central Government may direct notice to be served on the State if it is of the view that the interest of the State will be affected by the alteration. Where the alteration is affected by changing the registered office from one State to another State, the loss of revenue in one State would be accompanied by increase in revenue in the other and in such a case the interest of a particular State ought not to be considered but it is the interest of the country as a whole which should be considered. The decision to shift the registered office of the company to another state being a domestic matter rests with shareholders and the company is the best judge of how to run its business more economically, efficiently or conveniently, even though it would result in loss of revenue to the State. [*Satyashree Balaji Wires & Cables (P) Ltd., In re* (2006) 71 CLA 231 (CLB)].

A company was allowed to shift its registered office from Bihar to West Bengal in spite of the fact that Bihar Government had granted lease of land for the company's factory on the condition that it would not shift its registered office. The CLB also held that interest free loans, sales tax, electricity and other subsidies would have no bearing on the shifting [*Usha Beltron Re*, (2000) 27 SCL 124].

Employees' right to object in case of shifting of registered office from one state to another – Some legal cases

In the case of *Bharat Commerce and Industries Ltd., Re*, (1973) 43 Com Cases 162 (Cal.), it was held that

employees' union, which was a registered body and which represented quite a number of the employees at the registered office of the company, would have the legal standing to appear before the court and oppose the application on the ground that their interests are likely to be prejudicially affected if the resolution for shifting the registered office of the company from one state to another is confirmed by the court. However, it was held that the employees' union cannot oppose on the ground that there would be loss of revenue or unemployment in the State or that the meeting at which the special resolution was passed was itself not valid.

Further, in the case of *Metal Box India Ltd. Re*, (2000) 37 CLA 15, it was held that where the shifting of the registered office was in accordance with a scheme approved by the BIFR, it was held that the workers had no right of objection because their continuation in the company's employment was ensured unless, of course, a worker preferred voluntary retirement.

A different dimension to the employees' right can be seen in the case of *Kwality Ice Creams (India) P Ltd., Re*, (2009) 91 SCL 231 : (2009) 148 Com Cases 631 : (2010) 98 CLA 218 (CLB). In that case, the company's petition for shifting its registered office from West Bengal to Delhi was opposed by two employees of the head office on the ground that their action against the company would be prejudiced. The CLB said that the facility for litigation is not a valid ground to stall shifting. There was no restraint order from any Court against the proposed shifting. The Company Law Board allowed shifting subject to the condition that the interest of none of the employees at the registered office would be prejudiced by retrenchment or otherwise.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Change from one city to another within the same State of the registered office involves alteration of Memorandum.

- True
- False

Correct answer: False

ALTERATION OF OBJECTS CLAUSE OF THE COMPANY

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change its objects by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1). As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13(6)(a).

Consequently pursuant to Section 13(1) a company can change its objects clause by passing a special resolution. Further in case of a listed company, the special resolution for alteration in the objects clause of the Memorandum of Association needs to be passed through Postal Ballot in terms of section 110.

Further, section 13(8) lays down that a company, which has raised money from public through prospectus and has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

- (i) the details, as may be prescribed, in respect of such resolution shall be published in the newspapers

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

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

Also for deleting any portion of the objects clause, the procedure laid down in this section has to be followed.

A company may wish to alter its objects stated in its memorandum due to various reasons e.g. if a company wishes to cut-back i.e. where it feels it has diversified in various directions and that management of the company has become difficult or uneconomical, it may alter its objects to sell or dispose of whole or part of its undertaking(s).

Rule 32 of Companies (Incorporation) Rules states that

(1) when the company has raised money from public through prospectus and has any unutilised amount out of the money so raised, it shall not change the objects for which the money so raised is to be applied unless a special resolution is passed through postal ballot and the notice in respect of the resolution for altering the objects shall contain the following particulars, namely:-

- (a) the total money received;
- (b) the total money utilized for the objects stated in the prospectus;
- (c) the unutilized amount out of the money so raised through prospectus,
- (d) the particulars of the proposed alteration or change in the objects;
- (e) the justification for the alteration or change in the objects;
- (f) the amount proposed to be utilised for the new objects;
- (g) the estimated financial impact of the proposed alteration on the earnings and cash flow of the company;
- (h) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution;
- (i) the place from where any interested person may obtain a copy of the notice of resolution to be passed.

(2) The advertisement giving details of each resolution to be passed for change in objects which shall be published simultaneously with the dispatch of postal ballot notices to shareholders.

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

REGISTRATION OF ALTERATION

Section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar :

- (a) the special resolution passed by the company under section 13(1); and
- (b) the approval of the Central Government under section 13(2), if the alteration involves any change in the name of the company.

The special resolution shall be filed with the Registrar within thirty days of the passing or making thereof in the prescribed manner and payment of prescribed fees within the time specified under section 403.

As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the

special resolution in accordance with section 13 (6)(a).

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

The certificate of incorporation shall be conclusive evidence that all the requirements of this Act with respect to the alteration and confirmation thereof have been complied with. The Registrar of the State from which the registered office is transferred will send to the Registrar of the other State all the documents relating to the company registered in his office.

No alteration made under section 13 (i.e., alteration of memorandum) shall have any effect until it has been registered in accordance with the provisions of this section. [Section 13(10)].

The main spirit behind Section 13(7) of the Companies Act, 2013 in regard to the filing of the order confirming the transfer of the company's registered office from one State to another State with the Registrar of Companies of each State is that the Registrar of Companies from whose State the registered office is transferred should keep the order duly registered in his office as an evidence to such shifting and should transfer all other records of the company to the Registrar of Companies to whose State the Registered Office has been so shifted. The other Registrar of Companies will register the other copy of the order and keep that order with the records transferred to him by his counterpart.

ALTERATION OF LIABILITY CLAUSE

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change the liability clause of its memorandum of association by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).

ALTERATION OF CAPITAL CLAUSE

A limited company having a share capital may make the following types of alterations in its memorandum by an ordinary resolution, if so authorised by its articles, at its general meeting to (Section 61)—

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

A company may at any time increase its authorised share capital by the alteration of its memorandum. Although, section 61(1) (a) of the Companies Act, 2013 refers to the issue of new shares, it really deals with a case of increase in the authorised share capital, and not increase of the issued share capital. The case of increase of the issued or subscribed capital is dealt with separately by section 62 of the Act.

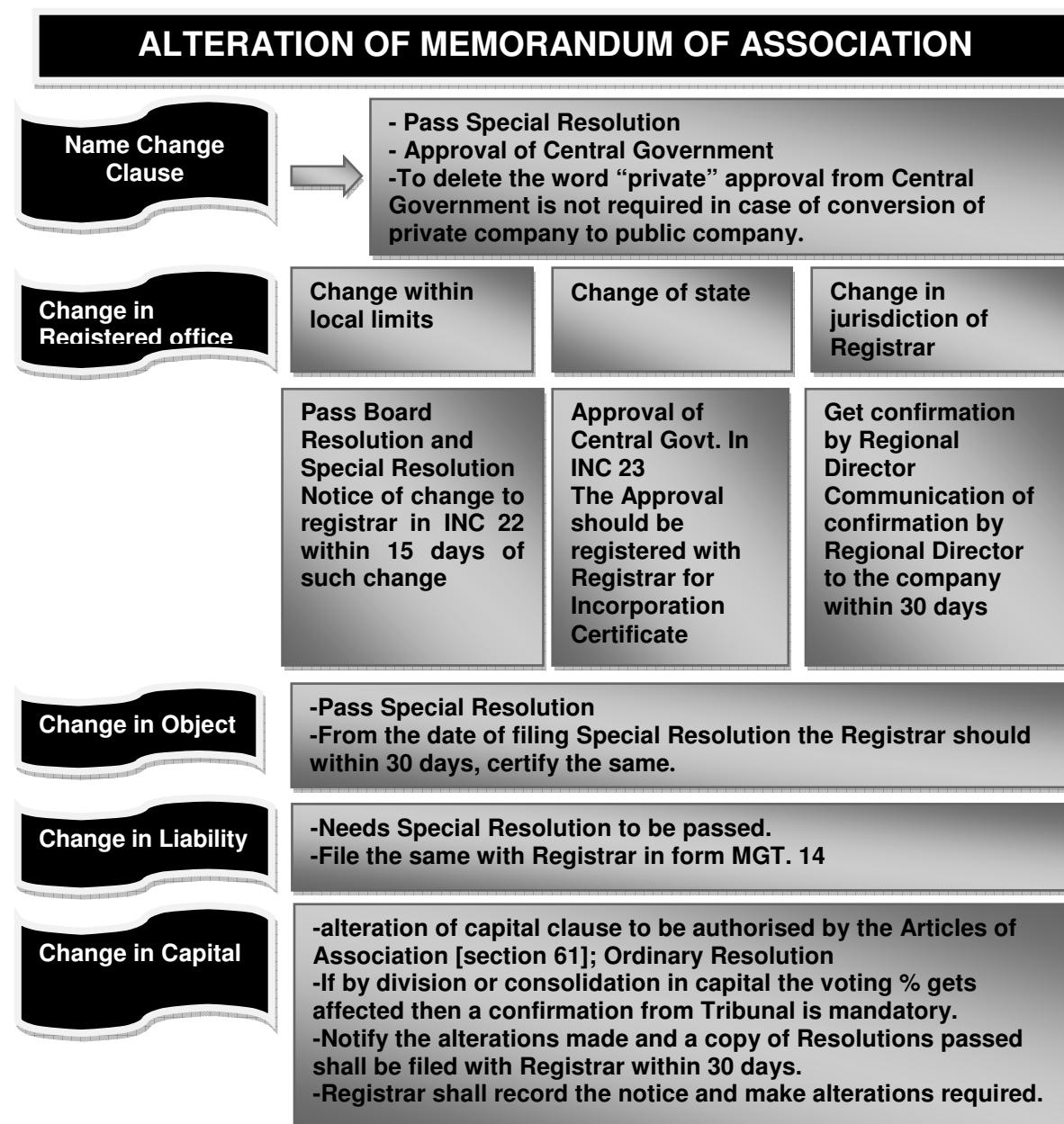
- (ii) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares;
- (iii) convert all or any of its fully paid-up shares into stock, and reconver that stock into fully paid-up shares of any denomination;
- (iv) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that the proportion between the amount paid and unpaid shall remain the same.

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

All the above alterations do not require the confirmation by the Tribunal except that alteration relating to consolidation and division which results in changes in the voting percentage of shareholders shall not take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

These alterations are, however, required to be notified and a copy of the resolution should be filed with the Registrar within 30 days of the passing of the resolution along with an altered memorandum. [Section 64(1)]

The Registrar shall record the notice and make any alteration which may be necessary in the company's memorandum or articles or both. It must be noted that cancellation of shares in pursuance of section 61(1) does not amount to reduction of share capital.



ARTICLES OF ASSOCIATION

NATURE OF ARTICLES

According to Section 2(5) of the Companies Act, 2013, 'articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

In terms of section 5(1), the articles of a company shall contain the regulations for management of the company. The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company *inter se*. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1875) L.R. 7 H.L. 653 as follows:

"The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit".

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members *inter se*. This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal v. The Calcutta Stock Exchange Association Ltd.*, AIR 1971 SC 422, (1971) 41 Com Cases 51]. But the Articles of Association of a company are not 'law' and do not have the force of law. In *Kinetic Engineering Ltd. v. Sadhana Gadia*, (1992) 74 Com Cases 82 : (1992) 1 Comp LJ 62 (CLB), the CLB held that if any provision of the articles or the memorandum is contrary to any provisions of any law, it will be invalid in toto.

Articles Subordinate to Memorandum

The articles of a company are subordinate to and subject to the memorandum of association and any clause in the Articles going beyond the memorandum will be *ultra vires*. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit. Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum [*Ashbury v. Watson*, (1885) 30 Ch. D 376 (CA)]. Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is *void* and incapable of ratification.

But neither the articles nor the memorandum can authorise the company to do anything so as to contravene any of the provisions of the Act. [See *Re Peveril Gold Mines*, (1989) 1 Ch 122 (CA)].

Articles in relation to Memorandum

The functions of the Articles in relation to the Memorandum have already been summed up in the *Ashbury Railway Carriage case* and even though the articles are subordinate to the memorandum yet if there be any ambiguity in the memorandum, the articles may be used to explain it but not so as to extend the objects. [Re. *South Durham Brewery Company* (1885) 3 Ch. D 261]. The memorandum of a company was not clear as to the classes of shares to be issued by a company but the articles made clear the doubt by giving the power to the company to issue shares of different classes.

The relationship between the two documents was further emphasised in *Guinness v. Land Corporation of Ireland*, (1882) 22 Ch D 349, where it was observed: "The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors, and the outside public, as well as of the shareholders. The articles of association are the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation and the internal regulations of the company are to be construed together... In any case it is, as it seems to me, certain that for anything which the Act of Parliament says shall be in the memorandum you must look at the memorandum alone. If the legislature has said one instrument is to be dominant you cannot turn to another instrument and read it in order to modify the provisions of the dominant instrument". Where the memorandum clearly establishes the rights of shareholders, a reference in the memorandum to the articles and an ambiguity said to arise from the construction of the articles should not be used to depart from the clear meaning of the memorandum so as to diminish those rights [*Scottish National Trust Co. Ltd. 1928 SC 499 (Scot); Kinetic Engineering Ltd. v. Sadhana Gadia*, (1992) 1 Comp LJ 62 (CLB)].

REVIEW QUESTIONS**State whether the following statement is “True” or “False”**

Regulations provided for in the Articles must not exceed the powers of the company as laid down by its Memorandum.

- True
- False

Correct answer: True

REGISTRATION OF ARTICLES

Section 7(1) provides that at the time of incorporation of a company there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

Every type of company whether public or private and whether limited by shares or limited by guarantee having a share capital or not having a share capital or an unlimited liability company must register their articles of association.

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. However, nothing prescribed in this sub-section shall be deemed to prevent a company from including such additional matters in its articles as may be considered necessary for its management.

The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company. [Section 5(6)]

A company may adopt all or any of the regulations contained in the model articles applicable to such company. [Section 5(7)]

Section 5(8) provides that in case of any company, which is registered after the commencement of Companies Act 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Therefore in terms of Section 5 of the Companies Act, 2013 a public company limited by shares may at its option register its articles of association signed by the same subscribers as to the memorandum, or alternatively it may adopt all or any of the regulations contained in Table F of First Schedule of the Act. If articles are not registered, automatically Table F in Schedule I apply, and if registered, Table F in Schedule I apply except in so far as it is excluded or modified by the articles. To avoid any confusion, normally every public company delivers its articles alongwith the memorandum for registration. Further it will be specifically stated therein that Table 'F' will not apply. The articles of a private company must contain the three restrictions as contained in Section 2(68).

A company limited by guarantee having a share capital or a company limited by guarantee not having a share capital or an unlimited company having a share capital or an unlimited company not having a share capital might adopt any of the appropriate regulations of Table G, H, I and J respectively in Schedule I [Section 5(6)].

However nothing in section 5 shall apply to the articles of a company registered under any previous company law unless amended under this Act [Section 5(9)].

ENTRENCHMENT PROVISIONS

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are met or complied with. [Section 5 (3)]

The Companies Act, 2013 recognizes an interesting concept of entrenchment. Essentially, the entrenchment provisions allow for certain clauses in the articles to be amended upon satisfaction of certain conditions or restrictions (such as obtaining a 100% consent) greater than those prescribed under the Act. This provision acts as a protection to the minority shareholders and is of specific interest to the investment community. This shall empower the enforcement of any pre-agreed rights and provide greater certainty to investors, especially in joint ventures.

The provisions for entrenchment referred to in section 5(3) shall be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company. [Section 5 (4)]

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed. [Section 5 (5)]

STATUTORY REQUIREMENTS

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act, 2013.

CONTENTS OF ARTICLES

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

1. Exclusion wholly or in part of Table F.
2. Adoption of preliminary contracts.
3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
9. Nomination.
10. Forfeiture of shares.
11. Alteration of capital.
12. Buy back.
13. Share certificates.
14. Dematerialisation.
15. Conversion of shares into stock.
16. Voting rights and proxies.
17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
19. Nominee directors.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
26. General meetings.
27. Directors meetings.
28. Borrowing powers.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Indemnity.
33. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be

contained therein so as not to hamper the working of the company later.

PROVISION IN ARTICLES AS REGARDS EXPULSION OF A MEMBER

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. The proviso to Section 5(2) provides that nothing in that sub-section shall be deemed to prevent a company from including any additional matters in its Articles, as may be considered necessary for its management. Section 5(8) provides that in case of any company, which is registered after the commencement of the Companies Act 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Section 6 of the Companies Act, 2013 provides that:-

- (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and
- (b) any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be..

In the light of above provisions, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 6 of the Act. It is opposed to the fundamental principles of the company's jurisprudence and is ultra vires of the company. [(Circular No. 32 of 1975) dated 01.11.1975)]

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles. The regulation of stock exchanges is mainly governed by Securities Contracts Regulation Act, 1956 (SCRA) and SEBI, Act, 1992 which are Special Acts. Hence, the Articles of Stock Exchange may provide for additional matters as per SCR Act, which may not be possible for inclusion in the Articles of a company, as per the provisions of the Companies Act. [*Madras Stock Exchange Ltd. v. S.S.R. Rajkumar* (2003) 116 Com Cases 214 (Mad.)].

ALTERATION OF ARTICLES OF ASSOCIATION

A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Section 14(1) provides that subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having the effect of conversion of a private company into a public company; or a public company into a private company. First proviso to section 14(1) lays down that where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company. Second proviso to section 14(1) stipulates that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.¹

¹ Second proviso to Section 14(1) is yet to be notified.

Every alteration of the articles under this section and a copy of the order of the Tribunal approving the alteration as per section 14(1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same. [Section 14 (2)]

Any alteration of the articles registered under section 14(2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles. [Section 14(3)]

The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles [*Walker v. London Tramway Co.* (1879) 12 Ch. D. 705].

However, in spite of the power to alter its articles, a company can exercise this power subject only to certain limitations. These are:

1. The alteration must not exceed the powers given by the memorandum. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

Similarly, where a resolution was passed expelling a member and authorising the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act [*Madhava Ramachandra Kamath v. Canara Banking Corporation* [1941] 11 Com Cases 78 (Mad)].

On the other hand, articles may impose on the company conditions stricter than those provided under the law; for example, they may provide that a matter should be passed by a special resolution when the Act requires it to be passed by an ordinary resolution.

3. The Articles must not include anything which is illegal or opposed to public policy.
4. The alteration must be *bona fide* for the benefit of the company as a whole.
5. The alteration must not constitute a fraud on the minority by a majority. If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter. [*All India Railway Mens Benefit Fund v. Jamadar Baheshwarnath Bali* (1945) 15 Com Cases 142 (Nag.)]

In *Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd.* [1992] 73 Com Cases 80 (Ker.), the Kerala High Court held that no majority of shareholders can, by altering the article retrospectively, affect, the prejudice of the consenting owners of shares, the right already existing under a contract nor take away the right accrued, e.g., after a transfer of share is lodged, the company cannot have a right of lien so as to defeat the transfer.

6. Articles cannot be altered so as to compel an existing member to take or subscribe for more shares or in any way increase his liability to contribute to the share capital, unless he gives his consent in writing (Section 38).
7. By effecting alteration in its articles, a company cannot defeat escape from its contractual obligation with any person. The company will always be liable in such a case.
8. The Articles of Association cannot be altered so as to have retrospective effects. The articles only operate from the date of the amendment [*Pyare Lal Sharma v. Managing Director, J.K. Industries*

Ltd. (1989) 3 Comp LJ (SL) 70].

9. The alteration must not be inconsistent with an order of the Court under Sections 397 or 398 and 404 of the Companies Act, 1956.
10. Amendment of Articles relating to Managing, Whole-time director and non-rotational directors requires Central Government's approval. (Section 268 –This section is of the Companies Act, 1956)

Subject to the foregoing conditions, the Articles in a company can be altered and no clause can be included in the Articles that it is not alterable. Persons who become members of a company have no right to assume that the Articles will always remain in a particular form.

Of course a section or a class of shareholders cannot be unfairly or oppressively treated. Thus, though the requisite majority of members could pass a special resolution to alter the Articles and if the alteration has the effect of making a fraud on the minority, the minority shareholders not being less than the number specified in Section 397 and 398 could move the Court for redressing their grievances. The Courts have entertained such applications from shareholders even where they are smaller in number [See *Menier N. Hooper Telegraph Works* (1874) 9 Ch. App. 350].

As already mentioned, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company. [*Southern Foundries v. Shirlaw*, [1940] AC 701].

The discussion on the above matter will not be complete without referring to the rule in *Foss v. Harbottle* (1843) 2 Hare 461 where the court held that no individual shareholder nor a minority of shareholders in a company can take it upon himself or themselves to remedy an alleged wrong involved in the actions of directors if the said wrongful act is something which the majority can regularise and approve of.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Articles of Association are subsidiary both to the Companies Act and the Memorandum of Association.

- True
- False

Correct answer: True

Effect of Altered Articles

Alteration binds members in the same way as original articles. The altered articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles.

Section 8 Company cannot alter Article except with the approval of Central Government

Section 8(4)(i) provides that a company registered under section 8 i.e. companies with charitable objects shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

ALTERATIONS OF MEMORANDUM OR ARTICLES TO BE NOTED IN EVERY COPY

Every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be. [Section 15(1)]

If a company makes any default in complying with the provisions of section 15(1), the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the memorandum or articles issued without such alteration. [Section 15(2)]

DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between the memorandum and articles are given below:

1. Memorandum of association is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation. Articles of association are the rules and regulations framed to govern this internal management of the company.
2. Clauses of the memorandum cannot be easily altered. They can only be altered in accordance with the mode prescribed by the Act. In some of the cases, alteration requires the permission of the Central Government or the Court. In the case of articles of association, members have a right to alter the articles by a special resolution. Generally there is no need to obtain the permission of the Court or the Central Government for alteration of the articles.
3. Memorandum of association cannot include any clause contrary to the provisions of the Companies Act. The articles of association are subsidiary both to the Companies Act and the memorandum of association.
4. The memorandum generally defines the relation between the company and the outsiders, while the articles regulate the relationship between the company and its members and between the members *inter se*.
5. Acts done by a company beyond the scope of the memorandum are absolutely void and *ultra vires* and cannot be ratified even by unanimous vote of all the shareholders. But the acts of the directors beyond the articles can be ratified by the shareholders.

LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES

The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles. Also, all monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company (Section 10).

We shall examine the extent to which the memorandum and articles bind:

- (a) the members to the company;
- (b) the company to the members;
- (c) the members *inter se*; and
- (d) the company to outsiders.

Members Bound to the Company

The memorandum and articles constitute a contract binding the members of the company. The members, as members, are bound to the company. Each member must, therefore, observe the provisions of the memorandum and articles.

Each member is bound by the covenants of the Memorandum as originally made and as altered from time to time [*Malleson v. National Insurance Co.*]. In another case, the shareholders could not enter into an agreement which was contrary to or inconsistent with the articles of association of the company [*V.B. Rangaraj v. V.B. Gopalkrishnan* (1992) 73 Com Cases 201 (SC)].

CASE LAW

In *Boreland's Trustee v. Steel Brother and Co. Ltd.* (1901) 1 Ch. 279, the articles of a company contained a clause that on the bankruptcy of a member his shares would be sold to other persons and at a price fixed by the directors. B, a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at their true value. It was held that the trustee was bound by the articles, as the shares were purchased by B in terms of the articles.

Company Bound to the Members

Since the articles constitute a contract binding the company to its members in their capacity as members, a member can bring an action against the company for infringement by it of the memorandum or articles. For example, an individual member can sue the company for an injunction restraining it from improper payment of dividend [*Hoole v. Great Western Railway* (1867) 3 Ch. D. 262]. Further, the company is bound to individual members in respect of their ordinary rights as members, e.g. the right to receive share certificate in respect of shares allotted to them, or to receive notice of general meeting, etc. Normally, action for breach of articles against the company can be brought only by a majority of the members. Individual or minority members cannot bring such a suit except when it is intended for enforcement of personal rights of members or to prevent the company from doing any ultra vires or illegal act, fraud, or oppression and mismanagement.

Member Bound to Member

As between the members inter se each member is bound by the articles to the other members but that does not mean the memorandum and articles create an express contract among the members of the company. Thus, a member of a company has no right to bring a suit to enforce the articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members inter se are regulated. A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or ultra vires acts.

Articles do not affect or regulate the rights arising out of a commercial contract, with which the members have no concern, i.e., rights completely outside the company's relationship.

Company not Bound to Outsiders

The term "outsider" signifies a person who is not a member of the company even if he is a director or or solicitor to the company. Even in regard to members, the articles bind the company to them in their capacity as members.

As between outsiders and the company, neither the memorandum nor the articles would give any contractual rights to outsiders against the company or its members even though the names of outsiders are mentioned in those documents in connection with the arrangements that the company might have contemplated for carrying on its business. The articles do not confer any contractual rights even upon a member in a capacity other than that of a member. To succeed, the party suing must prove a contract outside and independent of the articles [*Eley v. Positive Life Insurance Co.*, (1876) 1 E.X.D. 88].

In this case the articles provided that the solicitor to the company 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 discontinued his services and then he sued the company for damages for breach of contract. It was held that he had no cause of action because the articles did not constitute any contract between the company and himself. His action was dismissed.

This rule, however, proved to be rather harsh and so the Courts later on modified it. The modified rule is as follows:

While the articles cannot create a contract between the company and any person other than a member in his capacity as a member, they may indicate the basis upon which contracts may be made by the company. If such a contract is entered into whether with a member of the company or any other person, the conditions stated in the articles will be tacitly adopted by that contract, unless expressly negated or varied by the contract itself.

The question sometimes arises as to whether directors are bound by whatever is contained in the articles. In case the directors contravene the provisions in the articles, the directors render themselves liable for an action by members. On the other hand, members can also ratify acts of directors. If any loss is incurred by the company, directors are liable to reimburse to the company any loss so incurred.

CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES

The memorandum and articles, when registered, become public documents and can be inspected by anyone on payment of nominal fee. Therefore, every person who contemplates entering into a contract with a company has the means of ascertaining and is consequently presumed to know, not only the exact powers of the company but also the extent to which these powers have been delegated to the directors, and of any limitations placed upon the exercise of these powers. In other words, every person dealing with the company is deemed to have a "constructive notice" of the contents of its memorandum and articles. In fact, he is regarded not only as having read those documents but also as having understood them according to their proper meaning [*Griffith v. Paget*, (1877) Ch. D. 517]. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum, or outside the limits set on the authority of the directors, he cannot, as a general rule, acquire any rights under the contract against the company [*Mohony v. East Holyfrod Mining Co.*, (1875) L.R. 7 H.L. 869]. For example, if the articles provide that a bill of exchange to be effective must be signed by two directors, a person dealing with the company must see that it is so signed; otherwise he cannot claim under it.

In another case, the articles required that all documents should be signed by the managing director, secretary and the working director on behalf of the company. A deed of mortgage was executed by the secretary and the working director only and the Court held that no claim would lie under such a deed. The Court said that the mortgagee should have consulted the articles before the deed was executed. Therefore, even though the mortgagee may have acted in good faith and the money borrowed applied for the purpose of the company, the mortgage was nevertheless invalid [*Kotla Venkataswamy v. Rammurthy*, AIR 1934 Mad 579]. The doctrine of indoor management protects third parties who are entitled to an assurance that all the procedural aspects of a transaction are carried out.

Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.

The impact of this doctrine on practical relations is thus stated in HALSBURY: "A company is subject to the rule that, where the conduct of a party charged with a notice shows that he had suspicions of a state of facts the knowledge of which would affect his legal rights, but that he deliberately refrained from making inquiries,

he will be treated as having had notice, though he is not entitled to claim for his own advantage," [*Jones v. Smith*, (1841) 1 Hare 43].

MONEIES PAYABLE BY MEMBERS IS A DEBT [SUB-SECTION (2) OF SECTION 10]

Though all monies payable under the memorandum or articles by members is a debt due, the liability on the debt is not enforceable, unless proper notice is given in accordance with the articles. [*Pabna Dhana-Bhandar Co. Ltd. v. Foyezud din Mia* (1933) 3 Com Cases 41 : AIR 1932 Cal 716].

INTERPRETATION OF MEMORANDUM AND ARTICLES

Articles should be construed as a business document so as to give business efficacy preference to a construction which will prove unworkable [*Holmes v. Keyes (Lord)* (1958) 2 All ER 129 (CA)]. Where the conduct of the parties reveals that there has been some practice in vogue for several years which was accepted by everyone concerned without any challenge or question, then that practice in the course of long years in itself becomes an indication that the rules or articles which are framed by way of internal management were understood in that sense [*Krishnaswamy (S) v. South India film Chamber of Commerce*, AIR 1969 Mad 42 : (1968) 1 Comp LJ 75; cited in *Sunil Dev v. Delhi and District Cricket Assn.*, (1990) 2 Comp LJ 245, 255 : (1994) 80 Com Cases 174 (Del)].

The memorandum must like any other document be construed according to accepted principles applicable to the interpretation of all legal documents. No rigid canon of construction is to be applied to such a document. Like any other document, it must be read fairly and its import derived from a reasonable interpretation of the language which it employs. [*A Lakshmanaswami Mudaliar v. LIC of India* (1963) 33 Com Cases 420, 430 (SC); *Egyptian Salt & Soda Co. v. Port Said Salt Assn.*, (1931) AC 677 : AIR 1931 PC 182].

The memorandum and articles must be read together in the event of any ambiguity. In *Angostura Bitters & Co. Ltd. v. Kerr*, (1933) AC 550 : (1934) 4 Com Cases 1; the Privy Council held, "Except in respect of such matters as must be statutorily provided for by the conjunction with the articles. The two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum or to supplement it upon any matter as to which it is silent" — quoted with approval by the Supreme Court in *A. Lakshmanaswami Mudaliar v. LIC of India Ltd.* (1963) SC 1185.

DOCTRINE OF INDOOR MANAGEMENT

While the doctrine of 'constructive notice' seeks to protect the company against the outsiders, the principle of indoor management operates to protect the outsiders against the company.

According to this doctrine, as laid down in *Royal British Bank v. Turquand*, (1856) 119 E.R. 886, persons dealing with a company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the memorandum and articles, are not bound to inquire the regularity of any internal proceedings. In other words, while persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. It is no part of the duty of an outsider to see that the company carries out its own internal regulations.

CASE LAW UNDER ERSTWHILE COMPANIES ACT 1956

In *Royal British Bank v. Turquand*, the directors of a banking company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by resolution of the company in general meeting, be authorised to borrow. The directors gave a bond to Turquand without the authority of any such resolution. It was held that *Turquand* could sue the company on the strength of the bond, as he was entitled

to assume that the necessary resolution had been passed. *Lord Hatherly* observed : “Outsiders are bound to know the external position of the company, but are not bound to know its indoor management”.

Section 176 Provides for the Validity of Acts of Directors - No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles of the company:

Provided that nothing in this section shall be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or have been terminated.

The object of the section is to protect persons dealing with the company - outsiders as well as members by providing that the acts of a person acting as director will be treated as valid although it may afterwards be discovered that his appointment was invalid or that it had terminated under any provision of this Act or the Articles of the company [*Ram Raghbir Lal v. United Refineries (Burma) Ltd.*, (1932) 2 Com Cases 359; AIR 1931 Rang 139].

Relation of company with members and outsiders

The validation of the acts of unqualified directors may apply to circumstances from two different angles : (1) as between outsiders, strangers and the company as in *Royal British Bank v. Turquand*, (1956) 5 E&B 327, *British Asbestos Co. Ltd. v. Boyd*. (1903) 2 Ch 439 : (1900-3) All ER Rep 323; and *Ram Buran Singh v. Mufassil Bank Ltd.* AIR 1925 All 206; and (2) in relation to the internal affairs of the company as in *Dawson v. African Consolidated Land & Trading Co.*, (1898) 1 Ch 6 (CA), where calls made by unqualified directors were held valid. Even if the public documents of the company, and the facts which are apparent, would make it clear that a director was not duly qualified to act, this will not oust the effect of the Section 176 (British Asbestos case) (supra). Similarly in *Boschoek Proprietary Co. Ltd., v. Fuke*, (1906) 1 Ch 148, a resolution of a general meeting convened by de facto directors was upheld.

Forgery and incompetent acts

This section does not apply where the act itself is not in the competence of the Board of directors, e.g. compromising unpaid calls under the guise of forfeiture, the transaction being ultra vires and invalid [*Bhagirath Spinning & Wvg. Co. v. Balaji Bhavani Pawar*, AIR 1930 Bom. 267].

Directors not aware of their disqualification

The allotment and forfeiture of shares made by the directors who continued to act even after they were disqualified but were not aware of it, were saved by the Section 179. [*Shiromani Sugar Mills Ltd. v. Debi Prasad*, (1950) 20 Com Cases 296: AIR 1950 All 508]. Where this section does not save the situation, the company may in general meeting ratify allotment of shares even if made by *de facto* directors with *mala fide* intentions [*Bamford v. Bamford*, (1969) 39 Com Cases 838 : (1969) 2 WLR (1107) (CA) and an appeal (1969) : 1 All ER 969].

Where the directors in question were not aware of the fact that by virtue of certain provisions in the articles, they had vacated their office, their acts in passing resolutions for starting certain business transactions were held to be valid [*Seth Mohan Lal v. Grain Chambers Ltd.*, (1968) 38 Com Cases 543 : AIR 1968 SC 772; *Shiromani Sugar Mills Ltd. v. Debi Prasad*, (Supra).]

It is important to remember that the doctrine of “constructive notice”, can be invoked by the company and it does not operate against the company. It operates against the person who has failed to inquire but does not operate in his favour. But the doctrine of “indoor management” can be invoked by the person dealing with the company and cannot be invoked by the company.

An outsider is entitled to act on a certified copy of the resolution of the Board of directors delegating the powers of borrowing money to the managing director subject to the limitation mentioned therein [*C.K. Siva Sankara Panicker v. Kerala State Financial Corporation*, (1980) 50 Com Cases 817 (Ker.)].

EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The above noted ‘doctrine of indoor management’ is, however, subject to certain exceptions. In other words, relief on the ground of ‘indoor management’ cannot be claimed by an outsider dealing with the company in the following circumstances.

1. **Where the outsider had knowledge of irregularity** — The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company. Thus, a person knowing fully well that the directors do not have the authority to make the transaction but still enters into it, cannot seek protection under the rule of indoor management. In *Howard v. Patent Ivory Co.* (38 Ch. D 156), the articles of a company empowered the directors to borrow upto one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting. Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount. Held that, the debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity.
2. **No knowledge of memorandum and articles** — Again, the rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them. In *Rama Corporation v. Proved Tin & General Investment Co.* (1952) 1All. ER 554, T was a director in the company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. The Plaintiff relied on the rule of indoor management. Held, they could not because they even did not know that power could be delegated.
3. **Forgery** — The rule of indoor management does not extend to transactions involving forgery or to transactions which are otherwise void or illegal *ab initio*. In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction, and the question of his consent being free or otherwise does not arise. Consequently, it is not that the title of the person is defective but there is no title at all. Therefore, howsoever clever the forgery might have been, the personates acquire no rights at all. Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management [*Rouben v. Great Fingal Consolidated* (1906) AC 439].

Forgery, in the case of a company, can take different forms. It may, besides forgery of the signatures of the authorised officials, include the execution of a document towards the personal discharge of an official’s liability instead of the liability of the company. Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted [*Kreditbank Cassel v. Schenkers Ltd.* (1927) 1 KB 826]. The

bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

4. **Negligence** — The 'doctrine of indoor management', in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he is estopped from relying on the Rule. In the case of *Underwood v. Benko of Liverpool* (1924) 1 KB 775, a person who was a sole director and principal shareholder of a company deposited into his own account cheques drawn in favour of the company. Held, that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

Similarly, in the case of *Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd.* AIR 1942 Oudh 417, an accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

5. Again, the doctrine of indoor management does not apply where the question is in regard to the very existence of an agency. In *Varkey Souriar v. Keraleeya Banking Co. Ltd.* (1957) 27 Com Cases 591 (Ker.), the Kerala High Court held that the 'doctrine of indoor management' cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is with regard to the very existence of the agency.
6. This Doctrine is also not applicable where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely *ultra vires* the directors/officers but *ultra vires* the company itself — *Pacific Coast Coal Mines v. Arbuthnot* (1917) AC 607.

In the end, it is worthwhile to mention that section 6 of the Companies Act, 2013 gives overriding force and effect to the provisions of the Act, notwithstanding anything to the contrary contained in the memorandum or articles of a company or in any agreement executed by it or for that matter in any resolution of the company in general meeting or of its board of directors. A provision contained in the memorandum, articles, agreement or resolution to the extent to which it is repugnant to the provisions of the Act, will be regarded as void.

A corporation, organization or other entity set up to provide a legal shield for the person actually controlling the operation.

DOCTRINE OF ALTER EGO

It is used by the courts to ignore the status of shareholders, officers, and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly.

In *Lennards Caring Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] AC 705, Viscount Haldane propounded the "alter ego" theory and distinguished it from vicarious liability. The House of Lords stated that the default of the managing director who is the "directing mind and will" of the company, would be attributed to him and he be held for the wrong doing of the company.

LESSON ROUND-UP

- The Memorandum of Association is a document which sets out the constitution of the company and is the foundation on which the structure of the company stands. It defines as well as confines the powers of the company. If the company enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be *ultra vires* the company and hence void. However, the Companies Act, 2013 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act.
- The memorandum of association of a company may be altered by changing its name, altering it in regard to the State in which the registered office is to be situated or its objects, altering or reorganizing its share capital, reducing its capital or making the liability of the directors unlimited.
- Articles means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. It also includes the regulations contained in Tables F to J in Schedule I of the Act, in so far as they apply to the company.
- The memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members.
- A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Any alteration so made shall be as valid as if originally contained in the articles.
- The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.
- As per doctrine of constructive notice, every person dealing with the company is deemed to have a "constructive notice" of the contents of its memorandum and articles. Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.
- While the doctrine of constructive notice seeks to protect the company against the outsiders, the doctrine of indoor management operates to protect the outsiders against the company. While persons contracting with a company are presumed to know the provisions of the contents of the memorandum and articles, they are entitled to assume that the provisions of the articles have been observed by the officers of the company. However, there are certain exceptions to doctrine of indoor management.

GLOSSARY

Memorandum Association	of	The Memorandum of Association is the constitution of a company. It is a document, which amongst other things, defines the area within which the company can act. It is, therefore, required to state the object for which the company has been formed, the business that it would undertake, the liability, the capital which it shall be allowed to raise, the nature of liability of its members, the name of the State where the registered office of the company shall be located.
Articles Association	of	Articles of Association which contains the rules and regulations relating to the internal management of a company.
Indoor Management		It operates to protect outsiders against the company. It protects innocent parties who are doing business with the Company and are not in a position to know if some internal rule has not been complied with.

Rule of Constructive Notice To protect the company against outsiders. The rule of constructive notice is confined to the external position of the company and, therefore, it follows that there is no notice as to how the company's internal machinery is handled by its officers.

Alteration The state of being altered; a change made in the form or nature of a thing; changed condition. In Company Law the memorandum and articles sometime requires alterations.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

1. What do you understand by the memorandum of association? What is its purpose?
2. "Memorandum of association is a charter of the company". Comment upon the statement and explain the clauses which are included in a memorandum of association of a company.
3. What is "registered office" of a company? Within how much time a company must have a registered office?
4. What do you understand by the doctrine of "ultra-vires"? Discuss the decided case "*Ashbury Railway & Iron Co. v. Riche*".
5. What is the importance of the objects clause of the memorandum of association? If a company undertakes to do anything which is not either expressly or impliedly provided for by the objects clause, what would be the consequences?
6. "The power of altering the articles is wide, yet it is subject to a large number of limitations". Explain.
7. Discuss the extent to which articles of association binds:
 - (a) the members to the company,
 - (b) the company to the members,
 - (c) the members among themselves, and
 - (d) the company to the outsiders.
8. Distinguish Articles from Memorandum.
9. "The articles may contain provisions for entrenchment." Comment upon the statement and explain the significance of the entrenchment provisions.
10. What is the meaning and significance of the doctrine of "Indoor Management". Discuss with reference to decided case "*Royal British Bank v. Turquand*".

Lesson 5

Contracts and Conversions

LESSON OUTLINE

- Preliminary Contracts/Pre-incorporation contracts
- Provisional contracts.
- Common seal.
- Conversion of private company into public company and vice versa.
- Conversion of public company into private company.
- Conversion of one person company and conversion into a one person company
- Conversion of Section 8 Company to any other class of companies
- Commencement of business

LEARNING OBJECTIVES

Contracts made before the incorporation of company is called pre-incorporation contracts. Contracts made after incorporation, but before the company becomes entitled to commence business are called provisional contracts. The contracts after the incorporation/after the company becomes entitled to commence business, as the case may be, are post incorporation contracts, which are made under the common seal of the company and should be within the purview of Memorandum of Association.

Companies Act 2013 provides for conversion of public companies to private companies vice versa, conversion of one person company into public/private Company, conversion of Section 8 companies(companies for charitable purpose) into any other class of companies. Companies (incorporation) Rules 2014 provides details of the procedural aspects.

After reading this lesson, you will be able to understand the various types of contracts entered into by a public and private company; viz. preliminary or pre-incorporation contracts, provisional contracts, contracts made after commence business. In addition you will be able to understand the overall legal and procedural aspects relating to various conversions.

PRELIMINARY CONTRACTS

A company being an artificial person can contract only through its agents. A contract will be binding on a company only, if it is made on its behalf by any person acting under its authority, express or implied. The powers of the company are defined by its Memorandum of Association and any contract made beyond the limits laid down in the Memorandum of Association, will be *ultra vires* to the company and void even if all the shareholders assent to it.

When the company is being formed, the promoters, purporting to act on behalf of the company, enter into contracts for the purchase of property, or for securing the services of managers or other experts. Such contracts are obviously made before the incorporation of the company.

There are three situations as discussed below in the case of every company having a share capital (whether public or private) in which contracts are made:

- (a) Contracts made on behalf of the company before its incorporation—preliminary or pre-incorporation contracts.
- (b) Contracts made after incorporation but before filing of the prescribed declaration by a director and verification of its registered office by company with the Registrar under section 11 (which is a mandatory requirement before the company can commence business)—provisional contracts.
- (c) Contracts made after the company becomes entitled to commence business.

However, in the case of a company not having a share capital, there are only two situations in which contracts are made, i.e. contracts made on behalf of companies before incorporation and contracts made after incorporation. The reason is that a company not having a share capital can commence its business immediately after obtaining a certificate of incorporation. Hence, there is no need for provisional contracts in the case of a company not having a share capital.

Pre-incorporation Contracts

In Pennington's Company Law, the position is stated as under:

"Although a contract made before the company's incorporation cannot bind the company, it is not wholly denied of legal effect. It takes effect as a personal contract with the persons who purport to contract on the company's behalf and they are liable to pay damages for failure to perform the promises made in the company's name, even though the contract expressly provides that only the company's paid-up capital shall be answerable for performance".

Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation. Before incorporation, a company is non-existent and has no capacity to contract. Consequently, nobody can contract as agent on its behalf because an act which cannot be done by the principal himself cannot be done by him through an agent. Hence, a contract by a promoter purporting to act on behalf of a company prior to its incorporation never binds the company because at the time the contract was concluded the company was not in existence. Therefore it has no legal existence. Even if the parties act on the contract it will not bind the company. [*Northumberland Avenue Hotel Co.*, (1886) 33 Ch.D.16 (CA)]. Further even after incorporation such a purported contract cannot be ratified by the company (*Kelner v. Baxter* (1866) L.R. 2 C.P. 174]. The persons purporting to act as agents on behalf of the company would be personally liable. In *Kelner v. Baxter* (*ibid*) three persons A, B and C purported to enter into a contract as agents on behalf of a company before its incorporation for the purchase of certain goods from Kelner and signed it : "A, B and C, Directors". The company later obtained the certificate of incorporation but collapsed before the money was paid for the

goods which were supplied to it by Kelner. It was held that A, B and C were personally liable on the agreement and no subsequent ratification by the company would relieve them from that liability without the assent of Kelner.

Even if the company takes some benefit from a contract purported to have been made before its formation, the contract is not binding on the company. The promoters alone, therefore, remain personally liable for any contract they purport to make on behalf of the company, unless the company enters into the contract in terms of such agreement after incorporation. A company cannot ratify a pre-incorporation contract, but it is open to it to enter into a new contract after its incorporation to give effect to a contract made before its formation [*Howard v. Patent Ivory Co.* (1888) 38 Ch.D.] Since the pre-incorporation contract is a nullity, even the company cannot sue the vendor of property if he fails to carry out such a contract.

In India, however, Sections 15 and 19 of the Specific Relief Act, 1963, have considerably alleviated the difficulty. Section 15(h) provides that where the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of incorporation, the company may, if it has accepted the contract, and has communicated such acceptance to the other party to the contract, obtain specific performance of the contract. Under Section 19(e) under similar circumstances, specific performance may be enforced against the company by the other party to the contract.

A company cannot acquire shares prior to its incorporation. Where a company was named as the transferee in the share transfer forms prior to its incorporation, it was held that such transfers could not be registered. [*Inlec Investment (P) Ltd. v. Dynamatic Hydraulics Ltd.*, (1989) 3 Comp LJ 221, 225 (CLB)].

Any pre-incorporation agreement to subscribe to shares of a company to be formed, cannot be enforced and is usually revocable unless accepted by the company after its formation.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Pre-incorporation contracts cannot be ratified.

- True
- False

Correct answer: True

Provisional Contracts

In the case of a company having a share capital whether public or private, contracts made after incorporation but before the company becomes entitled to commence business in terms of section 11 are provisional and are not binding on the company until the company becomes so entitled after filing of the prescribed declaration by its director and verification of its registered office with the Registrar under that section. But after the company becomes entitled to commence business such contracts automatically become binding i.e. without any ratification.

Commencement of Business

In terms of section 11(1) of the Act, every company having a share capital shall not commence any business or exercise any borrowing powers unless—

- (a) a declaration is filed by a director in such form (Form No. INC 21) and verified in such manner as

may be prescribed, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him and the paid-up share capital of the company is not less than ₹ 5 lakh in case of a public company and not less than ₹ 1 lakh in case of a private company on the date of making of this declaration; and

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

Rule 24 of Companies (Incorporation) Rules 2014 states that the declaration filed by a director shall be in Form INC 21, duly verified by Practicing Company Secretary, Chartered Accountant or Cost Accountant. In case the Company requiring registration from sectoral regulators/SEBI, the approval of such regulator shall be required.

If, therefore, a public company is wound up before it is entitled to commence business the persons who have rendered services or supplied goods or materials to the company can have no claim against it [*In Re. Electrical Manufacturing Co.* (1906) 2 Ch. 390].

Section 11 of the Companies Act further provides for penalty and fine. If any default is made in complying with the requirements of this section, the company shall be liable to a penalty which may extend to ₹ 5000 and every officer who is in default shall be punishable with fine which may extend to ₹ 1000 for every day during which the default continues. [Section 11(2)]

Where no declaration by a director has been filed with the Registrar under section 11(1)(a) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may, without prejudice to the provisions of section 11(2), initiate action for the removal of the name of the company from the register of companies under Chapter XVIII. [Section 11(3)]

The approval of the Registrar of Companies of the declaration filed by a director and verification of registered office filed by the company entitles the company to commence business given in the objects clause of the Memorandum of Association. No business other than those given in the “objects clause” can be commenced without obtaining prior approval of the shareholders by way of special resolution.

COMMENCEMENT OF NEW BUSINESS BY AN EXISTING COMPANY

A company cannot commence any business other than those stated under “objects” clause of memorandum without obtaining the prior approval of the shareholders in general meeting by a special resolution.

Section 4(1)(c) requires all companies to state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change its objects by passing a special resolution. Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1). As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13(6)(a).

No business other than those given in the “objects clause” can be commenced without obtaining prior approval of the shareholders by way of special resolution. It means that a company can commence a new business i.e. a business not covered by its “objects” clause of the memorandum only after amending the objects clause after obtaining the approval of the shareholders by special resolution.

In this connection, the Department of Company Affairs (now Ministry of Corporate Affairs), has clarified that new business means a business which is not germane to the existing business carried on by the company. The guiding criterion, therefore, is whether the new activity is germane to the original business or not. In case the reply is 'yes', no special resolution is necessary and *vice versa*.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Provisional contracts, after the company becomes entitled to commence business become automatically binding without any ratification.

- True
- False

Correct answer: True

Contracts made after a company having a share capital becomes entitled to commence business

A company can do all such acts, as by its Memorandum, it is expressly or impliedly authorised, to do. Any purported act, which is not so authorized, is *ultra vires* the company, and the company cannot enforce it, nor can the other party enforce it against the company. Such a contract cannot be ratified even if every member of the company assents to it, as it is *void ab initio*. This rule is commonly known as the Doctrine of *Ultra Vires*. '*Ultra vires*' means "beyond the powers". The powers of the company are derived from its Memorandum of Association and the statute constituting it. Consequently, only those contracts which are *intra vires* or within the powers of the company will be valid and binding.

Where a contract is *intra vires* the company but *ultra vires* the directors, the company may be liable and may even ratify it. According to the rule in *Royal British Bank v. Turquand* (1856) 6 E and B 327, so long as the act done by the directors is not inconsistent with the memorandum and articles, an outsider is entitled to assume that the directors have acted properly.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

If a public company is wound up before it is entitled to commence business, the persons who have rendered services or supplied goods or materials to the company can have no claim against it.

- True
- False

Correct answer: True

COMMON SEAL

Since a body corporate is not a living person who can sign, therefore every company should necessarily have an instrument known as common seal which is used for making a physical impression to act as its signature on certain important documents. Pursuant to Section 12(3)(b), every company shall have its name

engraved in legible characters on its seal. Since, Section 12(3)(b) provides that the name of the company should be engraved, it appears that the seal should be made of metal.

Common seal and contracting under common seal: The following deeds and contracts are not valid unless made under the seal of the company:

- (i) Power of attorney which would be required to be made in favour of a person to execute the deeds on behalf of the company in any place either in or outside India.;
- (ii) Share certificates;
- (iii) Share warrants;
- (iv) Any deed as required by the Articles.

CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY AND VICE VERSA

Section 14 (1) states that subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having the effect of conversion of—

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

Private Company ceases to be private company on alteration of articles removing the restrictions required under Section 2(68) [Proviso to Section 14(1)]

When a company being a private company alters its articles in such a manner that they no longer include any of the three restrictions and limitations which are required to be included in the articles of a private company under section 2(68), the company shall, as from the date of such alteration, cease to be a private company. It also ceases to have the privileges and exemptions conferred on it by the Act as a private company. It becomes a public company and all the provisions of the Act applicable to such companies become applicable to it.

Let us Remember!!!!!!!!!!!!!!

As per section 2(68) Private Company should

- Have a minimum paid up capital of one lakh;
- Should by its Articles
 - (a) Restrict the right to transfer its shares
 - (b) Limits the number of members to two hundred
 - (c) Prohibits any invitation to public to subscribe for securities of the company

Conversion of a public Company into a private Company- Requires approval of National Company Law Tribunal

The second proviso to Section 14(1) states that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.

Section 14(2) states that every alteration of the articles under this section and a copy of the order of the Tribunal approving the alteration as per sub-section (1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

Please note that second proviso to Section 14(1) and section 14(2) are yet to be notified

REVIEW QUESTIONS**State whether the following statement is “True” or “False”**

A Private Limited Company ceases to be a Private Company and becomes a Public Company when it fails to comply with any of the three restrictive provisions required by Section 2(68) to be incorporated in its articles.

- True
- False

Correct answer: True

Rule 33 of Companies (Incorporation) Rules 2014

(1) For effecting the conversion of a private company into a public company or vice versa, the application shall be filed in Form No. INC.27 with fee.

(2) A copy of order of the competent authority approving the alteration shall be filed with the Registrar in Form No. INC.27 with fee together with the printed copy of the altered articles within fifteen days of the receipt of the order from the Central Government.

Let us remember!!!!!!

Conversion of Private Company to public company and vice versa requires Special Resolution as it results in alteration of Articles of Association.

MCA has clarified vide circular dated 11th June 2014 that the provisions of Companies Act, 1956 would continue to apply as second proviso to sub section 1 and Sub section 2 of Section 14 is not yet notified, as conversion of public to private needs approval of Tribunal.

CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE COMPANY UNDER COMPANIES ACT 1956(As second proviso to section 14(1) and Section 14(2) relating to conversion of public to private companies is not yet notified)

A public company can be converted into a private company only after the approval of the Central Government. It cannot be treated as a private company till the Central Government accords its approval.

Conversion of a public company into a private company will require:

- (i) Passing of a special resolution authorising the conversion and altering the Articles so as to include the matters specified in Section 3(1)(iii). In case of listed company the same has to be passed through postal ballot under Section 192A.
 - e-form 23 for special resolution within 30 days of its passing and
 - e-form 1B for conversion within 3 months of passing special resolution has to be filed RoC.
- (ii) Changing the name of the company by special resolution as required by Section 21.
- (iii) Obtaining the approval of the Central Government as required by Section 31. Proviso to Section 31(1) provides that no alteration made in the Articles which has the effect of converting a public company shall have effect unless such alteration has been approved by the Central Government.
- (iv) Filing of printed copy of the articles as altered within one month of the receipt of the approval.

PRIVATE COMPANY (WHICH IS A SUBSIDIARY OF PUBLIC COMPANY) DEEMED TO BE A PUBLIC COMPANY

Under proviso to section 2(71) of the Companies Act, 2013, a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles. Thus, it has been clearly provided that a subsidiary of public company shall be deemed to be public company even if it continues to be private company in its Articles. It places such a 'private company' at the same level as that of a public company and thereby demarcates between a private company and a private company which is not a subsidiary of a public company.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

A Public Company can be converted into a Private Company only after the approval of the Tribunal.

- True
- False

Correct answer: True

CONVERSION OF COMPANIES ALREADY REGISTERED

Section 18(1) of the Companies Act, 2013 provides that a company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of Chapter II of the Act.

Where the conversion is required to be done under this section, the Registrar shall on an application made by the company, after satisfying himself that the provisions of this Chapter applicable for registration of companies have been complied with, close the former registration of the company and after registering the documents referred to in section 18(1), issue a certificate of incorporation in the same manner as its first registration. [Section 18(2)]

The registration of a company under section 18 shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before conversion and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done. [Section 18(3)]

CONVERSION OF SECTION 8 COMPANY INTO A COMPANY OF ANY OTHER KIND

Section 8(4)(ii) provides that a company registered under section 8 i.e. companies with charitable objects may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

What is prescribed under Rule 21 and 22 of Companies (Incorporation) Rules 2014?

Conversion requires Special Resolution

A company registered under section 8 which intends to convert itself into a company of any other kind shall pass a special resolution at a general meeting for approving such conversion.

Explanatory Statement to be annexed to the notice

The explanatory statement annexed to the notice convening the general meeting shall set out in detail the reasons for opting for such conversion including the following, namely:-

- (a) the date of incorporation of the company;
- (b) the principal objects of the company as set out in the memorandum of association;
- (c) the reasons as to why the activities for achieving the objects of the company cannot be carried on in the current structure i.e. as a section 8 company;
- (d) if the principal or main objects of the company are proposed to be altered, what would be the altered objects and the reasons for the alteration;
- (e) what are the privileges or concessions currently enjoyed by the company, such as tax exemptions, approvals for receiving donations or contributions including foreign contributions, land and other immovable properties, if any, that were acquired by the company at concessional rates or prices or gratuitously and, if so, the market prices prevalent at the time of acquisition and the price that was paid by the company, details of any donations or bequests received by the company with conditions attached to their utilization etc.
- (f) details of impact of the proposed conversion on the members of the company including details of any benefits that may accrue to the members as a result of the conversion.

Certified copy of Special Resolution to be filed in Form No MGT-14

A certified true copy of the special resolution along with a copy of the Notice convening the meeting including the explanatory statement shall be filed with the Registrar in Form No.MGT.14 along with the fee

Application to Regional Director

The company shall file an application in Form No.INC.18 with the Regional Director with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for converting itself into a company of any other kind and the company shall also attach the proof of serving of the notice served to all the authorities prescribed. In this regard Rule 22(b) states that the company shall send a copy of the notice, simultaneously with its publication, together with a copy of the application and all attachments by registered post or hand delivery, to the Chief Commissioner of Income Tax having jurisdiction over the company, Income Tax Officer who has jurisdiction over the company, the Charity Commissioner, the Chief Secretary of the State in which the registered office of the company is situated, any organisation or Department of the Central Government or State Government or other authority under whose jurisdiction the company has been operating and if any of these authorities wish to make any representation to Regional Director, it shall do so within sixty days of the receipt of the notice, after giving an opportunity to the Company.

A copy to be filed with the Registrar also

A copy of the application with annexures as filed with the Regional Director shall also be filed with the Registrar.

Publication of notice

The company shall, within a week from the date of submitting the application to the Regional Director, publish a notice at its own expense, and a copy of the notice, as published, shall be sent forthwith to the

Regional Director and the said notice shall be in Form No. INC.19 and shall be published-

- (a) at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district; and
- (b) on the website of the company, if any, and as may be notified or directed by the Central Government.

The copy of proof of serving such notice shall be attached to the application.

Declaration to the effect that no dividend /bonus shares

The Board of directors shall give a declaration to the effect that no portion of the income or property of the company has been or shall be paid or transferred directly or indirectly by way of dividend or bonus or otherwise to persons who are or have been members of the company or to any one or more of them or to any persons claiming through any one or more of them.

No objection certificate from relevant authorities, in case of special status

Where the company has obtained any special status, privilege, exemption, benefit or grant(s) from any authority such as Income Tax Department, Charity Commissioner or any organisation or Department of Central Government, State Government, Municipal Body or any recognized authority, a "No Objection Certificate" must be obtained, if required under the terms of the said special status, privilege, exemption, benefit or grant(s) from the concerned authority and filed with the Regional Director, along with the application.

No failure in filing financial statements/Annual Return

The company should have filed all its financial statements and Annual Returns upto the financial year preceding the submission of the application to the Regional Director and all other returns required to be filed under the Act up to the date of submitting the application to the Regional Director and in the event the application is made after the expiry of three months from the date of preceding financial year to which the financial statement has been filed, a statement of the financial position duly certified by chartered accountant made up to a date not preceding thirty days of filing the application shall be attached.

Attach certificate of compliance for conversion

The company shall attach with the application a certificate from practicing Chartered Accountant or Company Secretary in practice or Cost Accountant in practice certifying that the conditions laid down in the Act and these rules relating to conversion of a company registered under section 8 into any other kind of company, have been complied with.

Company to give up concessions enjoyed or being enjoyed

On receipt of the application, and on being satisfied , the Regional Director shall issue an order approving the conversion of the company into a company of any other kind subject to such terms and conditions as may be imposed in the facts and circumstances of each case including the following conditions, namely:-

- (a) the company shall give up and shall not claim, with effect from the date its conversion takes effect, any special status, exemptions or privileges that it enjoyed by virtue of having been registered under the provisions of section 8;
- (b) if the company had acquired any immovable property free of cost or at a concessional cost from any government or authority, it may be required to pay the difference between the cost at which it

acquired such property and the market price of such property at the time of conversion either to the government or to the authority that provided the immovable property;

- (c) any accumulated profit or unutilised income of the company brought forward from previous years shall be first utilized to settle all outstanding statutory dues, amounts due to lenders claims of creditors, suppliers, service providers and others including employees and lastly any loans advanced by the promoters or members or any other amounts due to them and the balance, if any, shall be transferred to the Investor Education and Protection Fund within thirty days of receiving the approval for conversion;

On receipt of Approval of Regional Director

On receipt of the approval of the Regional Director,

- (i) the company shall convene a general meeting of its members to pass a special resolution for amending its memorandum of association and articles of association as required under the Act consequent to the conversion of the section 8 company into a company of any other kind;
- (ii) the Company shall thereafter file with the Registrar.-
 - (a) a certified copy of the approval of the Regional Director within thirty days from the date of receipt of the order in Form No.INC.20 along with the fee;
 - (b) amended memorandum of association and articles of association of the company.
 - (c) a declaration by the directors that the conditions, if any imposed by the Regional Director have been fully complied with.

On receipt of the documents referred above, the Registrar shall register the documents and issue the fresh Certificate of Incorporation.

Let us remember!

The Company shall file an application in Form No.INC.18 with the Regional Director with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for converting itself into a company of any other kind and the company.

CONVERSION OF ONE PERSON COMPANY INTO A PUBLIC COMPANY OR PRIVATE COMPANY

Rule 6 of Companies (Incorporation) Rules 2014

Paid up capital/turn over of one person company not to exceed prescribed limits

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

One person company to convert itself on exceeding the above limits

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

Alteration of Memorandum and Articles

The One Person Company shall alter its memorandum and articles by passing a resolution to give effect to

the conversion and to make necessary changes incidental thereto.

Notice to Registrar

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

Penalty for default

If One Person Company or any officer of the One Person Company contravenes the provisions of these rules, One Person Company or any officer of the One Person Company shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

Minimum number of members/directors/ capital to be complied on conversion

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

Rule 7- CONVERSION OF PRIVATE COMPANY INTO ONE PERSON COMPANY

(1) A private company other than a company registered under section 8 of the Act having paid up share capital of fifty lakhs rupees or less or average annual turnover during the relevant period is two crore rupees or less may convert itself into one person company by passing a special resolution in the general meeting.

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

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

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

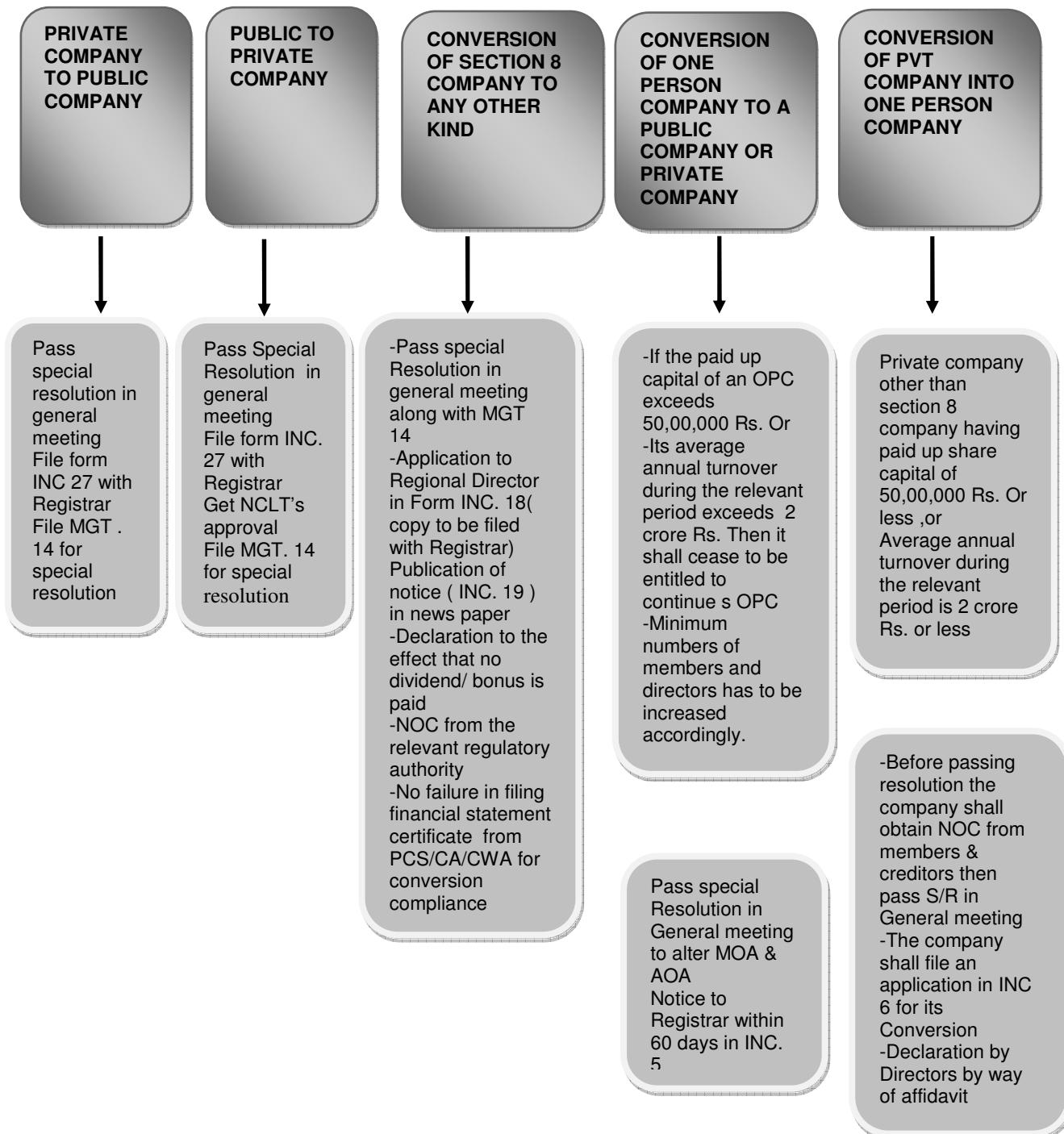
- (i) The directors of the company shall give a declaration by way of affidavit duly sworn in confirming that all members and creditors of the company have given their consent for conversion, the paid up share capital company is fifty lakhs rupees or less or average annual turnover is less than two crores rupees, as the case may be;
- (ii) the list of members and list of creditors;
- (iii) the latest Audited Balance Sheet and the Profit and Loss Account; and
- (iv) the copy of No Objection letter of secured creditors.

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

Let us remember!

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

CONVERSION OF COMPANIES



LESSON ROUND-UP

- Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation.
- A company cannot ratify a pre-incorporation contract, but it is open for the company to enter into a new contract after its incorporation to give effect to a contract made before its formation.
- In case of every company having a share capital (whether public or private), contracts made after incorporation but before filing with the Registrar of the declaration by director and verification of registered office by company are provisional and are not binding on the company until the company is entitled to commence business after approval of the said documents by the Registrar.
- Only those contracts which are *intra vires* or within the powers of the company will be valid and binding. Where a contract is *intra vires* the company but *ultra vires* the directors, the company may ratify it.
- Pursuant to Section 12(3)(b), every company shall have its name engraved in legible characters on its seal.
- Under section 2(71), a subsidiary of public company shall be deemed to be public company even if it continues to be private company in its Articles.
- A public company can be converted into a private company only after the approval of the Tribunal.
- A company having no share capital may commence business and exercise its various powers immediately after it is incorporated. A company having a share capital, on the other hand, must file with the Registrar declaration by director and verification of registered office and obtain his approval before it can commence business or exercise its borrowing powers.
- The approval of the Registrar of the declaration filed by the director and verification of registered office filed by the company is conclusive evidence that a company is entitled to commence business.
- The approval of the Registrar entitles the company to commence business given in the objects clause of the Memorandum of Association.
- For commencement of new business by an existing company, the guiding criterion is whether the new activity is germane to the original business or not.

GLOSSARY

Preliminary Contract	When the company is being formed, the promoters, purporting to act on behalf of the company, enter into contracts for the purchase of property, or for securing the services of managers or other experts. Such contracts are obviously made before the incorporation of the company.
Provisional Contract	In the case of a company having a share capital, contracts made after incorporation but before the company becomes entitled to commence business are provisional.
Company Seal	An embossing press used to indicate the official signature of a company.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to the questions are not be submitted for evaluation).

1. (a) Discuss the legal effects of pre-incorporation contracts and provisional contracts.
 (b) "A company cannot ratify a pre-incorporation contract though it is open to it to enter into fresh contract" — Discuss.
2. 'A', a furniture dealer, entered into a contract with the company for the furnishing of the offices of the company. The company went into liquidation before it could obtain certificate of commencement of

business. Can 'A' claim in the winding-up for the price of the furniture supplied to the company?

3. What are the requirements for conversion of a public company into a private company?
 4. Can contracts before incorporation be enforced against the company?
 5. State the provisions for conversion of a private company into a public company.
 6. Write short notes on:
 - (a) Pre-incorporation contracts;
 - (b) Commencement of business;
 - (c) Common Seal;
 - (d) Conversion by default under proviso to Section 14(1) of the Companies Act, 2013.

Lesson 6

CONCEPT OF CAPITAL AND FINANCING OF COMPANIES

LESSON OUTLINE

Meaning and classification of capital
Meaning and kinds of shares.
Various sources of capital.
Issue of shares/securities at premium/ discount.
Issue of shares with differential voting rights
Issue and redemption of preference shares
Further issue of shares
Bonus shares.
Preferential issue by existing companies
Employee stock option scheme.
Issue of Sweat equity shares

LEARNING OBJECTIVES

Sources of capital broadly include equity capital and preference capital. There are various ways to raise capital which include preferential allotment, employee stock option, issue of rights shares, issue of shares with differential voting rights. It involves various approvals, disclosures, filings, maintenance of records etc which are prescribed under Chapter IV of the Companies Act 2013. Besides Companies((Share Capital and Debentures) Rules, 2014 prescribes various aspects such as disclosures in the directors' report, matters to be stated in the explanatory statement to the resolution, prescribed forms as to maintenance of records, filings with registrar and so on.

After reading this lesson you will be able to understand the regulatory aspects and the broader procedural aspects involved in different types of issue of capital covering the Companies Act 2013 and Companies((Share Capital and Debentures) Rules, 2014.

MEANING OF THE TERM “CAPITAL”

The term “Capital” has variety of meanings. It may mean one thing to an economist, one to an accountant, while another to a businessman or a lawyer. A layman views capital as the money, which a company has raised by issue of its shares. It uses this money to meet its requirements by way of acquiring business premises and stock-in-trade, which are called the fixed capital and the circulating capital respectively.

The phrase “loan or borrowed capital” is sometimes used to mean money borrowed by the company and secured by issuing debentures. This, however, is not the proper use of the word “capital”.

In relation to a company limited by shares, the word “capital” means the share capital i.e., the capital in terms of rupees divided into specified number of shares of a fixed amount each. For e.g. share capital of a company is ₹1,00,000 which can be divided into 10,000 shares of ₹10 each or 1,000 shares of ₹100 each, whichever is feasible to the company.

USE OF THE WORD “CAPITAL” IN DIFFERENT SENSES

In Company Law, the “Capital” is the share capital of a company, which is classified as:

- (a) **Nominal, Authorised or Registered Capital:** As per section 2(8), “authorised capital” or “nominal capital” means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.
- (b) **Issued Capital:** As per section 2(50), “issued capital” means such capital as the company issues from time to time for subscription. It is that part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.
- (c) **Subscribed Capital:** According to Section 2(86), “subscribed capital” means such part of the capital which is for the time being subscribed by the members of a company. It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. It is clear that the entire issued capital may or may not be subscribed.
- (d) **Called up Capital:** As per section 2(15), “called-up capital” means such part of the capital, which has been called for payment. It is that portion of the subscribed capital which has been called up or demanded on the shares by the company
- (e) **Paid-up Share Capital:** As per section 2(64), “paid-up share capital” or “share capital paid-up” means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.
- (g) **Preference and Equity Share Capital:** As per explanation to Section 43

“equity share capital”, with reference to any company limited by shares, means all share capital which is not preference share capital;

“preference share capital”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

- (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

Equity share capital may be with similar rights or equity shares with different voting rights as described in Rule 4 of Companies (Share Capital and Debentures) Rules, 2014. A preference share has a preference in regard to payment of fixed amount of dividend or fixed rate of dividend and preferential right of the repayment of capital in the event of winding up of company.

REVIEW QUESTIONS



Choose the correct answer

1. For which type of capital a company pays the prescribed fees at the time of registration?
 - (a) Subscribed capital
 - (b) Authorised capital
 - (c) Paid-up capital
 - (d) Issued capital

Answer: (b)

MEANING AND NATURE OF A SHARE

Section 2(84) of the Act defines a share as “a share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied.

Nature of a Share

- (a) A share is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities while the company is a going concern and in its winding up. (Halsbury's Laws of England)
- (b) A share is the interest of a shareholder in the company measured by a sum of money, for the purposes of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se. [Borland's Trustee v. Steel Bros., (1901)].
- (c) A share is a right to participate in the profits made by a company, while it is a going concern and declares a dividend and in the assets of company when it is wound up [*Bacha Guzdar v. CIT* 57 Bom. L.R. 617 (SC)].
- (d) A share is not a sum of money but a bundle of rights and liabilities; it is an interest measured by a sum of money. These rights and liabilities are regulated by the articles of a company.
- (e) Section 44 of the Companies Act provides that a share or other interest of any member in a company is a movable property transferable in the manner provided by the articles of the company.
- (f) In India, a share is regarded as goods. According to the Sale of Goods Act, 1930, “Goods” means

any kind of movable property other than actionable claim and money, and includes stock and shares.

- (g) According to Section 45 of the Companies Act, 2013 every share in a company having a share capital shall be distinguished by its distinctive number but this provision shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

REVIEW QUESTIONS



State whether the following statements are “True” or “False”

1. Shares are regarded as goods.
2. A share is a right to participate in the profits made by a company.

True

False

Correct answer: 1. True 2. True

KINDS OF SHARES

Section 43 of the Companies Act, 2013 permits a company limited by shares to issue two classes of shares, namely:

- (a) Equity share capital—
 - (i) with voting rights; or
 - (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.
- (b) Preference Share Capital.

CAPITAL SHALL BE DEEMED TO BE PREFERENCE CAPITAL-WHEN?

Explanation to Section 43 states that the Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

- (a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Section 47(2) states that every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company:

Provided that the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares:

Provided further that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

PREFERENCE SHARES COMPARED WITH EQUITY SHARES

S. No	Preference capital	Equity share capital
1	Preference shares are entitled to a fixed rate of dividend.	The rate of dividend on equity shares depends upon the amount of profit available and the funds requirements of the company for future expansion etc.
2	Dividend on the preference shares is paid in preference to the equity shares.	The dividend on equity shares is paid only after the preference dividend has been paid.
3	In case of winding up, preference share holder get preference over equity share holders with regard to the payment of capital.	In case of winding up, equity share holder get payment of capital after the payment of capital to preference shareholders.
4	Dividend on preference share may be cumulative.	The dividend on equity shares is paid only after the preference dividend has been paid and it is not cumulative.
5	The voting rights of preference shareholders are restricted. A preference shareholder can vote only when his special rights as a preference shareholder are being varied, or on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital or their dividend has not been paid for a period of two years or more [section 47(2)].	An equity shareholder can vote on all matters affecting the company.
6	No bonus shares/right shares are issued to preference share holders.	A company may issue rights shares or bonus shares to the company's existing equity shareholders.
7	Redeemable preference shares may be redeemed by the company.	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy back of its own shares.
8	Voting right of a preference shareholders on a poll shall be in proportion to his share in the paid-up preference share capital of the company.	Voting right of an equity shareholders on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

ISSUE OF SECURITIES AT A PREMIUM

A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value. The Companies Act, 2013, does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. However, the Companies Act does impose conditions regulating the utilization of the amount of premium collected on securities.

Share Premium to be transferred to ‘securities premium account’

Section 52 (1) states that when a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a “securities premium account” and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

Utilisation of Securities premium

In accordance with the provisions of Section 52(2) of the Act, the securities premium can be utilised only for:

- (a) issuing fully paid bonus shares to members;
- (b) writing off the balance of the preliminary expenses of the company;
- (c) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company;
- (d) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

Section 52(3) further states that the securities premium account may, notwithstanding anything contained in sub-Sections (1) and (2), be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

- (a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or
- (b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or
- (c) for the purchase of its own shares or other securities under section 68.

Firstly, the premium cannot be treated as profit and as such the amount of premium is not available for distribution as dividend. Secondly, the amount of premium whether received in cash or in kind must be kept in a separate account, known as the “Securities Premium Account”. Thirdly, the amount of premium is to be maintained with the same sanctity as the share capital.

Where a company issues shares at a premium, even though the consideration may be other than cash, a sum equal to the amount or value of the premium must be transferred to the securities premium account. [*Head (Henry) & Co. Ltd. v. Ropner Holding Ltd.* (1951) 2 All ER 994: (152) Ch 124 (Ch D)].

Any premium paid does not give the shareholder any preferential rights in case of a winding up. Monies in the securities premium account cannot be treated as free reserves, as they are in the nature of capital reserve [See Departmental Circular No. 3/77 dated 15.4.1977].

PROHIBITION TO ISSUE THE SHARES AT DISCOUNT

Section 53 states that except as provided in section 54(i.e issue of sweat equity shares), a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be void. When a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

Remember That !

1. Issue of shares at discount is prohibited except by issue of sweat equity.
2. Share premium amount is not available for distribution of dividend.

ISSUE OF SWEAT EQUITY SHARES

According to section 2(88), sweat equity shares mean equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

According to Explanation to Rule 8(1) of Companies (Share Capital and Debentures) Rules, 2014.

- (i) the expressions “Employee” means-
 - (a) a permanent employee of the company who has been working in India or outside India, for at least last one year; or
 - (b) a director of the company, whether a whole time director or not; or
 - (c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;
- (ii) the expression ‘Value additions’ means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee

Section 54 permits issue of such equity shares to employees or directors in recognition of their contribution for providing know-how etc. as aforesaid. As the contribution made by employees/directors results in increased profits to the company for a number of years, sweat equity shares, provide a new form of adequate return.

Conditions for Issue of Sweat Equity Shares

Section 54(1) provides that notwithstanding anything contained in Section 53, a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- (i) the issue has been authorised by a special resolution passed by the company in the general meeting.
- (ii) the following are clearly specified in the resolution:
 - (a) number of shares;

- (b) current market price;
 - (c) consideration, if any; and
 - (d) class or classes of directors or employees to whom such equity shares are to be issued.
- (iii) as on the date of issue, at least one year should have elapsed from the date on which the company had commenced business.
 - (iv) a company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the regulations made in this behalf by SEBI.
 - (v) a company whose shares are not so listed should issue sweat equity shares in compliance with the rules made in this behalf by the Central Government (i.e., *Companies (Share Capital and Debentures) Rules, 2014*)

Holders of Sweat Equity Shares to be ranked pari passu with other Equity share holders

Section 54(2) provides that the rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014- ASPECTS RELATING TO SWEAT EQUITY SHARES

Explanatory statement to Special Resolution to contain certain particulars

Rule 8(2) states that the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following particulars, namely:-

- (a) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- (b) the reasons or justification for the issue;
- (c) the class of shares under which sweat equity shares are intended to be issued;
- (d) the total number of shares to be issued as sweat equity;
- (e) the class or classes of directors or employees to whom such equity shares are to be issued;
- (f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation ;
- (g) the time period of association of such person with the company;
- (h) the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
- (i) the price at which the sweat equity shares are proposed to be issued;
- (j) the consideration including consideration other than cash, if any to be received for the sweat equity;
- (k) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;
- (l) a statement to the effect that the company shall conform to the applicable accounting standards; and

- (m) diluted Earning Per Share pursuant to the issue of sweat equity shares , calculated in accordance with the applicable accounting standards.

Validity of Special Resolution authorizing sweat equity shares

Rule 8(3) the special resolution authorising the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

Limits on issue of sweat equity shares

Rule 8(4) states that the company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. The issuance of sweat equity shares in the Company shall not exceed twenty five percent, of the paid up equity capital of the Company at any time.

Sweat Equity Shares to be locked for three years

The sweat equity shares issued to directors or employees shall be locked in/non transferable for a period of three years from the date of allotment and the fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

Valuation aspects

- Rule 8(6) states that the sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- Rule 8(7) states that the valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.
- Rule 8(8) states that a copy of gist along with critical elements of the valuation report obtained under Rule 8 (6) and Rule 8 (7) shall be sent to the shareholders with the notice of the general meeting.

Sweat equity shares for non-cash consideration

Rule (9) states that when sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-

- (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
- (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

Sweat equity shares forming part of managerial remuneration

Rule 8(10) states that the amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act, if the following conditions are fulfilled, namely.-

- (a) the sweat equity shares are issued to any director or manager; and
- (b) they are issued for consideration other than cash, which does not take the form of an asset which

can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

Sweat equity shares and compensation aspects

- If the sweat equity shares are not issued pursuant to acquisition of an asset,

Rule 8(11) states that in respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares(i.e fair value by Registered valuer as mentioned in Rule 6) shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

- If the shares are issued pursuant to acquisition of an asset

Rule 8(12) states that if the shares are issued pursuant to acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards and such amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

Board's Report to disclose the details of sweat equity shares

Rule 8(13) states that the Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares namely:-

- (a) the class of director or employee to whom sweat equity shares were issued;
- (b) the class of shares issued as Sweat Equity Shares;
- (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them , if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;
- (d) the reasons or justification for the issue;
- (e) the principal terms and conditions for issue of sweat equity shares, including pricing formula;
- (f) the total number of shares arising as a result of issue of sweat equity shares;
- (g) the percentage of the sweat equity shares of the total post issued and paid up share capital;
- (h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;
- (i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Maintenance of Register

Rule 8(14)(a) The company shall maintain a Register of Sweat Equity Shares in Form No. SH.3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54. The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Let us recapitulate- Issue of Sweat Equity Shares!

- Issue of Sweat equity shares to be authorized by special resolution at a general meeting.
- Explanatory statement to the special resolution to contain certain particulars.
- The special resolution authorizing sweat equity shares is not valid if the allotment is made after 12 months of passing the resolution.i.e the validity of special resolution is 12 months.
- issue sweat equity shares not to exceed fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher and twenty five percent, of the paid up equity capital of the Company at any time.
- The price of sweat Equity shares is to be determined by a registered valuer.
- Board's Report to contain certain specified details of sweat equity shares issued.
- The company shall maintain a Register of Sweat Equity Shares in Form No. SH.3
- Issue of sweat equity shares to employees and directors at a discount under section 54 is outside the scope of section 53.

SHARES WITH DIFFERENTIAL VOTING RIGHTS

While Section 43 enables companies to issue a variety of equity shares with differential rights etc. Rule 4 of Companies (Share Capital and Debentures) Rules, 2014 states the following conditions regarding shares with differential voting rights.

Conditions for issuing shares with differential rights (Rule 4) Companies (Share Capital and Debentures) Rules, 2014

No company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions, namely:-

- (a) the articles of association of the company authorizes the issue of shares with differential rights;
- (b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders: When the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot ;
- (c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the company having consistent track record of distributable profits for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- (g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934 , the Securities and Exchange Board of India Act, 1992,

the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Disclosures in the explanatory statement to the notice of the meeting

Rule 4(2) of Companies (Share Capital and Debentures) Rules, 2014 states that the explanatory statement to be annexed to the notice of the general meeting in pursuance of section 102 or of a postal ballot in pursuance of section 110 shall contain the following particulars, namely:-

- (a) the total number of shares to be issued with differential rights;
- (b) the details of the differential rights ;
- (c) the percentage of the shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the reasons or justification for the issue;
- (e) the price at which such shares are proposed to be issued either at par or at premium;
- (f) the basis on which the price has been arrived at;
- (g) (i) in case of private placement or preferential issue-
 - (a) details of total number of shares proposed to be allotted to promoters, directors and key managerial personnel;
 - (b) details of total number of shares proposed to be allotted to persons other than promoters, directors and key managerial personnel and their relationship if any with any promoter, director or key managerial personnel;
- (ii) in case of public issue - reservation, if any, for different classes of applicants including promoters, directors or key managerial personnel;
- (h) the percentage of voting right which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- (i) the scale or proportion in which the voting rights of such class or type of shares shall vary;
- (j) the change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;
- (k) the diluted Earning Per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;
- (l) the pre and post issue shareholding pattern along with voting rights as per clause 35 of the listing agreement issued by Security Exchange Board of India from time to time.

Conversion of existing equity share capital into differential voting rights and vice-versa not possible

Rule 4(3) states that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.

Disclosures in the Boards' Report

Rule 4(4) states that the Board of Directors shall, inter alia, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details, namely:-

- (a) the total number of shares allotted with differential rights;
- (b) the details of the differential rights relating to voting rights and dividends;

- (c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- (d) the price at which such shares have been issued;
- (e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;
- (f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;
- (g) the diluted Earning Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;
- (h) the pre and post issue shareholding pattern along with voting rights in the format specified under sub-rule (2) of rule 4.

Rights of holders of equity shares with differential voting rights

Rule 4(5) states that the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

Register of Members to contain the details of equity shareholders having differential voting rights

Rule (6) states that when a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

Let us recapitulate the vital aspects relating to issue of shares with differential voting rights.

- Articles of association to authorise the issue
- An ordinary resolution is to be passed at a general meeting of the shareholders. If listed, approval by shareholders through postal ballot is required.
- It shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- consistent track record of distributable profits for the last three years;
- No default in filing financial statements and annual returns for the last three financial years
- no subsisting default in the payment of a declared dividend or repayment of its matured deposits or redemption of its preference shares or debentures that have become due
- No default in repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
- Not to be penalized by Court or Tribunal during the last three years of any offence under specified legislations.
- Details of the issue to be disclosed in the Board's Report
- Register of Members to contain the details of shares with differential voting rights

REVIEW QUESTIONS

State whether the following statement is “True” or “False”

A listed company has to obtain shareholders' approval through postal ballot or poll at a general meeting for issue of shares with differential voting rights.

True

False

Correct answer: True

ISSUE AND REDEMPTION OF PREFERENCE SHARES

Company cannot issue irredeemable preference shares or redeemable preference shares with the redemption period beyond 20 years

Section 55. (1) states that no company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable. Section 55(2) further states that a company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.

Exceptions

Issue and redemption of preference shares by company in infrastructure projects

Rule 10 states that a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Other conditions attached

Proviso to Section 55(2) states that

- (a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;
- (b) no such shares shall be redeemed unless they are fully paid;
- (c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and
- (d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed. Premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities

premium account, before such shares are redeemed.

- (ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Section 55 (3)¹ when a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

The capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prescriptions under Companies (Share Capital and Debentures) Rules, 2014 with regard to issue and redemption of Preference shares

Conditions

Rule 9(1) states that a company having a share capital may, if so authorised by its articles, issue preference shares subject to the following conditions, namely:-

- (a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
- (b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

Resolution authorising preference shares to set out certain particulars

Rule 9(2) states that a company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely:-

- (a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
- (b) the participation in surplus fund;
- (c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
- (d) the payment of dividend on cumulative or non-cumulative basis.
- (e) the conversion of preference shares into equity shares.

1. To be notified.

- (f) the voting rights;
- (g) the redemption of preference shares.

Explanatory statement to special resolution to set out certain particulars

Rule 9(3) states that the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall, inter-alia, provide the complete material facts concerned with and relevant to the issue of such shares, including-

- (a) the size of the issue and number of preference shares to be issued and nominal value of each share;
- (b) the nature of such shares i.e. cumulative or non - cumulative, participating or non - participating , convertible or non - convertible
- (c) the objectives of the issue;
- (d) the manner of issue of shares;
- (e) the price at which such shares are proposed to be issued;
- (f) the basis on which the price has been arrived at;
- (g) the terms of issue, including terms and rate of dividend on each share, etc.;
- (h) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;
- (i) the manner and modes of redemption;
- (j) the current shareholding pattern of the company;
- (k) the expected dilution in equity share capital upon conversion of preference shares.

Register of Members to contain the particulars of preference share holder(s)

Rule 9(4) states that when a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference share holder(s).

Redemption of preference shares

Rule 9(6) states that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed:-

- (a) at a fixed time or on the happening of a particular event;
- (b) any time at the company's option; or
- (c) any time at the shareholder's option.

PUBLICATION OF AUTHORISED, SUBSCRIBED AND PAID-UP CAPITAL

Section 60 (1) states that when any notice, advertisement or other official publication, or any business letter, billhead or letter paper of a company contains a statement of the amount of the authorised capital of the company, such notice, advertisement or other official publication, or such letter, billhead or letter paper shall also contain a statement, in an equally prominent position and in equally conspicuous characters, of the amount of the capital which has been subscribed and the amount paid-up. Sub-section (2) states that any

default is made in complying with the requirements of sub-section (1), the company shall be liable to pay a penalty of ten thousand rupees and every officer of the company who is in default shall be liable to pay a penalty of five thousand rupees, for each default.

FURTHER ISSUE OF SHARES

Section 62 of the Companies Act provides for the issue of "Rights Shares" and states that whenever at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to the existing holders of equity shares in proportion to the paid-up share capital on their shares at the time of further issue by sending a letter of offer. For listed companies, the information as regards the quantum of such issue and the proportion in which rights shall be offered shall be supplied to the concerned Stock Exchanges in advance.

The company must give notice to each of the equity shareholders, giving him option to take the shares offered to him by the company. The shareholder must be informed of the number of shares he has opted to buy giving him at least 15 days but not more than 30 days to decide. The said notice shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least 3 days before the opening of the issue. If the shareholder does not convey to the company his acceptance of the company's offer of further shares he shall be deemed to have declined the offer. Unless the articles of the company otherwise provide, the directors must state in the notice of offer of rights shares the fact that the shareholder has also the right to renounce the offer in whole or in part, in favour of some other persons.

If a shareholder has neither renounced in favour of another person nor accepted the shares, the Board of directors may dispose of the shares so declined in such manner which is not dis-advantageous to the shareholders and the company.

Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed.

Section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —

- (1) the company in General Meeting passes a special resolution to this effect; and
- (2) the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

The provisions of section 62 are applicable to all types of companies.

The restrictions contained in Section 62 of the Act regarding issue of further shares do not apply to:-

- (a) increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loans raised by the company to convert such debentures or loans into shares in the company [Section 62(3)].

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loans by a special resolution passed by the company in the general meeting.

- (b) conversion of part or whole of the debentures issued to or loans obtained from any Government in shares of the company in pursuance of a direction issued by that Government in public interest on such terms and conditions as appear to be fair and reasonable to the Government even if the terms of issue of such debentures or loans do not contain a term providing for an option for such

conversion.[Section 62(4)].

Provided that where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

In determining the terms and conditions of conversion under section 62(4), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary. [Section 62(5)]

Where the Government has, by an order made under section 62(4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under section 62(4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into. [Section 62(6)]

(It may be noted that Section 62(4), 62(5) and 62(6) are yet to be notified)

CASE LAWS

Judicial Pronouncement relating to further issue of shares by a company

- (a) **Nanalal Zaver v. Bombay Life Assurance Co. Ltd.**, AIR 1950 SC 172: (1950) 20 Com Cases 179:

Section 81 (Corresponding to section 62 of the Companies Act, 2013) is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the directors decide to increase the capital within the authorised limit, by issue of further shares.

The above judgement was followed by the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 51 Com Cases 743 at 816: AIR 1981 SC 1298: (1982) 1 Comp LJ1. The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they does not exercise powers for the benefit of the company but simply and solely for personal aggrandisement and to the detriment of the company, the court will interfere and prevent the directors from doing so.

- (b) See **Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.** The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers or to enable it to comply with statutory requirements.

The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time.

- (c) **Balkrishan Gupta v. Swadeshi Polytex Ltd.** (1985) 58 Com Cases 563: AIR 1985 SC 520].

Although the term 'holders of the equity shares' is used in Sub-section (1)(a) and 'members' in Sub-section (1A)(b) of Section 81 (Corresponding to section 62 of the Companies Act, 2013), the two terms are synonymous and mean persons whose names are entered in the register of members

- (d) In **Worldwide Agencies (P) Ltd. v. Margaret T. Desor**, (1990) 67 Com Cases 607: AIR 1990 SC 737, it was held that persons who have become entitled to the shares of a deceased member can

exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not.

- (e) *Mathalone (R) v. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385: (1954) 24 Com Cases 1. The Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

REVIEW QUESTIONS



Choose the correct answer

Which of the following types of shares are issued by a company to raise capital from the existing shareholders?

- (a) Equity shares
- (b) Rights shares
- (c) Preference shares
- (d) Bonus shares

BONUS SHARES

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras v. A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

Advantages of Issuing Bonus Shares

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

Sources for issue of Bonus shares

According to section 63(1), a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

- (i) its free reserves;
- (ii) the securities premium account; or

(iii) the capital redemption reserve account.

No issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares

In terms of section 63(2), no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

No Bonus shares in lieu of dividend

The bonus shares shall not be issued in lieu of dividend. [Section 63(3)],

SEBI has issued regulations for Bonus Issue which are contained in Chapter IX of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to bonus issues by listed companies. Students may refer to study material ‘Capital Markets and Securities Laws’ for details.

Prescriptions under Companies (Share Capital and Debentures) Rules, 2014 with regard to issue

Rule 14 states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Bonus shares can be issued only if the articles provide for it.

True

False

Correct answer: True

EMPLOYEE STOCK OPTION SCHEME

The term ‘Employee Stock Option’ (ESOP) has been defined under Sub-section (37) of Section 2 of the Companies Act, 2013, according to which “employees’ stock option” means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

As discussed earlier, Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed. Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 with regard to issue of Employee stock options covers issue of ESOPs.

Rule 12 of Companies(Share Capital and Debentures) Rules, 2014 with regard to issue of Employee stock options

A company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines shall not offer shares to its employees under a scheme of employees' stock option (hereinafter referred to as "Employees Stock Option Scheme"), unless it complies with the following requirements, namely:-

- (i) the issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution.

Who is an employee for the purpose of Section 62(1)(b)

- (a) a permanent employee of the company who has been working in India or outside India; or
 - (b) a director of the company, whether a whole time director or not but excluding an independent director; or
 - (c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company
- but does not include-
- (i) an employee who is a promoter or a person belonging to the promoter group; or
 - (ii) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

Disclosures in explanatory statement

Rule 12 (2) states that the company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-

- (a) total number of stock options to be granted;
- (b) identification of classes of employees entitled to participate in the Employees Stock Option Scheme;
- (c) the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;
- (d) the requirements of vesting and period of vesting;
- (e) the maximum period within which the options shall be vested;
- (f) the exercise price or the formula for arriving at the same;
- (g) the exercise period and process of exercise;
- (h) the Lock-in period, if any ;
- (i) the maximum number of options to be granted per employee and in aggregate;
- (j) the method which the company shall use to value its options;
- (k) the conditions under which option vested in employees may lapse e.g. in case of termination of

- employment for misconduct;
- (l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and
 - (m) a statement to the effect that the company shall comply with the applicable accounting standards.

Free pricing in conformity with accounting policies

Rule 12(3) states that the companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

Separate resolution for granting options to employees of holding/subsidiary companies etc in certain cases

Rule 12 (4) states that the approval of shareholders by way of separate resolution shall be obtained by the company in case of-

- (a) grant of option to employees of subsidiary or holding company; or
- (b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

Varying the terms of ESOP requires special resolution

Rule 12(5)(a) The company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interests of the option holders. The notice for passing special resolution for variation of terms of Employees Stock Option Scheme shall disclose full of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.

Minimum one year vesting period

Rule 12 (6)(a) states that there shall be a minimum period of one year between the grant of options and vesting of option. In a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause;

Company has freedom to specify lock-in period

Rule 12(6)(b) states that the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

No right of dividend or voting till exercise of option

Rule 12(6)(c) states that the Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

Forfeiture/refund

Rule 12(7) states that the amount, if any, payable by the employees, at the time of grant of option-

- (a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or
- (b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

Conditions

Rule 12(8) states the following conditions:

- The option granted to employees shall not be transferable to any other person.
- The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- No person other than the employees to whom the option is granted shall be entitled to exercise the option.

Death/permanent disability/resignation of employees who were granted with options

Rule 12(8) states that in the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

Disclosure in the Board's Report

Rule 12(9) states that the Board of directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

- (a) options granted;
- (b) options vested;
- (c) options exercised;
- (d) the total number of shares arising as a result of exercise of option;
- (e) options lapsed;
- (f) the exercise price;
- (g) variation of terms of options;
- (h) money realized by exercise of options;
- (i) total number of options in force;
- (j) employee wise details of options granted to;-

- key managerial personnel;
- any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
- identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

Maintenance of Register

Rule 12(10) states that the company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall forthwith enter therein the particulars of option granted under clause (b) of sub-section (1) of section 62.

The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

Listed companies has to comply with the SEBI guidelines

Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

ISSUE OF SHARES ON PREFERENTIAL BASIS

As discussed earlier, Section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —

- (1) the company in General Meeting passes a special resolution to this effect; and
- (2) the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

Rule 13 of Companies (Share Capital and Debentures) Rules, 2014 makes certain prescriptions with regard to issue of shares on preferential basis.

RULE 13 OF COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014

What is the meaning of Preferential offer?

- The expression 'Preferential Offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities;

Preferential offer by unlisted companies to comply with the rules

- When the preferential offer of shares or other securities is made by a company whose share or other securities are listed on a recognized stock exchange, such preferential offer shall be made in accordance with the provisions of the Act and regulations made by the Securities and Exchange Board, and if they are not listed, the preferential offer shall be made in accordance with the provisions of the Act and rules made hereunder and subject to compliance with the following requirements,

namely:-

- (a) the issue is authorized by its articles of association;
- (b) the issue has been authorized by a special resolution of the members;
- (c) the securities allotted by way of preferential offer shall be made fully paid up at the time of their allotment.
- (d) The company shall make the following disclosures in the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 of the Act:
 - (i) the objects of the issue;
 - (ii) the total number of shares or other securities to be issued;
 - (iii) the price or price band at/within which the allotment is proposed;
 - (iv) basis on which the price has been arrived at along with report of the registered valuer;
 - (v) relevant date with reference to which the price has been arrived at;
 - (vi) the class or classes of persons to whom the allotment is proposed to be made;
 - (vii) intention of promoters, directors or key managerial personnel to subscribe to the offer;
 - (viii) the proposed time within which the allotment shall be completed;
 - (ix) the names of the proposed allottees and the percentage of post preferential offer capital that may be held by them;
 - (x) the change in control, if any, in the company that would occur consequent to the preferential offer;
 - (xi) the number of persons to whom allotment on preferential basis have already been made during the year, in terms of number of securities as well as price;
 - (xii) the justification for the allotment proposed to be made for consideration other than cash together with valuation report of the registered valuer.
- (xiii) The pre issue and post issue shareholding pattern of the company in the prescribed format
- (e) the allotment of securities on a preferential basis made pursuant to the special resolution passed pursuant to sub-rule (2)(b) shall be completed within a period of twelve months from the date of passing of the special resolution.
- (f) if the allotment of securities is not completed within twelve months from the date of passing of the special resolution, another special resolution shall be passed for the company to complete such allotment thereafter.
- (g) the price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer;
- (h) When convertible securities are offered on a preferential basis with an option to apply for and get equity shares allotted, the price of the resultant shares shall be determined beforehand on the basis of a valuation report of a registered valuer and also complied with the provisions of section 62 of the Act;
- (i) When shares or other securities are to be allotted for consideration other than cash, the valuation of such consideration shall be done by a registered valuer who shall submit a valuation report to the company giving justification for the valuation;

- (j) When the preferential offer of shares is made for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company-
- (i) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
 - (ii) where clause (i) is not applicable, it shall be expensed as provided in the accounting standards.

ISSUE OF CAPITAL

ISSUE OF SHARES AT PREMIUM [SECTION 52]

- Share premium to be transferred to share premium account
- Utilisation of share premium account should be as prescribed in section 52

ISSUE OF SHARES AT DISCOUNT [SECTION 53]

- Issue of shares at discount is prohibited except by issue of sweat equity shares
- Any share issued by the company at a discounted price shall be void

ISSUE OF SWEAT EQUITY SHARES [SECTION 54]

- Special resolution – valid for only 12 months from the date of passing the resolution
- Not less than 1 year has elapsed since the date of commencement of business
- Listed companies to comply with SEBI regulations
- Explanatory statement annexed to the notice to state the particulars prescribed under rule 8(2)
- Sweat equity not to exceed 15% of paid up capital or value of 5 crore whichever is higher in a year and not to exceed 25% of paid up equity any time.

ISSUE OF SHARES WITH DIFFERENTIAL VOTING RIGHTS [SECTION 43(a) (ii)]

- Articles to authorise the issue
- Ordinary resolution to be passed and if shares are listed then approval through postal ballot.
- Not to exceed 26% of total post issue paid up equity capital including shares with differential voting rights at any point of time
- The company not to be penalised under specified legislature in last 3 years
- No default in filing financial statements in the last 3 years.
- No default in payment of dividend

ISSUE / REDEMPTION OF PREFERENCE SHARES [SECTION 55]

- Issue to be authorised by special resolution
- Explanatory statement to be annexed to the notice of general meeting containing the relevant material facts
- No company shall issue irredeemable preference shares of redeemable preference shares with the redemption period beyond 20 years.
- Infrastructural companies may issue preference shares for a period exceeding 20 years but not exceeding 30 years

**RIGHT ISSUE/
FURTHER
ISSUE OF
SHARES
[SECTION 62]**

- Listed companies to inform concerned stock exchanges
- Company to give notice to equity shareholder giving him 15-30 days to decide
- Company can issue shares to other than existing share holder for cash or other than cash if a special resolution is obtained
- Price to be determined by the registered valuer's report
- The provisions of section 62 are applicable to all type of companies

**BONUS
SHARES
[SECTION 63]**

- Authorised by articles
- Authorised on recommendation of the board in general meeting
- No default in payment of interest or principle in respect of debt securities and fixed deposits and in respect of payment to employees
- Partly paid up shares to be made fully paid up on allotment
- Listed companies to follow SEBI regulations
- Once announced by the board about bonus issue no company shall withdraw the same

ESOP

RULE 12 OF THE
COMPANIES (SHARE
CAPITAL AND
DEBENTURE)
RULES,2012

- Pass special resolution
- Disclosures to be made in explanatory statement
- Free pricing in conformity with accounting policies
- Separate resolution to be obtained for granting options to employees of holding/subsidiaries
- Minimum 1 year period between grant of options and vesting of option
- Company is free to set lock-in period
- Option granted shall not be transferable, pledged, hypothecated, mortgaged in any manner
- Disclosures to be made in board report
- Register to be maintained in form sh-6
- Listed companies to comply with SEBI guidelines

**PREFERENTIAL
ISSUE**

RULE 13 OF THE
COMPANIES (SHARE
CAPITAL AND
DEBENTURES) RULES,
2014

- Pass special resolution
- Listed company shall follow SEBI regulations
- Issue to be authorised by the articles
- Securities to be made fully paid up on allotment
- Disclosures to be made in explanatory statement to be annexed to the notice of general meeting
- Allotment to get completed within 12 months if not completed a fresh resolution is required
- Price determination by the registered valuer's report

LESSON ROUND-UP

- Share capital of a company can be classified as:
 - (a) nominal, authorized or registered capital;
 - (b) issued and subscribed capital;
 - (c) called up and uncalled capital;
- A share is defined as a share in the share capital of a company, including stock except where a distinction between stock and shares is expressed or implied.
- The Companies Act, 2013 permits a company limited by shares to issue two classes of shares, namely equity share capital and preference share capital.
- A preference share or preference share capital is that part of share capital which carries a preferential right with respect to both dividend and capital.
- Preference shares may be of various types, namely participating and non-participating, cumulative and non-cumulative shares, redeemable and irredeemable preference shares.
- Equity share capital means all share capital which is not preference share capital.
- Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

GLOSSARY

Share Capital	Funds raised by issuing shares in return for cash or other considerations. The amount of share capital a company can change over time because each time a business sells new shares to the public in exchange for cash, the amount of share capital will increase. Share capital can be composed of both common and preferred shares.
Debenture	A formal debt agreement. It refers to both the agreement and the document that verifies it. It is usually issued by companies and is generally supported by security over some property of the debtor. If the debtor defaults, the creditor can take and sell the property. Debentures are often transferable, so the creditor can sell it and there are markets on formal stock exchanges that deal in types of debenture. It is sometimes referred to as debenture stock. A mortgage is a type of debenture but one that is always secured, usually against land.
Redemption of shares	Where a company issues shares on terms stating that they can be bought back by the company. Not all shares can be redeemed, only those stated to be redeemable when they were issued. The payment for the shares must generally come from reserves of profit so that the capital of the company is preserved.
Sweat Equity Share	Sweat equity shares mean equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
Rights Issue	Rights issue is an issue of capital to be offered to the existing shareholders of the company through a letter of offer.
Bonus Share	When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the

existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to the questions are not be submitted for evaluation).

1. Discuss the various kinds of share capital. How is the preference share capital distinguished from equity share capital?
 2. Define and explain the term share. What are the different classes of shares which a company may issue?
 3. State the provisions of the Companies Act, 2013, relating to issue of shares at premium and at discount.
 4. Discuss in brief SEBI Regulations for Public Issue of Shares?
 5. Discuss the procedure for issue of further shares to existing shareholders under Section 62(1) of the Companies Act.
 6. What is the difference between Reserve Capital and Capital Reserve?
 7. Can a company issue shares with differential voting rights? If so, how?

Lesson 7

Alteration of Share Capital

LESSON OUTLINE

- Alteration of company and power of alteration to company.
- Nature of stock and difference between stock and share.
- Reduction of share capital and types of reduction of capital commonly adopted.
- Reduction of share capital without sanction of the Tribunal, reduction when company is defunct, reduction when company is unlimited.
- Diminution of share capital not treated as reduction of share capital.
- Creditor's right to object to reduction and liability of members in respect of reduced share capital.
- Power of company to purchase its own securities (buy-back of securities) and conditions for buy-back.
- Prohibition for buy-back in certain circumstances.
- Companies (Share capital & Debentures) Rules 2014

LEARNING OBJECTIVES

Financial restructuring involves alteration of share capital which includes aspects such as increase of share capital, reduction of share capital, buy back of shares etc.

After reading this lesson you will be able to know about the Regulatory and Procedural aspects involved in alteration of share capital through consolidation, sub-division, reduction of share capital, buy back of shares etc.,

The students may note that the provisions relating to reduction is yet to be notified, where as Provisions relating to buy-back are already notified.

This lesson is based on Companies Act 1956, with respect to reduction of capital and Companies Act 2013 with respect to Buy-back of shares. However provisions of Companies Act 2013 relating to reduction of capital is given for information and reference.

After reading this lesson you will be able to understand the legal and procedural aspects relating to consolidation, sub-division and reduction of capital and buy-back of securities, especially unlisted securities, the procedural aspects of which are covered under Companies (Share Capital and Debentures) Rules 2014.

ALTERATION OF SHARE CAPITAL

Section 61 of the Companies Act, 2013 provides that a company limited by shares or guarantee and having a share capital may, if so authorised by its articles, alter, by an ordinary resolution, its memorandum in the following ways:

- It may increase the authorised share capital by such amount, as it thinks expedient;
- It may consolidate and divide, all or any of its existing shares into a larger denomination than of its existing shares e.g., by consolidating ten shares of Rs10 each into one share of Rs100 each. Proviso to Section 61(1)(b) states that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner; (*Proviso to Section 61(1)(b) is yet to be notified*).
- It may convert all or any of its fully paid-up shares into stock or reconvert that stock into fully paid-up shares of any denomination.
- It may sub-divide its existing shares or any of them into smaller denomination than fixed by its Memorandum but it must keep the existing proportion between the paid-up and unpaid amount e.g., one share of Rs 100 each, Rs 60 paid up and be sub-divided into ten shares of Rs 10 each, Rs 6 paid-up per share.
- It may cancel shares which have not been taken up or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. However, such cancellation of shares will not be deemed to be a reduction of share capital, within the meaning of Section 66 of the Companies Act, 2013. In other words, it is cancellation of unissued share capital not being taken or agreed to be taken up by any person.

In order to alter its capital clause in the Memorandum, the company requires authority in its articles. But if the articles give no power to this effect, the articles must be amended by a special resolution before the power to alter the capital clause can be exercised by the company [*Re. Patent Invert Sugar Co.* (1885) 31 Ch. D. 166]. Further, the power to alter capital clause should be exercised *bona fide* and in the interest of the company and not for the benefit of any group. An ordinary resolution will be enough for altering capital clause in the Memorandum of Association.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Alteration of capital clause of MoA, to be authorized by AoA. If not so, AoA has to be amended.

- True
- False

Correct answer: True

Section 64(1) states that when—

- a company alters its share capital in any manner specified in sub-section (1) of section 61;
- an order made by the Government under sub-section (4) read with sub-section (6) of section 62 has

the effect of increasing authorised capital of a company; or

- (c) a company redeems any redeemable preference shares,

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

Rule 15 of Companies (Share Capital and Debentures) Rules, 2014 states that

When a company alters its share capital in any manner specified in sub-section (1) of section 61, or an order is passed by the Government increasing the authorized capital of the company in pursuance of sub-section (4) read with sub-section (6) of section 62 or a company redeems any redeemable preference shares, the notice of such alteration, increase or redemption shall be filed by the company with the Registrar in Form No. SH.7 along with the fee.

As per Section 64(2) Contravention in this case will make the company and every officer of the company who is in default liable to a fine extending up to ₹ 1000 per day during which the default continues or ₹ 5 lakh, whichever is less (Section 64).

Review question

Does the company require to file notice of alteration (Form No. SH7) when they redeem preference shares?

Ans: yes.

WHEN SHARE CAPITAL STANDS AUTOMATICALLY INCREASED?

Under Section 64 read with section 62 of the Act, the share capital of a company stands automatically increased when any Government, by its order made under Section 62(4) of the Act, directs that any debentures issued to, or the loans obtained from the Government by a company or any part thereof shall be converted into shares in the company, on such terms and conditions as are considered by that Government to be reasonable in the circumstances.

However, where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

Where the Government has, by an order made under section 62(4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under that section or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into. [Section 62(6)].

(Subsection (4) to Subsection (6) of Section 62 is yet to be notified)

CASE LAWS

Judicial Pronouncement about a company's power to alter its share capital

1. The powers under Section 95 of the Act [Corresponds to section 61 of the Companies Act, 2013] can be exercised by the members only if authorised by the articles. *In Re North Cheshire Brewery Co., 1920 WN 149. Re Metropolitan Cementry Co., (1934) SC 65*

2. The power should be exercised *bona fide* in the interest of the company and not for benefiting any group. [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981) 1 Com Cases 743 (SC)].
3. The consent of meeting of classes of shareholders will not be required as the increase of any kind of share capital cannot be said to 'vary' or 'affect' class rights. The increased capital may consist of preference shares, provided that this is not inconsistent with rights given by the Memorandum of Association. [*Andrews v. Gas Meter Co.* (1897) 1 Ch 361: (1895) All Eng. Rep 1280 (CA)].
4. The notice convening the meeting to pass the resolution for increase must specify the amount of the proposed increase. [*Mac Connell v. E. Prill & Co. Ltd.*, (1916) 2 Ch 57 : (1916-17) All Eng. Rep Ext 1344].
5. Where shares were issued beyond the authorised amount and a resolution was subsequently passed at a general meeting ratifying the issue, it was held that although the original issue was not in accordance with the articles, the ratification was effective and the allottees were bound [*Sewell's case* (1868) 3 Ch App 131].
6. Consolidation and sub-division may be effected by the same resolution [*North Cheshire Borewery Co. Ltd.*]
7. In this case it was held that cancellation of unissued shares or of shares issued but not taken up by any person, may be effected without seeking confirmation of the Court. [*Castiglione Erskine & Co. Ltd.*, (1958) 2 All ER 455 : (1958) 28 Com Cases 452 (Ch D),
8. Under Section 94(1) [Corresponding to section 61(1) of the Companies Act, 2013] it is open to a limited company to cancel shares which have not been taken or agreed to be taken by any person but a resolution for such cancellation is required to be passed by the company in general meeting under Section 94(2) [*Surendra Maganlal Mehta v. Reliance Textile Ind. Ltd.*, (1982) 3 Comp LJ 103 (Bom)].
9. It is not the function of the Court to interfere with the Company's power to consider a resolution for cancelling the unissued portion of its share capital. The exercise of power by a company to cancel the unissued shares cannot be restrained by an injunction [*Swindon Town Football Co. Ltd.*, 1990 BCAC 467 (Ch D)].
10. Fee paid to the ROC for registering increase of capital is in the nature of capital expenditure irrespective of the fact whether an increased capital will lead to increase in profits. [*Punjab State Industrial Development Corpn. Ltd. v. CIT*, (1997) 26 Corpt LA 333 : (1997) 10 SCC 184]

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Fee paid to ROC for registering the increase of capital is a capital expenditure.

- **True**
- **False**

Correct answer: True

NATURE OF STOCK

Section 61 allows the company to convert its fully paid-up shares into stock, and it is, therefore, important to understand the nature of stock and the advantages which it may have.

Section 2(84) of the Act in defining a share, states that "share means a share in the share capital of a company and includes stock". Thus by converting shares into stock, a shareholder is known as a stockholder. A stockholder has the same rights as to dividends as a shareholder.

It should be noted that (i) only fully paid-up shares can be converted into stock, and (ii) no direct issue of stock by a company is lawful. It is only the conversion of fully-paid shares into stock, that is allowed by Section 61(1)(c) and not a direct issue of stock.

After shares are converted into stock, the stockholder may own ₹1,000 worth of stock where formerly he held one hundred shares of ₹10 each. Thus, though his investment in the company remains the same, the interest of the stockholder in the company is described differently.

DIFFERENCE BETWEEN SHARE AND STOCK

S.No	Share	Stock
1	Shares in physical form bear distinct numbers	Stocks are the consolidated value of share capital
2	Shares may or may not be fully paid-up	Stock is always fully paid-up
3	Shares have a nominal value	Stock does not have any nominal value
4	All shares are of equal denomination	Denomination of stocks varies
5	It is not possible to transfer shares into fraction	Stock is divisible into any amount required. Thus, it is possible to transfer even into fractions
6	Shares comes into existence before the stock and it is issued initially	Stock comes into existence after conversion of shares into stock and on conversion of shares into stock, the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Only fully paid-up shares can be converted into stock.

- True
- False

Correct answer: True

REDUCTION OF SHARE CAPITAL (SECTION 66)(SECTION 66 IS YET TO BE NOTIFIED)

REDUCTION OF CAPITAL TO BE APPROVED BY SPECIAL RESOLUTION AND CONFIRMED BY THE TRIBUNAL [SECTION 66(1)]

(1) Subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any

manner and in particular, may—

- (a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- (b) either with or without extinguishing or reducing liability on any of its shares,—
 - (i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
 - (ii) pay off any paid-up share capital which is in excess of the wants of the company,

alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

No Reduction of Capital would be allowed in case of Arrears In the Repayment of Deposits and Interest thereon [Proviso to Section 66(1)].

It may be noted that reduction of capital shall not be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

NOTICE BY TRIBUNAL [SECTION 66(2)]

The Tribunal shall give notice of every application made to it under sub-section (1) to

- the Central Government,
- Registrar
- the Securities and Exchange Board, in the case of listed companies, and
- the creditors of the company

It shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice.

If no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction [Proviso to Section 66(2)]

CONFIRMATION OF REDUCTION OF CAPITAL [SECTION 66(3)]

The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit:

No sanction for reduction unless complied with accounting standards.

Proviso to Section 66(3) provides that –

No application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

PUBLICATION OF THE ORDER OF THE TRIBUNAL [SECTION 66(4)]

The order of confirmation of the reduction of share capital by the Tribunal under Section 66(3) shall be published by the company in such manner as the Tribunal may direct.

DELIVER A COPY OF ORDER OF TRIBUNAL TO REGISTRAR(SECTION 66(5))

The company shall deliver a certified copy of the order of the Tribunal under subsection (3) and of a minute¹ approved by the Tribunal showing—

- (a) the amount of share capital;
- (b) the number of shares into which it is to be divided;
- (c) the amount of each share; and
- (d) the amount, if any, at the date of registration deemed to be paid-up on each share,

to the Registrar within thirty days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

Difference in Alteration of share capital and reduction of share capital

S.No.	Alteration of share capital	Reduction of share capital
1	Alteration of share capital is governed by the provisions of section 61 of the Companies Act, 2013.	Reduction of share capital is governed by the provisions of section 66 of the Companies Act, 2013.
2	Alteration of share capital is required to be done by ordinary resolution.	Reduction of share capital is required to be done by special resolution.
3	Alteration of share capital is not required to be confirmed by the Tribunal.	Reduction of share capital is to be confirmed by the Tribunal.
4	Alteration of share capital may be done in the following manner:- <ul style="list-style-type: none"> (a) Increasing its nominal capital by issuing new shares (b) Consolidating and dividing all or any of its share capital into shares of large denomination (c) Converting fully paid up shares into stock or vice versa (d) Sub dividing its shares or any of them into shares of smaller amount (e) Canceling shares which have not been taken up and diminishing the amount of share capital by the amount of the shares so cancelled. 	Reduction of share capital may be done in the following manner:- <ul style="list-style-type: none"> (a) Extinguishing or reducing the liability of members in respect of the capital not paid up (b) Writing off or canceling any paid up capital which is in excess of the needs of the company (c) Paying off any paid up share capital which is in excess of the needs of the company

Diminution of share capital is not a reduction of capital

Diminution of capital — As per section 61(1)(e) of the Companies Act, 2013 (enforced), diminution of capital is the cancellation of the unsubscribed part of the issued capital . It can be effected by an ordinary resolution provided articles of the company authorises to do so. According to section 61(2),

¹ Means document submitted to Tribunal detailing the reduction and approved by the tribunal. Here the word minute has different meaning from the word minutes used for proceedings.

cancellation of shares under section 61(1) shall not be deemed to be reduction of share capital. It does not need any confirmation of the Tribunal under section 66.

- (d) Redemption of redeemable preference shares.
- (e) Purchase of shares of a member by the Company on order of the Tribunal under Section 242 of Companies Act, 2013 (yet to be enforced).
- (f) Buy-back of its own securities under Section 68.

In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

- (i) Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 61(1)(e) Companies Act, 2013];
- (ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 55 [Explanation to section 55(3) Companies Act, 2013];
- (iii) Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital;
- (iv) Where the company buys-back its own shares under Section 68 of the Act [Section 66(6) (yet to be enforced)];
- (v) Where the reduction of share capital is effected in pursuance of the order of the Tribunal sanctioning any compromise or arrangement under section 230 (yet to be notified).

In all these cases, the procedure for reduction of capital as laid down in Section 66 is not attracted.

REDUCTION OF SHARE CAPITAL UNDER COMPANIES ACT 1956

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company. The share capital of a company may be reduced u/s 100 only if the articles of the company authorize so. If there is no such clause in the articles, the articles must be amended by a special resolution for giving the power of reducing the share capital.

As per Section 100 of the Companies Act, 1956 Subject to confirmation by the court, a company limited by shares or a company limited by guarantee and having a share capital may, ***if authorized by its articles, by special resolution,*** reduce its share capital in any way and in particular and without prejudice to the generality of the forgoing power, may:

1. Reduce or extinguish the liability on any of its shares in respect of share capital not paid up e.g., where the shares are of ₹100 each with ₹75 paid-up reduce them to ₹75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of ₹25 per share;
2. Either with or without extinguishing or reducing liability on any of its shares, cancels any paid up share capital which is lost, or is unrepresented by available assets or
3. Either with or without extinguishing or reducing liability on any of its shares, pay off any paid up share capital which is in excess of the wants of the company where the shares are fully paid-up, reduce them to ₹75 each and pay back, ₹25 per share, and
4. by following a combination of any of the preceding methods.

REVIEW QUESTIONS**State whether the following statement is “True” or “False”**

Reduction of capital is to be authorized by AoA.

- True
- False

Correct answer: True

CASE LAWS**Judicial Pronouncement about reduction of Share capital of a company**

1. **SIEL Ltd., In re. [(2008) 144 Com Cases 469 (Del)]**, the view was that reduction of the share capital of a company is a domestic concern of the company and the decision of the majority would prevail. If the majority by special resolution decides to reduce the share capital of the company, it has the right to decide to reduce the share capital of the company and it has the right to decide how this reduction should be effected. While reducing the share capital, the company can decide to extinguish some of its shares without dealing in the same manner with all other shares of the same class. A selective reduction is permissible within the frame work of law for any company limited by shares.
2. **Indian National Press (Indore) Ltd., In re. (1989) 66 Com Cases 387, 392 (MP)** The need for reducing capital may arise in various circumstances for example trading losses, heavy capital expenses and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a capital may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.
3. **Elpro International Ltd., In re [(2009) 149 Com Cases 646 (Bom.)]**, a company proposed to extinguish and cancel 8,89,169 shares held by shareholders constituting 25 per cent, of the issued and paid up share capital and return capital to such shareholders at ₹183 per equity share of ₹10 each so cancelled and extinguished in accordance with Section 100 of the Act (corresponds to section 66 of the Companies Act, 2013). According to the scheme as approved by the shareholders, the reducing of 25 percent, of the issued and paid up capital was to take place from amongst 3,835 share holders which included 112 shareholders who voted for the resolution, and 3,723 shareholders who did not object to the resolution. It was held that a selective reduction of share capital is legally permissible. The shareholders who did not cast their votes were those who had abstained from voting at the meeting. Moreover, there was no objection from any of the shareholders to the proposed reduction.
4. **British and American Trustee and Finance Corp. v. Couper, (1894) AC 399, 403: (1991-4) All ER Rep 667.** The Act does not prescribe the manner in which the reduction of capital is to be effected. Nor is there any limitation of the power of the Court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured.
5. **British and American Trustee Corp. v. Couper, (1894) (ibid)** When exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short the Court shall consider the following, while sanctioning the reduction:

- (i) The interests of creditors must be safeguarded;
- (ii) The interests of shareholders must be considered; and
- (iii) Lastly, the public interest must be considered as well.

6. **Borough Commercial and Bldg. Society, (1893) 2 Ch 242. Reduction in shares capital of an unlimited company :** An unlimited company to which Section 100 (corresponds to section 66 of the Companies Act, 2013) does not apply, can reduce its capital in any manner that its Memorandum and Articles of Association allow. It is not governed by Sections 61 and 66 of the Act. Section 13 (corresponds to section 4 of the Companies Act, 2013) does not provide that its capital shall be stated in the Memorandum. However, even if its capital is stated in the Memorandum, the Companies Act impliedly gives power to the member to alter it.
7. **Great Universal Stores Ltd., Re (1960) 1 All ER 252: (1960) Reduction of capital when company is defunct:** The Registrar of Companies has been empowered under Section 560 (corresponds to section 248 of the Companies Act, 2013) to strike off the name of the company from register on the ground of non-working. Therefore, where the company has ceased to trade, and Registrar exercises his power under Section 560 (corresponds to section 248 of the Companies Act, 2013) a reduction of capital cannot be prevented.
8. **Marwari Stores Ltd. v. Gouri Shanker Goenka, (1936) 6 Com Cases 285. Equal Reduction of Shares of One Class:** Where there is only one class of shares, *prima facie*, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalising the amount so paid-up. The same principle is to be followed where there are different classes of shares [Bannatyne v. Direct Spanish Telegraph Co., (1886) 34 Ch D 287].
9. **Asian Investments Ltd. Re, (1992) 73 Com Cases 517, 523 (Mad).** It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly where reduction is not involved Section 100 (corresponds to section 66 of the Companies Act, 2013) would not be attracted.

REDUCTION OF SHARE CAPITAL WITHOUT SANCTION OF THE COURT

The following are cases which amount to reduction of share capital and where no confirmation by the Tribunal is necessary:

- (a) **Surrender of shares** — “Surrender of shares” means the surrender to the company on the part of the registered holder of shares already issued. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [Collector of Moradabad v. Equity Insurance Co. Ltd., (1948) 18 Com Cases 309: AIR 1948 Oudh 197]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from further liability on shares.

The Companies Act contains no provision for surrender of shares. Thus, surrender of shares is valid only when Articles of Association provide for the same and:

- (i) Where forfeiture of such shares is justified; or
- (ii) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. But in the former case, it is at the initiative of company and in the latter case at the initiative of member or shareholder.

- (b) **Forfeiture of shares** — A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal.

Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised *bona fide* and in the interest of the company.

Creditors' Right to Object to Reduction

After passing the special resolution for the reduction of capital, the company is required to apply to the Court by way of petition for the confirmation of the resolution under Section 101. Where the proposed reduction of share capital involves either (i) diminution of liability in respect of unpaid share capital, or (ii) the payment to any shareholder of any paid-up share capital, or (iii) in any other case, if the Court so directs, the following provisions shall have effect:

The creditors having a debt or claim admissible in winding up are entitled to object. To enable them to do so, the Court will settle a list of creditors entitled to object. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured. The Court, in deciding whether or not to confirm the reduction will take into consideration the minority shareholders and creditors.

A Company might decide to return a part of its capital when its paid-up share capital is in excess of its needs. It is not simply handed over to shareholders in proportion to their holdings. Their class rights will be considered with the Court treating the reduction as though it was analogous to liquidation. Therefore, the preference shareholders who have priority to return of capital in liquidation will be the first to have their share capital returned to them in a share capital reduction, even if they prefer to remain members of the company.

Confirmation and Registration of reduction of share capital

Section 102 of the Act states that if the Court is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been determined, discharged, paid or secured, it may confirm the reduction. The Court may also direct that the words "and reduced" be added to the company's name for a specified period, and that the company must publish the reasons for the reduction, and the causes which led to it, with a view to giving proper information to the public.

The Court's order confirming the reduction together with the minutes giving the details of the company's share capital, as altered, should be delivered to the Registrar who will register them. The reduction takes effect only on registration of the order and minutes, and not before. The Registrar will then issue a certificate of registration which will be a conclusive evidence that the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be altered accordingly.

Conclusiveness of certificate for reduction of capital

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd.*, (1903) 88 LT 792 (Ch D)]. Similarly, in a case the special resolution for reduction was an invalid one, but the company had gone through with the reduction. It was held that the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook*, (1900) 2 QB 376].

BUY BACK OF SECURITIES(SECTION 68)

Sources

According to Section 68(1) of the Companies Act, 2013 a company may purchase its own shares or other specified securities (hereinafter referred to as “buy-back”) out of:

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

Authorisation (Section 68(2))

The primary requirement is that the articles of association of the company should authorise buyback. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buy-back. Buy-back can be made with the approval of the Board of directors at a board meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

Quantum (Section 68(2))

- (a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buy back has to be authorized by the board by means of a resolution passed at the meeting.
- (b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution upto 25% of total equity capital in that year.

Let us remember!!!

- Board can authorise buy back upto 10% equity capital and free reserves in a resolution passed at the Board Meeting
- Shareholders can authorize buy back by special resolution upto 25% of the total paid-up capital and free reserves of the company and in a financial year, upto 25% of total equity capital in that year.

Special Resolution to be accompanied by Explanatory Statement (Section 68(3))

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

- (a) a full and complete disclosure of all material facts;
- (b) the necessity for the buy-back;
- (c) the class of shares or securities intended to be purchased under the buy-back;

- (d) the amount to be invested under the buy-back; and
- (e) the time-limit for completion of buy-back.

Rule 17(1) Companies (Share Capital and Debentures) Rules, 2014 states that explanatory statement to contain certain disclosures

Explanatory statement to the special resolution authorising buy-back, to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following disclosures:

- (a) the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
- (b) the objective of the buy-back;
- (c) the class of shares or other securities intended to be purchased under the buy-back;
- (d) the number of securities that the company proposes to buy-back;
- (e) the method to be adopted for the buy-back;
- (f) the price at which the buy-back of shares or other securities shall be made;
- (g) the basis of arriving at the buy-back price;
- (h) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed
- (i) the time-limit for the completion of buy-back;
- (j)
 - (i) the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
 - (ii) the aggregate number of equity shares purchased or sold by persons mentioned in (i) above during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
 - (iii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant date;
- (k) if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back –
 - (i) the quantum of shares proposed to be tendered;
 - (ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition.
- (l) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;
- (m) a confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-
 - (i) that immediately following the date on which the general meeting is convened there will be no grounds on which the company could be found unable to pay its debts;

- (ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
 - (iii) in forming their opinion for the above purposes, the directors have taken into account the liabilities(including prospective and contingent liabilities); as if the company were being wound up under the provisions of the Companies Act, 2013.
- (n) a report addressed to the Board of directors by the company's auditors stating that:
- (i) they have inquired into the company's state of affairs;
 - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;
 - (iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document, and
 - (iv) the Board of directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date;

Letter of Offer to be Filed with Registrar of Companies before Buy-Back(Rule 17(2))

The company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in **Form No SH 8**, along with the fee as prescribed. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

Dispatch of letter of offer to shareholders(Rule 17(4))

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

Offer for buy back open for(Rule 17(5))

The offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

Post buy-back debt-equity ratio not to exceed 2:1(Section 68(2)(d))

The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

Shares/Securities being Bought Back are to be Fully Paid up(Section 68(2))

All the shares or other specified securities for buy-back are to be fully paid-up.

Time gap between two buybacks (proviso to Section 68(2))

No offer of buy-back under Section 68(2) shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

Time limit for completion of buyback (Section 68(4))

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

Methods of buy-back(Section 68(5))

The buy-back under sub-section (1) may be—

- (a) from the existing shareholders or security holders on a proportionate basis;
- (b) from the open market;
- (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Filing Declaration of Solvency with SEBI/ROC as the case may be (Section 68(6) read with Rule 17(3) of Companies Share Capital & Debentures) Rules, 2014.

When a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution or board resolution as the case may be , it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board(in case of listed companies), a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in Form No. SH.9 and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board.

Extinguishment of securities bought backSection 68(7)

When a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

Prohibition of further issue of shares or securities(Section 68(8))

When a company completes a buy-back of its shares or other specified securities it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Register of buy-back(Section 68(9))

When a company buys back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

Return of buyback(Section 68(10))

A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (in case of listed companies) a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed:

Rule 17(14) of Companies(Share Capital and Debentures) Rules 2014 states that there shall be annexed to

the return filed with the Registrar in Form No. SH.11, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

Punishments(Section 68(11))

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer to and application of Capital Redemption Reserve Account(Section 69)

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Circumstances prohibits buy-back(Section 70(1))

No company shall directly or indirectly purchase its own shares or other specified securities—

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist. (Proviso to Section 70(i))

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92(Annual Return), 123(Declaration of Dividend), 127(punishment for failure to distribute dividend) and section 129(Financial Statement).

Test yourself:

Can “Share premium account” be used for buy back of Shares?

Ans: Yes.

LESSON ROUND-UP

- A company limited by shares or guarantee and having a share capital may alter its share capital in any of the ways provided under the Companies Act. These powers can be exercised by the members in general meeting only if authorized by the articles.
- Reduction of capital means reduction of issued, subscribed or paid-up share capital of the company. Various modes of reduction have been laid down in the Companies Act.

- A company limited by shares or a company limited by guarantee and having a share capital may, by a special resolution and subject to its confirmation by the Tribunal on application by the company, reduce its share capital. While sanctioning such reduction, interests of creditors, shareholders and public should be safeguarded.
- Surrender of shares, forfeiture of shares, diminution of capital, redemption of redeemable preference shares, purchase of shares of a member by the company on order of the Tribunal, buy-back of own shares amount to reduction of share capital but no confirmation by the Tribunal is necessary.
- Where the company has ceased to trade and Registrar exercises his power to strike off the name of the company from the register on the ground of non-working, a reduction of capital cannot be prevented.
- Where the directors are required to hold qualification shares, care must be taken that the effect of a reduction does not disqualify any director.
- The creditors having a debt or claim against the company are entitled to object in reduction. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured.
- The Registrar's certificate on confirmation of reduction will be conclusive evidence that the requirements of the Act have been complied with.
- Certain provisions introduced in the Companies Act allow the companies to buy-back their own shares, subject to the conditions and in any of the modes provided therein. They also provide for prohibition for buy-back in certain circumstances.

GLOSSARY

Stock	Stock is always fully paid-up. These are the consolidated value of share capital. They come into existence after conversion of shares into stock and on conversion of shares into stock, the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock.
Reduction of Share Capital	Reduction of share capital means reduction of issued, subscribed and paid-up share capital of the company. The share capital of a company may be reduced by passing a special resolution and subject to confirmation by the Tribunal on an application by the company.
Surrender of Shares	Surrender of shares means the surrender to the company on the part of the registered holder of shares already issued.
Forfeiture of shares	A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal.
Diminution of capital	Diminution of capital is the cancellation of the unsubscribed part of the issued capital. It can be affected by an ordinary resolution provided articles of the company authorise to do so. It does not need any confirmation of Court.
Buyback of shares	The repurchase of shares by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available (reducing supply), or to eliminate any threats by shareholders who may be looking for a controlling stake.
Alteration of share capital	Any increase, any consolidation and division, any conversion into stock or stock to shares, any sub-division or cancellation of shares is known as alteration of share capital.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Distinguish between share and stock.
 2. What are the methods for reduction of share capital of a company?
 3. How can a company reduce its share capital without sanction of the Tribunal?
 4. Write short notes on:
 - (i) Diminution of share capital
 - (ii) Surrender of shares
 - (iii) Forfeiture of shares
 5. Explain in detail, the provisions as regards buy-back of securities by the companies.

Lesson 8

Private Placement and Prospectus

LESSON OUTLINE

- Meaning and definition of prospectus.
- Private placement
- Public offer
- Matters to be disclosed in the prospectus.
- Reports to be set out in the prospectus
- Shelf Prospectus and Red-herring prospectus.
- Liability for untrue statement.
- Remedies for misrepresentation in prospectus.
- Penalty for fraudulently inducing to invest money.
- Prohibition of personation for acquisition of securities.

LEARNING OBJECTIVES

Prospectus is a disclosure document inviting public, to subscribe for the securities of the company, to enable the investors to take rational investment decisions and to protect their rights, by giving various material facts and prospects about the company.

Chapter III of Companies Act, 2013 covers procedural aspects as to private placement , which are dealt in Part II of Chapter III and Part I covers and procedural aspects relating to public offer which include registration of prospectus, its' format, disclosures, remedy against misstatement in prospectus, civil/criminal liabilities of directors, penalty for fraudulent inducement to purchase securities etc.

After reading this lesson you will be able to understand the meaning of prospectus, shelf prospectus information memorandum and red-herring prospectus along with relevant provisions under the Companies Act including disclosures, approval, penalties etc.

MEANING AND DEFINITION OF PROSPECTUS

Section 2(70) of the Companies Act, 2013 defines a prospectus as “any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.”

On the basis of aforesaid definition, it may be said that a document should have following ingredients to constitute a prospectus:

- (a) There must be an invitation to the public;
- (b) The invitation must be made “by or on behalf of the company or in relation to an intended company”;
- (c) The invitation must be “to subscribe or purchase”;
- (d) The invitation must relate to any securities of the company.

INVITATION TO PUBLIC

In essence, it means that a prospectus is an invitation issued to the public to offer for purchase/subscribe any securities of the company. A document is deemed to be issued to the public, if the invitation to subscribe for share capital is such as to be open to any one who brings his money and applies in prescribed form, whether the prospectus was addressed to him or not. The test is not who receives the document, but who can apply for the securities in response to the invitation contained in it.

However, an issue will not be “Public” if-

- (i) It is directed to a specified person or a group of persons, and
- (ii) It is not calculated to result in the securities becoming available to other persons.

CASE LAWS

Some important judicial pronouncement about an invitation to be termed as an invitation to public

- (A) Advertisement in news paper to invite application for purchase of remaining shares of a company is prospectus (*Pramatha Nath Sanyal v. Kali Kumar Dutt*, A.I.R. 1925 Cal. 714). In this case directors were penalized for not complying with the requirements of filing a copy thereof with Registrar of Companies.
- (B) A single private communication does not satisfy the term “issue” [*Nash v. Lynde* (1929) A.C. 158]. In this case, several copies of a document marked “strictly confidential” and containing particulars of a proposed issue of shares, were sent accompanied with application form by the managing director who, in turn, gave it to a client who passed it on to a relation. Thus, the document was passed on privately through a small circle of friends of the directors. The House of Lords held that there had been no issue to the public and any action for compensation by the allottee for loss sustained by reason of an omission in the document, failed.
- (C) In *Rattan Singh v. Managing Director, Moga Transport Co. Ltd.* (1959) 29 Com Cases 165 it was held that offer to buy one's kith and kin cannot be considered to be an invitation to public. Offer to buy shares made to an individual as such is not within the definition of the word public as used in Section 67 (Corresponds to section 23 and 42 of the Companies Act, 2013).

- (D) In the case of *Govt. Stock and Other Securities Investment Co. Ltd. v. Christopher*, (1956) I.W.L.R. 237 it was held that a circular issued by a company to the shareholders of other companies to acquire their shares held in those companies and issue its own shares in exchange of those shares did not amount to be a prospectus, as there is no public issue. It was pointed out that the circular did not involve an offer for the purchase of any shares. The shares in question were unissued shares of new company, so that they could not be the subject of an offer for purchase. Thus, the circular was not a prospectus, but only the communication of an offer to exchange shares in the new company for shares in the other existing companies.
- (E) In *Re. South of England Natural Gas and Petroleum Co. Ltd.*, (1911) 1 Ch. 573 it was held that "Public" is a general word, and includes any section of the public. If a document inviting persons to buy shares is issued, for example, to all advocates, or to all doctors, or to all foreigners living in India, or to all Indian citizens, or to all shareholders in a particular company, it will still be deemed to be issued to the public within the meaning of the Act. In the aforesaid case, 3,000 copies of a document in the form of a prospectus were sent out and distributed among the members of certain gas companies only. It was held that the document so sent and distributed was a prospectus issued to the public.

PROVISIONS OF COMPANIES ACT, 2013 WITH RESPECT TO PROSPECTUS

Public Offer and Private Placement

Chapter III (Section 23 to Section 42) of the Companies Act, 2013 deals with prospectus and allotment of securities. It is divided into 2 parts.

- Part I deals with public offer and
- Part II deals with private placement.

According to section 23(1), a public company may issue securities—

- (a) to public through prospectus (herein referred to as "public offer") by complying with the provisions of this Part(i.e Part I); or
- (b) through private placement by complying with the provisions of Part II of this Chapter; or
- (c) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Section 23(2) lays down that a private company may issue securities—

- (a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or
- (b) through private placement by complying with the provisions of Part II of this Chapter.

As per explanation to section 23, for the purposes of Chapter III, "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

PRIVATE PLACEMENT

As per Explanation II(ii) to Section 42(2), "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42.

Private placement offer letter

Section 42(1) provides that without prejudice to the provisions of section 26(dealing with matters to be stated in the prospectus) a company may, subject to the provisions of this section, make private placement through issue of a private placement offer letter in Form PAS-4.(Refer to Rule 14 of Companies (Prospectus and Allotment of Securities) Rules 2014)

The company has to issue private placement offer letter in Form PAS-4

Maximum number of persons to whom offer can be made and other incidental matters

As per section 42(2), the offer of securities or invitation to subscribe securities i.e. private placement, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, [excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62], in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

Rule 14(2)(b) of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year.

Any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

For the purposes of this sub-rule, it is hereby clarified that -

- (i) the restrictions under sub-clause (b) would be reckoned individually for each kind of security that is equity share, preference share or debenture;

Rule 14(2)(c) states that the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;

Rule 14(2)(d) states that the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received.

Monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

Private placement to be approved by special resolution

Rule 14(2) of Companies (Prospectus and Allotment of Securities) Rules, 2014

The rule states that a company shall not make a private placement of its securities unless -

- (a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations:

Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed:

Provided further that in case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

No fresh offer, in case of earlier offer being withdrawn, pending allotments with respect to earlier offer etc.,

Section 42(3) states that no fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

Rule 14(2)(b)((ii) of Companies (Prospectus and Allotment of Securities) Rules, 2014

The explanation to Rule 14(2)(b)(ii) states that the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;

Private placement under section 42 to be treated as public offer if conditions prescribed there under is not fulfilled

Sub-section(4) of section 42 states that any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

Mode of payment of subscription money

Section 42(5) states that all monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

Time limit for allotment and payment of interest/refund of subscription money otherwise

Section 42(6) states that a company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day:

Subscription money to be kept in a separate bank account

Proviso to Section 42(6) states that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to allot securities.

Offer to be made specifically addressing persons

Section 42(7) states that Private Placement shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such person shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

Rule 14(1)(b)of Companies (Prospectus and Allotment of Securities) Rules, 2014

Rule 14(1)(b) states that a private placement offer letter shall be accompanied by an application form serially

numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons in accordance with sub-section (7) of section 42:

Proviso to Rule 14(l)(b) states that no person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

No public advertisements for private placement

Section 42(8) states that no company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

Return of allotment

Section 42 (9) states that whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Rule 14 (4) of Companies (Prospectus and Allotment of Securities) Rules, 2014

Rule 14 (4) states that a return of allotment of securities under section 42 shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing-

- (i) the full name, address, Permanent Account Number and E-mail ID of such security holder;
- (ii) the class of security held;
- (iii) the date of allotment of security ;
- (iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

Maintenance of Record of Private Placement offer

Rule 14(3) of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that the company shall maintain a complete record of private placement offers in Form PAS-5. A copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

Penalty

Section 42 (10) states that if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

PRIVATE PLACEMENT

An Offer or invitation for subscription to securities through issue of private placement

- Offer Letter to be in Form No. PAS-4
- The offer letter with application form under 42(7) to be specifically addressed to persons whom the offer is made within 30 days of recording their name
- The offer shall not be made to more than 200 persons excluding QIBs and the employees of the company in a financial year under the scheme of ESOS only the person addressed in the application can apply
- All monies payable on subscription shall not be paid by cash.
- The company making invitation shall allot the securities within 60 days from the date of receipt of allotment
- If unable to allot within 60 days then repay the money in 15 days from the end of those 60 days and money shall be refunded with interest @12%p.a.
- Money received shall be kept in a separate bank account in a scheduled bank.

Record of offer

-Offer only to be made to those whose names are recorded by the company
 -The record shall be kept in Form No. PAS-5
 -A copy of record to be filed with registrar along with PAS-4 and with SEBI and the stock exchange within 30 days

Information of the offer to be made to registrar

Within 30 days of circulation of private placement offer letter inform Registrar

Prohibition of advertisement of private placement offer

The company shall not use:

- Any public advertisement
- Any media marketing or distribution channels
- Or any agents

 to advertise private placement offer

Return of allotment to be filed with Registrar

Return of allotment of securities under section 42 in Form No. PAS-3 to be filed with registrar within 30 days along with fee

Violation of section 42

Punishments for violation:
 Company, Promoters, and directors shall be liable for penalty which may extend to the amount involved in the offer or Rs. 2 crore, whichever is higher.
 -Company to refund all monies to subscribers within 30 days of the order levying penalty

PUBLIC OFFER**What is Public Offer?**

Explanation to Section 23 states that for the purposes of Chapter III, "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

Deemed Prospectus

Section 25(1) states that when a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public,

- any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company; and
- all enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply with the modifications specified in subsections (3) and (4) and shall have effect accordingly, as if the securities had been offered to the public for subscription and as if persons accepting the offer in respect of any securities were subscribers for those securities, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof.

Section 25(2) states that unless the contrary is proved, it shall be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

- (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or
- (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

As per section 25(3); section 26 as applied by this section shall have effect as if —

- (i) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—
 - (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
 - (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;
- (ii) the persons making the offer were persons named in a prospectus as directors of a company.

Section 25(4) states that where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the abovesaid document is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be.

Unless the contrary is proved, it shall be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

- (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or

- (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

Matters to be stated in the prospectus

Section 26(1) states that every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state the information, stated in the following table.

As regards to the matters prescribed in the prospectus the company has to comply with Section 26(1) read with Rule 3 of Companies (Prospectus and Allotment of Securities) Rules 2014. Accordingly the company has to comply with the disclosure requirements prescribed under Section 26(1) of the Act and Rule 3.

<i>What is to be disclosed in the prospectus as per Provisions of Section 26(1)?</i>	<i>What is prescribed under Rule 3 of Companies (Prospectus and Allotment of Securities) Rules, 2014 with respect to such disclosure</i>
(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed;	The names, addresses and contact details of the corporate office of the issuer company, compliance officer of the issuer company, merchant bankers and co-managers to the issue, registrar to the issue, bankers to the issue, stock brokers to the issue, credit rating agency for the issue, arrangers, if any, of the instrument, names and addresses of such other persons as may be specified by the Securities and Exchange Board in its regulations;
(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;	The date relating to opening and closing of issue - A declaration which shall be made by the Board or the Committee authorised by the Board in the prospectus that the allotment letters shall be issued or application money shall be refunded within fifteen days from the closure of the issue or such lesser time as may be specified by Securities and Exchange Board or else the application money shall be refunded to the applicants forthwith, failing which interest shall be due to be paid to the applicants at the rate of fifteen per cent. per annum for the delayed period.
(iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner;	A statement given by the Board that all monies received out of the issue shall be transferred to a separate bank account maintained with a Scheduled Bank; Further, the details of all utilized and unutilised monies out of the monies collected in the previous issue made by way of public offer shall be disclosed and continued to be disclosed in the balance sheet till the time any part of the proceeds of such

	previous issue remains unutilized indicating the purpose for which such monies have been utilized, and the securities or other forms of financial assets in which such unutilized monies have been invested;
(iv) details about underwriting of the issue	<p>the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them;</p> <p>Besides Rule 13 further prescribes that the prospectus of the company shall disclose -</p> <ul style="list-style-type: none"> (i) the name of the underwriters; (ii) the rate and amount of the commission payable to the underwriter; and (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
(v) the consent in writing of the directors, the auditors, bankers to the issue, expert's opinion, if any, all the persons named in the prospectus and of such other persons, as may be prescribed;	The consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders and experts;
(vi) the authority for the issue and the details of the resolution passed therefor;	--
(vii) procedure and time schedule for allotment and issue of securities;	--
(viii) capital structure of the company in the prescribed manner;	<p>The capital structure of the company shall be presented in the following manner, namely: -</p> <ul style="list-style-type: none"> (i) (a) the authorised, issued, subscribed and paid up capital (number of securities, description and aggregate nominal value); (b) the size of the present issue; (c) the paid up capital- <ul style="list-style-type: none"> (A) after the issue; (B) after conversion of convertible instruments (if applicable); (d) the share premium account (before and after the issue); (ii) the details of the existing share capital of the issuer company in a tabular form, indicating therein with regard to each allotment, the date of allotment, the number of shares allotted, the face value of the

	shares allotted, the price and the form of consideration:
(ix) main objects of public offer, terms of the present issue and such other particulars as may be prescribed;	The prospectus to be issued shall contain the following particulars, namely: - <ul style="list-style-type: none"> (a) the objects of the issue; (b) the purpose for which there is a requirement of funds ; (c) the funding plan (means of finance); (d) the summary of the project appraisal report (if any); (e) the schedule of implementation of the project; (f) the interim use of funds, if any
(x) main objects and present business of the company and its location, schedule of implementation of the project;	--
(xi) particulars relating to— <ul style="list-style-type: none"> (A) management perception of risk factors specific to the project; (B) gestation period of the project; (C) extent of progress made in the project; (D) deadlines for completion of the project; and (E) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company; 	<ul style="list-style-type: none"> (i) the details of any litigation or legal action pending or taken by any Ministry or Department of the Government or a statutory authority against any promoter of the issuer company during the last five years immediately preceding the year of the issue of the prospectus and any direction issued by such Ministry or Department or statutory authority upon conclusion of such litigation or legal action shall be disclosed; (ii) the details of pending litigation involving the issuer, promoter, director, subsidiaries, group companies or any other person, whose outcome could have material adverse effect on the position of the issuer; (iii) the details of pending proceedings initiated against the issuer company for economic offences; (iv) the details of default and non-payment of statutory dues etc
(xii) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;	--
(xiii) details of directors including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed; and	The details of directors including their appointment and remuneration, and particulars of the nature and extent of their interests in the company shall be disclosed in the following manner, namely:- <ul style="list-style-type: none"> (i) the name, designation, Director

	<p>Identification Number (DIN), age, address, period of directorship, details of other directorships;</p> <p>(ii) the remuneration payable or paid to the director by the issuer company, its subsidiary and associate company; shareholding of the director in the company including any stock options; shareholding in subsidiaries and associate companies; appointment of any relatives to an office or place of profit;</p> <p>(iii) the full particulars of the nature and extent of interest, if any, of every director:</p> <ul style="list-style-type: none"> (a) in the promotion of the issuer company; or (b) in any immoveable property acquired by the issuer company in the two years preceding the date of the Prospectus or any immoveable property proposed to be acquired by it. <p>(iv) where the interest of such a director consists in being a member of a firm or company, the nature and extent of his interest in the firm or company, with a statement of all sums paid or agreed to be paid to him or to the firm or company in cash or shares or otherwise by any person either to induce him to become, or to help him qualify as a director, or otherwise for services rendered by him or by the firm or company, in connection with the promotion or formation of the issuer company shall be disclosed.</p>
(xiv) disclosures in such manner as may be prescribed about sources of promoter's contribution;	<p>The sources of promoters' contribution, if any, shall be disclosed in the following manner, namely:-</p> <p>(i) the total shareholding of the promoters, clearly stating the name of the promoter, nature of issue, date of allotment, number of shares, face value, issue price or consideration, source of funds contributed , date when the shares were made fully paid up, percentage of the total pre and post issue capital;</p> <p>(ii) the proceeds out of the sale of shares of</p>

	<p>the company and shares of its subsidiary companies previously held by each of the promoters;</p> <p>(iii) the disclosure for sources of promoters contribution shall also include the particulars of name, address and the amount so raised as loan, financial assistance etc , if any, by promoters for making such contributions and in case of own sources, complete details thereof.</p>
----	<p>In the case of an initial public offer of an existing company, the details regarding individual allotment shall be given from the date of incorporation of the issuer and in the case of a listed issuer company, the details shall be given for five years immediately preceding the date of filing of the prospectus:</p> <p>The issuer company shall also disclose the number and price at which each of the allotments were made in the last two years preceding the date of the prospectus separately indicating the allotments made for considerations other than cash and the details of the consideration in each case.</p>

Reports to be set out in the Prospectus.-

Section 26(1)(b) states that the following reports to be set out in the prospectus for the purposes of the financial information, namely:—

Requirement under Section 26(1)(b)	Prescribed under Rule 4 and 5 of Companies (Prospectus and Allotment of Securities) Rules, 2014
(i) reports by the auditors of the company with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed;	<p>The reports by the auditors with respect to profit and assets and liabilities - The report shall also include the amounts or rates of dividends, if any, paid by the issuer company in respect of each class of shares for each of the five financial years immediately preceding the year of issue of the prospectus, giving particulars of each class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares for any of those years:</p> <p>If no accounts have been made up in respect of any part of the period of five years ending on a date three months before the issue of the prospectus, a statement of that fact accompanied by a statement</p>

	of the accounts of the issuer company in respect of that part of the said period up to a date not earlier than six months of the date of issue of the prospectus indicating the profit or loss for that period and assets and liabilities position as at the end of that period together with a certificate from the auditors that such accounts have been examined and found correct and the said statement may indicate the nature of provision or adjustments made or which are yet to be made.
(ii) reports relating to profits and losses for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed:	The reports relating to profits and losses for each of the five financial years or where five financial years have not expired, for each of the financial year immediately preceding the issue of the prospectus shall- <ul style="list-style-type: none"> (a) if the company has no subsidiaries, deal with the profits or losses of the company (distinguishing items of a non-recurring nature) for each of the five financial years immediately preceding the year of the issue of the prospectus; and (b) if the company has subsidiaries, deal separately with issuer company's profits or losses as provided in clause (a) and in addition, deal either - <ul style="list-style-type: none"> (i) as a whole with the combined profits or losses of its subsidiaries, so far as they concern members of the issuer company; or (ii) individually with the profits or losses of each subsidiary, so far as they concern members of the issuer company; or (iii) as a whole with the profits or losses of the company, and, so far as they concern members of the issuer company, with the combined profits or losses of its subsidiaries
(iii) reports made in the prescribed manner by the auditors upon the profits and losses of the business of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus:	
In case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in the	

prescribed manner, the reports made by the auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of its business on the last date before the issue of prospectus; and	
(iv) reports about the business or transaction to which the proceeds of the securities are to be applied directly or indirectly;	

Rule 5. Companies (Prospectus and Allotment of Securities) Rules, 2014**Other matters and reports to be stated in the prospectus.**

The prospectus shall include the following other matters and reports, namely:-

(1) 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 –

- (a) in the purchase of any business; or
- (b) in the purchase of an interest in any business and by reason of that purchase, or anything to be done in consequence thereof, or in connection therewith; the company shall become entitled to an interest in either the capital or profits and losses or both, in such business exceeding fifty per cent. thereof, a report made by a chartered accountant (who shall be named in the prospectus) upon-
 - (i) the profits or losses of the business for each of the five financial years immediately preceding the date of the issue of the prospectus ; and
 - (ii) the assets and liabilities of the business as on the last date to which the accounts of the business were made up, being a date not more than one hundred and twenty days before the date of the issue of the prospectus;
- (c) in purchase or acquisition of any immoveable property including indirect acquisition of immoveable property for which advances have been paid to even third parties, disclosures regarding -
 - (i) the names, addresses, descriptions and occupations of the vendors;
 - (ii) the amount paid or payable in cash, to the vendor and, where there is more than one vendor, or the company is a sub-purchaser, the amount so paid or payable to each vendor, specifying separately the amount, if any, paid or payable for goodwill;
 - (iii) the nature of the title or interest in such property proposed to be acquired by the company; and
 - (iv) the particulars of every transaction relating to the property, completed within the two preceding years, in which any vendor of the property or any person who is, or was at the time of the transaction, a promoter, or a director or proposed director of the company had any interest, direct or indirect, specifying the date of the transaction and the name of such promoter, director or proposed director and stating the amount payable by or to such vendor, promoter, director or proposed director in respect of the transaction.

(2)(a) If -

- (i) the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or are to be applied directly or indirectly and in any manner resulting in the acquisition by the company of shares

- in any other body corporate; and
- (ii) by reason of that acquisition or anything to be done in consequence thereof or in connection therewith, that body corporate shall become a subsidiary of the company, a report shall be made by a Chartered Accountant (who shall be named in the prospectus) upon -
 - (A) the profits or losses of the other body corporate for each of the five financial years immediately preceding the issue of the prospectus; and
 - (B) the assets and liabilities of the other body corporate as on the last date to which its accounts were made up.
- (b) The said report shall -
- (i) indicate how the profits or losses of the other body corporate dealt with by the report would, in respect of the shares to be acquired, have concerned members of the issuer company and what allowance would have been required to be made, in relation to assets and liabilities so dealt with for the holders of the balance shares, if the issuer company had at all material times held the shares proposed to be acquired; and
 - (ii) where the other body corporate has subsidiaries, deal with the profits or losses and the assets and liabilities of the body corporate and its subsidiaries in the manner as provided in sub-clause (ii) of clause (a).
- (3) The matters relating to terms and conditions of the term loans including re-scheduling, prepayment, penalty, default.
- (4) The aggregate number of securities of the issuer company and its subsidiary companies purchased or sold by the promoter group and by the directors of the company which is a promoter of the issuer company and by the directors of the issuer company and their relatives within six months immediately preceding the date of filing the prospectus with the Registrar of Companies shall be disclosed.
- (5) The matters relating to Material contracts; Time and place at which the contracts together with documents will be available for inspection from the date of prospectus until the date of closing of subscription list.
- (6) The related party transactions entered during the last five financial years immediately preceding the issue of prospectus as under -
- (a) all transactions with related parties with respect to giving of loans or, guarantees, providing securities in connection with loans made, or investments made ;
 - (b) all other transactions which are material to the issuer company or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer company or any of its parent companies was a party:
- The disclosures for related party transactions for the period prior to notification of these rules shall be to the extent of disclosure requirements as per the Companies Act, 1956 and the relevant accounting standards prevailing at the said time.
- (7) The summary of reservations or qualifications or adverse remarks of auditors in the last five financial years immediately preceding the year of issue of prospectus and of their impact on the financial statements and financial position of the company and the corrective steps taken and proposed to be taken by the company for each of the said reservations or qualifications or adverse remarks.
- (8) The details of any inquiry, inspections or investigations initiated or conducted under the Companies Act or

any previous companies law in the last five years immediately preceding the year of issue of prospectus in the case of company and all of its subsidiaries; and if there were any prosecutions filed (whether pending or not); fines imposed or compounding of offences done in the last five years immediately preceding the year of the prospectus for the company and all of its subsidiaries.

(9) The details of acts of material frauds committed against the company in the last five years, if any, and if so, the action taken by the company.

(10) A fact sheet shall be included at the beginning of the prospectus which shall contain -

- (a) the type of offer document ("Red Herring Prospectus" or "Shelf Prospectus" or "Prospectus").
- (b) the name of the issuer company, date and place of its incorporation, its logo, address of its registered office, its telephone number, fax number, details of contact person, website address, e-mail address;
- (c) the names of the promoters of the issuer company;
- (d) the nature, number, price and amount of securities offered and issue size, as may be applicable;
- (e) the aggregate amount proposed to be raised through all the stages of offers of specified securities made through the shelf prospectus;
- (f) the name, logo and address of the registrar to the issue, along with its telephone number, fax number, website address and e-mail address;
- (g) the issue schedule -
 - (i) date of opening of the issue;
 - (ii) date of closing of the issue;
 - (iii) date of earliest closing of the issue, if any.
- (h) the credit rating, if applicable;
- (i) all the grades obtained for the initial public offer;
- (j) the name(s) of the recognised stock exchanges where the securities are proposed to be listed;
- (k) the details about eligible investors;
- (l) coupon rate, coupon payment frequency, redemption date, redemption amount and details of debenture trustee in case of debt securities.

When Section 26(1) is not applicable?

Section 26(2) states that section 26(1) does not apply to

- (a) to the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of section 62 in favour of any other person; or
- (b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

Filing a copy of prospectus with registrar etc..

Section 26(4) states that no prospectus shall be issued by or on behalf of a company or in relation to an

intended company unless on or before the date of its publication, there has been delivered to the Registrar for registration, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

Section 26(6) further states that every prospectus issued under sub-section (1) shall, on the face of it,—

- (a) state that a copy has been delivered for registration to the Registrar as required under sub-section (4); and
- (b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

Section 26(7) states that the Registrar shall not register a prospectus unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

Section 26(8) states that no prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar under sub-section (4).

Including a statement by an expert in the prospectus

Section 26(5) states that a prospectus issued under sub-section (1) shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company and has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration and a statement to that effect shall be included in the prospectus.

Penalty for contravention of Section 26

Section 26(9) states that if a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Let us recapitulate Section 26

- Section 26(1) requires certain disclosures to be made in the prospectus, certain reports to be set out in the prospectus.
- Prospectus to be delivered to the registrar before its publication
- Prospectus to be issued within 90 days after the date on which a copy thereof is delivered to the registrar.
- Prospectus issued shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management

Variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued

Section 27 (1) states that a company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution:

Notice in respect of resolution to shareholders, shall also published in English and in vernacular language in the city where the registered office of the company is situated indicating clearly the justification for such variation company not to use any amount raised by it through Prospectus.

Rule 7 of Companies (Prospectus and Allotment of Securities) Rules, 2014

1. When the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot and the notice of the proposed special resolution shall contain the following particulars, namely:-
 - the original purpose or object of the issue;
 - the total money raised;
 - the money utilised for the objects of the company stated in the prospectus;
 - the extent of achievement of proposed objects(that is fifty percent, sixty percent, etc);
 - the unutilised amount out of the money so raised through prospectus,
 - the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;
 - the reason and justification for seeking variation;
 - the proposed time limit within which the proposed varied objects would be achieved;
 - the clause-wise details as specified in sub-rule (3) of rule 3 as was required with respect to the originally proposed objects of the issue;
 - the risk factors pertaining to the new objects; and
 - the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.
2. The notice in respect of such resolution to shareholders, shall also be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation: The advertisement of notice shall be in Form PAS-1 and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders.
3. The notice shall also be placed on the web-site of the company, if any.
4. The company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

Dissenting shareholders to variation of terms are to be given exit option

Section 27(2) states that the dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

Let us recapitulate Section 27 read with Companies (Prospectus and Allotment of Securities) Rules, 2014

- Variation of the terms of a contract referred to in the prospectus or objects for which the prospectus requires passing a special resolution through postal ballot.
- The notice in respect of such resolution to shareholders, shall also be published in the newspapers in Form PAS-1

PROSPECTUS

Disclosures to be made in prospectus



Reports to be set out



Other compliances



- ✓ Matters relating to terms and conditions of the term loans
- ✓ The aggregate number of securities of the issuer company and its subsidiary companies purchased or sold by the promoter group and by the director
- ✓ The related party transactions entered during the last five financial years
- ✓ Summary of reservations or qualifications or adverse remarks of auditors in the last five financial years.
- ✓ Inquiry, inspection or investigation initiated or conducted under the companies act or any previous company law in the last five years
- ✓ Fines imposed or

- ✓ Reports by auditors of the company
 - ✓ Reports relating to profit and loss for each of five financial years immediately preceding the issuing financial year
 - ✓ Reports made by auditors upon the profit and losses of business of the company for each of five financial year immediately preceding issue and assets and liabilities of the business on the last date to which the accounts of the business were being made up but not more than 180 days.
 - ✓ Reports about the Business or transactions to which the proceeds of the securities are to be applied directly or indirectly

- ✓ Prospectus Shall be dated and signed
- ✓ On or before the date of publication the company shall register a copy of prospectus with registrar
- ✓ Expert's statement to be included in prospectus
- ✓ Prospectus filed with ROC is valid for 90 days from the date of filing

For advertisement of prospectus a company shall specify:

- Contents of memorandum, capital, objects and liability of members.
- Name of signatories to memorandum and number of shares issued to them
- Its capital structure

Offer of Sale by Members.-

Section 28.(1) states that where certain members of a company propose, in consultation with the Board of Directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed.

Section 28(2) further states that any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

Sub-section (3) states that the members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

Rule 8 of Companies (Prospectus and Allotment of Securities) Rules, 2014

(1) The provisions of Part I of Chapter III namely “Prospectus and Allotment of Securities” and rules made there under shall be applicable to an offer of sale referred to in section 28 except for the following, namely:-

- (a) the provisions relating to minimum subscription;
- (b) the provisions for minimum application value;
- (c) the provisions requiring any statement to be made by the Board of directors in respect of the utilization of money; and
- (d) any other provision or information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply with such provisions.

(2) The prospectus issued under section 28 shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.

Offer of sale by members to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and Provisions of Part I of Chapter III would be applicable accordingly, with some exceptions specified in the rules.

Dematerialisation of Securities-mandatory

Section 29. (1) states that notwithstanding anything contained in any other provisions of this Act,—

- (a) every company making public offer; and
- (b) such other class or classes of public companies as may be prescribed,

shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

(2) Section 29 further states that any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Rule 9 of Companies (Prospectus and Allotment of Securities) rules 2014 states that the promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialised form:

Provided that the entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only

Advertisement of Prospectus

Section 30 provides that where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the objects, the liability of members and the amount of share capital of the company, and the names of the signatories to the memorandum and the number of shares subscribed for by them, and its capital structure.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The prospectus can contain statements of experts who are interested in the formation and management of the company, as long as the consent of the expert is taken in this regard.

- True
- False

Correct answer: False

Shelf Prospectus

"Shelf Prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. Accordingly as per Section 31—

1. Any class of companies, as prescribed by the Securities and Exchange Board may file a shelf prospectus with the Registrar at the stage of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under such prospectus. Further, in respect of a second or subsequent offer issued during the period of validity of shelf prospectus, no further prospectus is required.
2. A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer and other prescribed changes, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under such prospectus.

Where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, they shall intimate the changes to such applicants. If the applicants express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days.

3. Where an information memorandum is filed, every time an offer of securities is made as aforesaid, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

The concept of shelf prospectus will save expenditure and time of the companies in issuing a new

prospectus every time they wish to issue securities to the public within a period of one year.

Information Memorandum to be filed before the issue of a second or subsequent offer of securities under the shelf prospectus

Rule 10 of Companies (Prospectus and Allotment of Securities) Rules, 2014 states that the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

Red-Herring Prospectus

"Red Herring Prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Section 32 of the Act deals with Red Herring Prospectus. It provides that—

1. As per this section, a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
2. A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.
3. A red herring prospectus shall carry the same obligations as are applicable to a prospectus. Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
4. Upon the closing of the offer of securities, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

Red herring prospectus is issued during book building process. Red herring prospectus contains either the floor price of securities offered or a price band along with the range within which the Bids can move. The applicants bid for the shares quoting the price and the quantity that they would like to bid at. SEBI (ICDR) Regulations prescribe certain disclosures to be made in the red-herring prospectus.

Once the offer for securities is closed, a final prospectus stating therein the total capital raised whether by way of debt or share capital, the closing price of the securities and any other details which are not complete in the red-herring prospectus shall be filed with SEBI in the case of listed public company and in any other case with the Registrar of companies only.

The compliances under SEBI (ICDR) Regulations 2009 relating to shelf prospectus and red-herring prospectus is covered under chapter "issue of Securities" in paper Capital Markets and Securities Laws of Executive programme.

Application to be accompanied by abridged prospectus

"Abridged Prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. [Section 2(1)]

Section 33 states that no form of application can be issued for the purchase of any securities of a company unless it is accompanied by an abridged prospectus. There are, however, four exceptions to this rule:

- (a) where the offer is made in connection with the *bona fide* invitation to a person to enter into an

- underwriting agreement with respect to such securities;
- (b) where the securities are not offered to the public;
 - (c) where the offer is made only to the existing members or debenture holders of the company with or without a right to renounce;
 - (d) where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognised stock exchange.

A copy of the prospectus shall be furnished to a person on a request being made by him before the closing of the subscription list and the offer.

If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default.

The Golden Rule Or Golden Legacy

It is the duty of those who issue the prospectus to be truthful in all respects. This Golden Rule was pronounced by Kinderseley, V.C. in *New Brunswick, etc., Co. v. Muggeridge*, (1860) 3 LT 651, and has come to be known as the "golden legacy". "Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representation contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as a fact which is not so and no fact should be omitted, the existence of which might in any degree affect the nature or quality of the privileges and advantages which the prospectus holds out as inducement to take shares. In short, the true nature of the company's venture should be 'disclosed'. If concealment of any material fact has prevented an adequate appreciation of what was stated, it would amount to misrepresentation. Thus, even if every specific statement is literally true, the prospectus may be false if by reason of the suppression of other material facts, it conveys a false impression".

In *R.V. Kylsant* (1932) K.B. 442, all statements in the prospectus were literally true but it failed to disclose that the dividends stated in it as paid, were not paid out of trading profits, but out of realized capital profits (secret reserves). The statement that the company had paid dividends for a number of years was true. But the company has incurred losses for all those years (1921-27) and no disclosure was made of this fact. The prospectus was held to be false in material particulars and the managing director and chairman, who knew that it was false, were held guilty of fraud.

Liability for Untrue Statement in Prospectus

It is now clear that a prospectus must be complete and perfect in all details or in other words nothing should be omitted and nothing must be untrue in a prospectus.

Where an untrue statement occurs in a prospectus, there may arise (i) civil liability (ii) criminal liability. Every person who is a director of the company at the time of the issue of the prospectus, every promoter of the company and every person, including an expert, who has authorised the issue of a prospectus, shall be liable. Since the liability of these persons is to the allottee of securities, we may discuss this matter under the heading remedies for mis-statements in a prospectus.

What is an Untrue Statement?

It is essential to know as to what constitutes an untrue statement. To protect the interests of prospective investors in the securities of a company, the law prescribes a wider meaning to this term. Whether a statement is untrue or not is to be judged by the context in which it appears and the totality of impression it would create. A statement included in a prospectus shall be deemed to be untrue, if the statement is

misleading in the form and context in which it is included.

Further, where any inclusion or omission of any matter in a prospectus is likely to mislead, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included.

The expression "Included" with reference to a prospectus means included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith. Even if every word included in the prospectus is true, the suppression of material facts may cause the prospectus to be fraudulent.

Onus for Proof of Mis-statement

The burden of proof in a suit by an allottee that he has been misled by the mis-statement in the prospectus lies on the allottee. He must prove the following:

- (i) The misrepresentation was of a fact;
- (ii) It was in respect of a material fact. What is a material statement of fact will depend upon the circumstances of each case.
- (iii) He acted on the misrepresentation; and
- (iv) He suffered damages in consequence.

Remedies for Misrepresentation in Prospectus

A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company, e.g., the Board of directors. The company is also liable for misstatement in prospectus even though the prospectus is issued by the promoters & the Board ratifies and adopts the issue of prospectus.

The first remedy against the company is to rescind the contract. A person who takes securities on the faith of a prospectus containing false statements, may apply to the Court for setting contract aside, and striking off his name from the register of members. He may also claim his money back. But the allottee must act within a reasonable time, before any proceedings to wind up the company have been commenced, and before he does anything after notice of misrepresentation which is inconsistent with the right to rescind.

The second remedy against the company is to sue for damages for deceit. This suit is founded on the tort of deceit, and is not a case of fraud on the part of directors or promoters. The allottee may recover damages from the company for any loss he may have suffered if the invitation to take securities is emanating from the company and the persons making it on behalf of the company have fraudulently mis-represented material facts. The allottee cannot both retain the securities and get damages against the company. In actual practice, however, suits for damages against the company are rarely filed. Damages are generally claimed from the directors, promoters and other persons who authorised the issue of the prospectus.

Remedies against Directors or Promoters

A person who subscribed for shares on the faith of a false prospectus may claim from directors or promoters:

- (i) damages for fraudulent misrepresentation,
- (ii) Compensation under Section 35 of the Act,
- (iii) Damages for non-compliance with the requirements of Section 26 of the Act.

(i) Damages for fraudulent misrepresentation

An allottee may sue the director for damages for deceit, if there are fraudulent misrepresentations in the

prospectus. But the directors will not be liable for damages for mis-statement if they believed them to be true [Derry v. Peek, (1889) 14 AC 337].

(ii) Compensation for untrue Statement

An allottee is also entitled to claim compensation from directors, promoters and any other persons who authorised the issue of the false prospectus, for damages sustained by reason of any untrue statement in it. As per section 35(1), where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company, then, the following persons are liable to pay compensation to every person who has sustained loss or damage by reason of untrue statement included in a prospectus:

- (a) every person who is a director of the company at the time of the issue of the prospectus;
- (b) every person who has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- (c) every person who is a promoter of the company;
- (d) every person who has authorised the issue of the prospectus; and
- (e) is an expert referred to in sub-section (5) of section 26

The above stated liability shall be without prejudice to any punishment to which any person may be liable under section 36.

When civil liability can be avoided [Section 35(2)]

No person referred above shall be liable for civil action if he proves:

- (i) that having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- (ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

Further an expert may also escape the liability, if he proves that having given his consent under Section 26 to the issue of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration to the Registrar.

REVIEW QUESTIONS



Choose the correct answer

A person who acted upon the false prospectus, may claim the following damages:

- (a) Damages for fraudulent misrepresentation
- (b) Compensation for untrue statement.
- (c) Damages for non-compliance with the requirements of section 26 of the Act.
- (d) All of the above

Criminal Liability for Mis-statements in Prospectus

According to Section 34 of the Companies Act, 2013, where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under section 447. Section 447 provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

However, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years

However, where a person who has authorised the issue of prospectus proves, either that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary may be relieved from the criminal liability.

Action by affected persons

Section 37 states that a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

This above provision provides for filing class action suits by a persons or group of persons or association of persons affected by misleading statements.

Who is entitled to remedies?

The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has "subscribed" for securities on the faith of the prospectus containing untrue statement. The word 'subscribed' denotes that the shares were acquired directly from the company by allotment. A subsequent purchaser of shares in the open market has no remedy against the company or the directors or promoters. Also, a subscriber to the memorandum cannot seek relief, as the company cannot be said to be in existence when he signed the memorandum, and he cannot be said to have been influenced by any statement, in the prospectus. Again, liability under a prospectus can only arise when the prospectus has been issued, and only in favour of persons who subscribe for securities in response to it and relied upon the statement made therein.

If, however, a prospectus is issued with the object of inducing persons to buy securities in the open market, any person who buys on the strength of the false representation made in it, has a right of action for fraudulent misrepresentation against the company. But the purchaser must have been directly induced by the false statement in the prospectus and nothing else. Two cases may be noted:

CASE LAWS

- (i) In *Peek v. Gurney* (1873) 43 L.J. Ch. 19, a deceitful prospectus was issued by the directors on behalf of the company. P received a copy of it but did not take any shares originally in the company. The allotment of shares to applicants was completed, and several months afterwards he bought 2,000 shares on the stock exchange. His action against the directors for deceit was rejected. It was observed by the Court that the office of a prospectus is to invite persons to become allottees, and, allotment having been completed, such office is exhausted and liability to allottees does not follow

the shares into the hands of subsequent transferees.

- (ii) In *Andrews v. Mockford* (1869) I.Q.B. 372, the directors sent to A, a prospectus of the company which they knew would be a sham in order to induce A to purchase shares therein. A did not subscribe for the shares at that time. The prospectus, having produced but a scanty subscription for shares, the directors thereupon fraudulently published a telegram in newspaper. A believing in the truth of the telegram was induced to purchase shares in the open market. The directors were held liable for the systematic fraud. "The function of the prospectus was not exhausted, and the false telegram was brought into play by defendants to reflect back upon and countenance the false statements in the prospectus."

Further, by reason of the decision of the House of Lords in *Hedley Byrne Co. v. Hellers & Partners*, (1964) A.C. 465, a person may become liable for holding out a false statement to any one whom he knew or ought to have known would act in reliance upon the statement.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

The allottee can both retain the securities and get damages against the company, for untrue statement in prospectus.

- True
- False

Correct answer: False

The allottee cannot both retain the shares and get damages against the company.

Penalty For Fraudulently Inducing To Invest Money

Section 36 provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into,—

- (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or
 - (b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
 - (c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution,
- shall be liable for action under section 447.

Prohibition of personation for acquisition etc. of securities

As per Section 38(i) any person who—

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

- (c) otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name,

shall be liable for action under section 447.

Section 38 (2)

The provisions of section 38(1) shall be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

Section 38 (3)

Where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person.

Section 38 (4)

The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

LESSON ROUND-UP

- Prospectus has been defined as any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.
- One of the ingredients of a prospectus is to make invitation to the public to subscribe for securities of a body corporate which is construed as including a reference to any section of the public, whether selected as members or debenture-holders of the company or as clients of the person issuing the prospectus. However, there are exceptions to it.
- All public companies making public offer issue a prospectus.
- Shelf prospectus means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.
- Red herring prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
- Companies Act and SEBI guidelines provide for contents and disclosures required in a prospectus.
- No application form can be issued for securities unless it is accompanied by a memorandum containing such salient features of prospectus as may be prescribed.
- A company is responsible for a statement in prospectus only if it is shown that the prospectus was issued by the company or by some one with the authority of the company. The company is also liable if though the prospectus is issued by the promoters, the Board ratifies and adopts the issue.
- A person who subscribed for securities on the faith of a false prospectus may claim from directors or promoters damages for fraudulent misrepresentation, compensation, damages for non-compliance with the requirements of the Act.
- Where a prospectus includes any untrue statement, every person who has authorised the issue of the prospectus shall be punishable with imprisonment, fine or both.

- The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has subscribed for securities on the faith of the prospectus containing untrue statement.
- Penalty is also leviable under the Act for fraudulently inducing a person to invest money.
- Impersonation for the acquisition of securities has been made an offence under the Companies Act, punishable with imprisonment.

GLOSSARY

Shelf prospectus	A Prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over certain period without the issue of a further Prospectus.
Red Herring Prospectus	Red herring prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
Abridged Prospectus	Abridged Prospectus is usually a shorter form of the Prospectus and possesses all the significant features of a Prospectus. This accompanies the application form of public issues.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What is a prospectus? Is the issue of a prospectus compulsory on the part of a company?
2. What amounts to a misstatement in a prospectus? What are the remedies available to a subscriber who has taken shares on the basis of a misstatement in a prospectus?
3. Discuss the liability of a company for untrue statements or omissions in its prospectus.
4. Discuss the civil as well as criminal liability of persons who authorise the issue of a false prospectus.
5. Explain the legal provisions relating to issue and registration of a prospectus?
6. What are the remedies open to an allottee of securities who have had applied for them on the faith of a false and misleading prospectus and what are the defenses available to the directors of the company who have issued such a prospectus?
7. Discuss in detail the contents and the form of a prospectus.
8. Who is deemed to be an expert in relation to the prospectus of a company? What conditions must be satisfied before a report by an expert can be published therein? Is there any remedy available to the allottee of the securities who has been induced to take securities on the faith of an untrue statement of an expert in the prospectus?
9. 'Prospectus is the window through which company is displayed without distortion'. — Comment.
10. Write short notes on:
 - (a) Abridged prospectus;

- (b) Registration of a prospectus.
 - (c) Shelf prospectus.
 - (d) Information Memorandum.
 - (e) Red-herring prospectus.
 - (f) Deemed Prospectus

Lesson 9

Debt Capital

LESSON OUTLINE

- Borrowing power of the company
- Unauthorized or ultra vires borrowing
- Intra vires borrowing but outside the scope of agent's authority
- Distinction between debenture and shares
- Special resolution to issue convertible debentures
- Creation of Debenture Redemption Reserve
- Debenture Trust Deed
- Secured debenture to comply with certain conditions
- Public sector bonds and foreign bonds, brokerage
- Developments in corporate debt financing

LEARNING OBJECTIVES

The provisions to issue debentures are covered under Section 71 of the Companies Act 2013. Further rule 18 of Companies (Share Capital and Debentures) Rules 2014. The listed companies are additionally governed by listing agreement and SEBI (Issue and Listing of Debt Securities) Regulations, 2008. Further the borrowing powers of the board are regulated by Section 179 which mandates that power to borrow has to be through properly convened board meeting.

After going through this lesson you will be able to understand the provisions of Companies Act and rules made there under, with respect to debentures including creation of debenture redemption reserve, trust deed, appointment of trustees, shareholders approval through special resolution for issue of convertible debentures, way of securing debentures etc., Besides, you will get a broad over view of public sector bonds, foreign bonds, money market instruments etc.,

"Debt is one person's liability, but another person's asset."

– Paul Krugman

BORROWING

In order to run a business effectively/successfully, adequate amount of capital is necessary. In some cases capital arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. External Commercial borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits etc. Thus, borrowing is a mechanism used whereby the money is arranged through external resources with an implied or expressed intention of returning money.

Power of Company to Borrow

The power of the company to borrow is exercised by its directors, who cannot borrow more than the sum authorized. The powers to borrow money and to issue debentures whether in or outside India can only be exercised by the Directors at a duly convened meeting. Pursuant to Section 179(3) (c) & (d) directors have to pass resolution at a duly convened Board Meeting to borrow moneys. The power to issue debentures cannot be delegated by the Board of directors. However, the power to borrow monies can, however, be delegated by a resolution passed at a duly convened meeting of the directors to a committee of directors, managing director, manager or any other principal officer of the company. The resolution must specify the total amount up to which the moneys may be borrowed by the delegates. Often the power of the company to borrow is unrestricted, but the authority of the directors acting as its agents is limited to a certain extent. For example, Section 180(1)(c) of the Act prohibits the Board of directors of a company from borrowing a sum which together with the monies already borrowed exceeds the aggregate of the paid-up share capital of the company and its free reserves apart from temporary loans obtained from the company's bankers in the ordinary course of business unless they have received the prior sanction of the company by a special resolution in general meeting. Explanation to section 180(1)(c) provides that the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

It is further provided in proviso to Section 180(1)(c) that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be borrowing of monies by the banking company within the meaning of clause (c) of Sub-section (1) of Section 180. It is important at this stage to distinguish between, borrowing which is *ultra vires* the company and borrowing which is *intra vires* the company but outside the scope of the director's authority.

The provisions of Sub-section (5) of Section 180 clearly lay down that debts incurred in excess of the limit fixed by clause (c) of Sub-section (1) shall not be valid unless the lender proves that he lent his money in good faith and without knowledge of the limit imposed by Sub-section (1) being exceeded.

Unauthorized or Ultra Vires Borrowing

Where a company borrows without the authority conferred on it by the articles or beyond the amount set out in the Articles, it is an *ultra vires* borrowing. Any act which is *ultra vires* the company is void. In such a case the contract is void and the lender cannot sue the company for the return of the loan. The securities given for such *ultra-vires* borrowing are also void and inoperative. *Ultra vires* borrowings cannot even be ratified by a resolution passed by the company in general meeting. However, equity assists the lender where the common law fails to do so. If the lender has parted with his money to the company under an *ultra vires* borrowing, and is, therefore, unable to sue for its return, or enforce any security granted to him, he

nevertheless has, in equity, the following remedies:

- (A) **Injunction and Recovery:** Under the equitable doctrine of restitution he can obtain an injunction provided he can trace and identify the money lent, and any property which the company has bought with it. Even if the monies advanced by the lender cannot be traced, the lender can claim repayment if it can be proved that the company has been benefited thereby.
- (B) **Subrogation:** Where the money of an *ultra vires* borrowing has been used to pay off lawful debts of the company, he would be subrogated to the position of the creditor paid off and to that extent would have the right to recover his loan from the company. Subrogation is allowed for the simple reason that when a lawful debt has been paid off with an *ultra vires* loan, the total indebtedness of the company remains the same. By subrogating the *ultra vires* lender, the Court is able to protect him from loss, while debt burden of the company is in no way increased.
- (C) **Suit against Directors:** In case of *ultra vires* borrowing, the lender may be able to sue the directors for breach of warranty of authority, especially if the directors deliberately misrepresented their authority [*Executors v. Himpheys* (1866) QBD 64].

Intra vires Borrowing but outside the Scope of Agents' Authority

A distinction should always be made between a company's borrowing powers and the authority of the directors to borrow. Where the directors borrowed money beyond their authority and the borrowing is not *ultra vires* the company, such borrowing is called *Intra vires* borrowing but outside the Scope of Agents' Authority. The company will be liable to such borrowing if the borrowing is within the directors' ostensible authority and the lender acted in good faith or if the transaction was ratified by the company.

Where the borrowing is *intra vires* the company but outside the authority of the directors e.g. where the articles provide that the directors shall have the power only up to ₹ 100 lacs and prior approval of the shareholders would be required to borrow beyond ₹ 100 lacs; any borrowing beyond ₹ 100 lacs without shareholders approval i.e. *ultra vires* the directors can be ratified by the company and become binding on the company. The company would be liable, particularly if the money has been used for the benefit of the company. Here the legal position is quite clear. The company has power or capacity to borrow, but the authority of the directors is restricted either by the articles of the company or by the statute, and they have exceeded it. The company may, if it wishes, ratify the agent's act in which case the loan binds the company and the lender as if it had been made with company's authority in the first place.

On the other hand, the company may refuse to ratify the agent's act. Here the normal principles of agency apply. The doctrine of Indoor Management (also known as rule in *Royal British Bank v. Turquand* (1856) 11 Cl & B 327) shall protect the lender, provided he can establish that he advanced the money in good faith. A third-party who deals with an agent knowing that the agent is exceeding his authority has no right of action against the principal. Bearing in mind that the memorandum and articles are public documents, the contents of which the third-party is deemed to know, he will obviously have no right of action against the company if the agent's lack of authority is obvious from reading them. But a third-party is not effected by secret restrictions on the agent's authority, as the lack of authority is not clear from the public documents and the lender can not be aware of it from some other source. Therefore, the company will be liable.

CASE LAWS

Judicial Pronouncement relating to borrowing power of a company

- (A) '**Borrowing**' necessarily implies repayment at some time and under some circumstances [*Re. Southern Brazilian Rio* (1905) 2 Ch. 78].

- (B) Where the directors mortgaged the company's property exceeding the limits of their authority, it was held that the lending bank was entitled to retain possession and to claim institution before it could be compelled to surrender possession [*Deonarayan Prasad Bhadani v. Bank of Baroda Ltd.* (1957) 27 Com Cases 223, 239 (Bom.)].
- (C) The behaviour of the directors, as the company's agents, can have no effect whatsoever on the validity of the loan for no agent can have more capacity than his principal. No agent can have a power which is not with the principal. If, therefore, the borrowing is *ultra vires* the company so that the company has no capacity to undertake it, the lender can have no rights at common law. No debt is created and any security which may have been created in respect of the borrowing is also void. The lender cannot sue the company for the repayment of the loan. [*Sinclair v. Brouguham* (1914) 88 LJ Ch 465].
- (D) The power of a company to borrow money is implied in the case of all trading companies. [*General Auction Estate Co. v. Swith* (1891) Ch 432].
- (E) A power to borrow money cannot be implied [*Baronness Wenlock v. River Dee* (1885) 10 App Cas 354].
- (F) If the borrowing by the directors is *ultra vires* their powers, the directors may, in certain circumstances, be personally liable for damages to the lender, on the ground of the implied warranty given by them, that they had power to borrow [*Firbank's Executors v. Humphreys*, (1886) 18 QBD 54; *Garrard v. James*, 1925 Ch. 616].
- (G) Sometimes it happens that a power to borrow exists but is restricted to a stated amount, in such a case if by a single transaction an amount in excess is borrowed, only the excess would be *ultra vires* and not the whole transaction [*Deonarayan Prasad Bhadani v. Bank of Baroda*, (1957) 27 Com Cases 223 (Bom.)].
- (H) The acquiescence of all shareholders in excess loans contracted by directors beyond their powers but not *ultra vires* the powers of the company would be sufficient to validate such excess debts. [*Sri Balasaraswathi Ltd. v. Parameswara Aiyar*, (1956) 26 Com Cases 298, 308: AIR 1957 Mad 122].
- (I) If the borrowing is unauthorized, the company will be liable to repay, if it is shown that the money had gone into the company's coffers [*Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.*, (1957) 27 Com Cases 660: AIR 1957 All 311].
- (J) In *V.K.R.S.T Firm v. Oriental Investment Trust Ltd.*, AIR 1944 Mad 532 under the authority of the company, its managing director borrowed large sums of money and misappropriated it. The company was held liable stating that where the borrowing is within the powers of the company, the lender will not be prejudiced simply because its officer have applied the loan to unauthorised activities provided the lender had no knowledge of the intended misuse.
- (K) In *T.R. Pratt. (Bom) Ltd. v. E.D. Sassoon and Co. Ltd.*, (1936) 6 Com Cases 90, there was no limit on the borrowing for business in the memorandum of the company. But the directors could not borrow beyond the limit of the issued share capital of the company without the sanction of the general meeting. The directors borrowed money from the plaintiff beyond their powers. It was held that the money having been borrowed and used for the benefit of the principal either in paying its debts, or for its debts, or for its legitimate business, the company cannot repudiate its liability on the ground that the agent had no authority from the company to borrow. When these facts are established a claim on the footing of money had been received would be maintainable. It was also held that under the general principle of law when an agent borrows money for a principal without the authority of the principal, but if the principal takes benefit of the money so borrowed or when the

money so borrowed have gone into the coffers of the principal, the law implies a promise to repay. In that connection it was observed that there appears to be nothing in law which makes this principle inapplicable to the case of a joint stock company and even in cases where the directors or the managing agent had borrowed money without there being authorization for the company, if it has been used for the benefit of the company, the company cannot repudiate its liability to pay.

- (L) In *Equity Insurance Co. Ltd. v. Dinshaw & Co.*, AIR 1940 Oudh 202, it was held that "where the managing agent of a company who is not authorised to borrow, has borrowed money which is not necessary, neither *bona fide*, nor for the benefit of the company, the company is not liable for the amount borrowed".
- (M) In *Suraj Babu v. Jaitly & Co.* AIR 1946 All 372, P & Co., were the managing agents of L & Co., which was in liquidation. P the manager borrowed a sum of money from J in his own name. In one letter to J he indicated that the loan was for a requirement of L & Co. and that company had actually benefited. It was held that there was no intention to bind the company. "The mere fact that the company had benefited was not in itself sufficient to bind the company".
- (N) In *Krishnan Kumar Rohatgi and Others v. State Bank of India and Others*, (1980) 50 Com Cases 722, the company borrowed an amount of ₹ 5 lakhs from the Bank under a Promissory Note. The repayment was guaranteed by a person by executing a guarantee in favour of the company. The company used to make payments towards loan and the promissory note used to be renewed from time to time. In the suit for recovery, the company contended that the pro-note was executed by the Chairman without there being a resolution of the Board of directors authorizing the Chairman to execute the pro-note as required under Section 292(1)(c) of the Act, 1956 [Corresponds to section 179(1)(d) of the Companies Act, 2013]. Rejecting these contentions the Patna High Court held that in cases where the directors borrow funds without their having authorization from the company and if the money has been used for the benefit of the company, the company cannot repudiate its liability to repay. Under the general principles of law, when an agent borrows money for a principal without the authority of the principal but the principal takes the benefit of the money so borrowed or when the money so borrowed has gone into the coffers of the principal, the law implies a promise to be paid by the principal.

Ultra vires borrowings cannot even be ratified by a resolution passed by the company in a general meeting.

TYPES OF BORROWINGS

A company uses various kinds of borrowing to finance its operations. The various types of borrowings can generally be categorized into: 1) Long term/short term borrowing, 2) Secured/unsecured borrowing, 3) Syndicated/ Bilateral borrowing, 4) Private/Public borrowing.

- 1A. **Long Terms Borrowings** - Funds borrowed for a period ranging for five years or more are termed as long-term borrowings. A long term borrowing is made for getting a new project financed or for making big capital investment etc. Generally Long term borrowing is made against charge on fixed Assets of the company.
- 1B. **Short Term Borrowings** - Funds needed to be borrowed for a short period say for a period up to one year or so are termed as short term borrowings. This is made to meet the working capital need of the company. Short term borrowing is generally made on hypothecation of stock and debtors.
- 1C. **Medium Term Borrowings** - Where the funds to be borrowed are for a period ranging from two to five years, such borrowings are termed as medium term borrowings. The commercial banks normally finance purchase of land, machinery, vehicles etc.

- 2A **Secured/unsecured borrowing** – A debt obligation is considered secured, if creditors have recourse to the assets of the company on a proprietary basis or otherwise ahead of general claims against the company.
- 2B **Unsecured debts comprise** financial obligations, where creditors do not have recourse to the assets of the company to satisfy their claims.
- 3A **Syndicated borrowing** – if a borrower requires a large or sophisticated borrowing facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. The borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate loans, each with different terms and conditions.
- 3B **Bilateral borrowing** refers to a borrowing made by a company from a particular bank/financial institution. In this type of borrowing, there is a single contract between the company and the borrower.
- 4A **Private borrowing** comprises bank-loan type obligations whereby the company takes loan from a bank/financial Institution.
- 4B **Public borrowing** is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter, with few if any restrictions i.e. Debentures, Bonds etc.

Borrowing on Security of Property

The power to borrow includes the power to give security, which may take the form of a mortgage, a charge, hypothecation, lien, guarantee, pledge etc. The creditor's position becomes safer when security is given, for he will not only be able to sue the company for the amount of money which he has lent to it, but he will also be able to enforce his security, i.e., claim that the property charged belongs to him to the extent of the total amount due to him.

A loan taken by a company may be secured by any of the following:

- (a) A legal mortgage of specific part of its property;
- (b) An equitable mortgage by deposit of title deeds;
- (c) A mortgage of movable property;
- (d) Issuing Bonds;
- (e) Issuing Promissory notes and bills of exchange;
- (f) A charge on uncalled capital;
- (g) A charge on calls made but not paid;
- (h) A floating charge on the assets of the company;
- (i) Issuing Debentures or debenture stock;
- (j) A mortgage of book debts (but not of book);
- (k) A charge on a ship or any share in a ship;
- (l) A charge on goodwill or a patent or a license under a patent, or a trade mark, or on a copyright;
- (m) A pledge of goods.

Charge on Uncalled Capital

A company does not have implied power of charging its uncalled share capital and a company may charge its uncalled capital if its articles or memorandum authorise it to charge it. The memorandum may give an

express power to charge uncalled capital, or the power may be so wide that it can be inferred by implication. For example, in *Newton v. Debenture holders of Anglo-Australian Investment Co.*, (1895) A.C. 224, the memorandum authorised the company to borrow "upon any security of the company". It was held that the power was wide enough to include a charge on uncalled capital. However, a company cannot mortgage or charge any part of its "reserve capital", i.e., such portion (if any) of its uncalled share capital as is incapable of being called up except in the event of winding up of the company.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

A company has implied power to mortgage its uncalled share capital.

- True
- False

Correct Answer: False

3. DEBENTURES

According to Section 2(30) of Companies Act 2013 "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not; It is evident from the definition that the term debentures covers both secured and unsecured debentures.

Kinds of Debentures

Debentures are generally classified into different categories on the basis of: (1) convertibility of the instrument (2) Security of the Instrument, (3) Redemption ability (4) Registration of Instrument

1. On the basis of convertibility, Debentures may be classified into following categories:

- (A) **Non Convertible Debentures (NCD):** These instruments retain the debt character and can not be converted into equity shares.
- (B) **Partly Convertible Debentures (PCD):** A part of these instruments are converted into Equity shares in the future at notice of the issuer. The issuer decides the ratio for conversion. This is normally decided at the time of subscription.
- (C) **Fully convertible Debentures (FCD):** These are fully convertible into Equity shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.
- (D) **Optionally Convertible Debentures (OCD):** The investor has the option to either convert these debentures into shares at price decided by the issuer/agreed upon at the time of issue.

2. On the basis of Security, debentures are classified into:

- (A) **Secured Debentures:** These instruments are secured by a charge on the fixed assets of the issuer company. So if the issuer fails on payment of either the principal or interest amount, his assets can be sold to repay the liability to the investors. Section 71(3) of the Companies Act, 2013 provides that secured debentures may be issued by a company subject to such terms and conditions as may be prescribed by the Central Government through rules.
- (B) **Unsecured Debentures:** These instrument are unsecured in the sense that if the issuer

defaults on payment of the interest or principal amount, the investor has to be along with other unsecured creditors of the company, they are also said to be naked debentures.

3. On the basis of Redeemability, debentures are classified into:

- (A) **Redeemable Debentures:** It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice, or under a system of periodical drawings. Debentures are generally redeemable and on redemption these can be reissued or cancelled. The person who has been re-issued the debentures shall have the same rights and priorities as if the debentures had never been redeemed.
- (B) **Perpetual or Irredeemable Debentures:** A Debenture, in which no time is fixed for the company to pay back the money, is an irredeemable debenture. The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation. *However, after the commencement of the Companies Act, 2013, now a company cannot issue perpetual or irredeemable debentures.*

4. On the basis of Registration, debentures may be classified as

- (A) **A Registered Debentures:** Registered debentures are made out in the name of a particular person, whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders. Such debentures are transferable in the same manner as shares by means of a proper instrument of transfer duly stamped and executed and satisfying the other requirements specified in Section 56 of the Companies Act, 2013.
- (B) **Bearer debentures:** Bearer debentures on the other hand, are made out to bearer, and are negotiable instruments, and so transferable by mere delivery like share warrants. The person to whom a bearer debenture is transferred become a "holder in due course" and unless contrary is shown, is entitled to receive and recover the principal and the interest accrued thereon. [Calcutta Safe Deposit Co. Ltd. v. Ranjit Mathuradas Sampat (1971) 41 Com Cases 1063].

Pari Passu Clause in case of Debentures

Debentures are usually issued in a series with a *pari passu* clause and it follows that they would be on an equal footing as to security and should the security be enforced, the amount realised shall be divided pro-rata, i.e. they are discharged rateably. In the event of deficiency of assets, they will abate proportionately. The expression '*pari passu*' implies with equal step, equally treated, at the same rate, or at par with. When it is said that existing debentures shall be issued *pari passu* clause, it implies that no difference will be made between the old and new debentures.

If the words *pari passu* are not used, the debentures will be payable according to the date of issue, and if they are all issued on the same day, they will be payable accordingly to their numerical order. However, a company cannot issue a new series of debentures so as to rank *pari passu* with prior series, unless the power to do so is expressly reserved and contained in the debentures of the previous series.

Debenture Stock

A company, instead of issuing debentures, each in respect of separate and distinct debt, may raise one aggregate loan fund or composite stock known as 'debenture stock'. Accordingly, a debenture stock is a

borrowed capital consolidated into one mass for the sake of convenience. Instead of each lender having a separate bond or mortgage, he has a certificate entitling him to a certain sum being a portion of one large loan. It is generally secured by a trust deed. As in the case of shares, a person may subscribe for, or transfer any amount even a fraction amount. Debenture stock is the indebtedness itself, and the debenture stock certificate furnishes evidence of the title or interest of the holder in the indebtedness. Debenture is the document which furnishes evidence of the debt. Debenture stock must be fully paid, while debenture may or may not be fully paid.

Difference between Debenture and Debenture Stock – Debenture is the description of an instrument, while 'debenture stock' is the description of a debt or sum secured by an instrument. In the words of LORD LINDLEY, it is "borrowed capital consolidated into one mass for the sake of convenience".

Distinction between Debenture and Loan – A debenture means a document which creates or acknowledges a debt. A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money [*Ram Ratan Karmarkar v. Amulya Charan Karmarkar*, 56 CWN 728 at p. 729].

Distinction Between Debentures and Shares

S. No	Debentures	Shares
1	Debentures constitute a loan.	Shares are part of the capital of a company.
2	Debenture holders are creditors.	Shareholders are members/owners of the company.
3	Debentures holder gets fixed Interest which carries a priorities over dividend.	Shareholder gets dividends with a varying rate.
4	Debentures generally have a charge on the assets of the company.	Shares do not carry any such charge.
5	Debentures can be issued at a discount without restrictions.	Shares cannot be issued at a discount.
6	The rate of interest is fixed in the case of debentures.	Whereas on equity shares the dividend varies from year to year depending upon the profit of the company and the Board of directors decision to declare dividends or not.
7	Debentureholders do not have any voting right.	Shareholders enjoy voting right.
8	Interest on debenture is payable even if there are no profits i.e. even out of capital.	Dividend can be paid to shareholders only out of the profits of the company and not otherwise.
9	Interest paid on debenture is a business expenditure and allowable deduction from profits.	Dividend is not allowable deduction as business expenditure.
10	Return of allotment is not required for allotment of debentures.	Return of allotment in e-Form No. 2 is to be filed for allotment of shares.

BROAD REGULATORY FRAMEWORK FOR DEBT SECURITIES

- (a) SEBI (ICDR) Regulations 2009
- (b) Listing Agreement for Debentures issued through public issue/Rights issue.
- (c) Listing agreement for privately placed Debentures
- (d) SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- (e) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
- (f) The Companies Act, 2013
- (g) Companies (Share Capital and Debentures) Rules, 2014

(a) SEBI (ICDR) Regulations 2009

Under SEBI (ICDR) Regulations 2009, “specified securities” means equity shares and convertible securities. The “convertible security” has been defined to mean a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instrument and convertible preference shares. Thus, the conditions specified under these regulations for Equity shares are equally applicable to public issue of convertible debt instruments also.

Additionally, the issuer of convertible debt instruments has to comply with the following.

- (a) obtain credit rating from one or more credit rating agencies;
- (b) appoint one or more debenture trustees in accordance with the provisions of Section 117B of Companies Act, 1956 [new section 71(5) of the Companies Act, 2013] and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;
- (c) create debenture redemption reserve in accordance with the provisions of Section 117C of Companies Act, 1956 [new section 71(4) of the Companies Act, 2013;]
- (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
 - such assets are sufficient to discharge the principal amount at all times;
 - such assets are free from any encumbrance;
 - where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or *pari passu* charge has been obtained and submitted to the debenture trustee before the opening of the issue;
 - the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

The issuer shall redeem the convertible debt instruments in terms of the offer document. These regulations also deal with Roll over of non convertible portion of partly convertible debt instruments.

(b) SEBI (Issue and Listing of Debt Securities) Regulations, 2008

These regulations deals with compliances with respect to non-convertible debt instruments and are applicable to (a) Public issue of debt securities and (b) listing of debt securities issued through public issue or

on private placement basis on a recognized stock exchange. It deals with aspects which include filing of offer documents, disclosures, price discovery mechanism through book building and other routine public issue aspects.

(c) Listing agreement

Listing agreement for public issue of debt instruments and privately placed debt instruments covers aspects of disclosure mechanism to stock exchanges which are routine and non-routine and other listing compliances including corporate governance aspects.

(d) SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations 2008

Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.

Securitised Debt Instrument means any certificate or instrument by whatever name called, of the nature referred to in sub-clause (ie) of clause (h) of Section 2 of SCRA.

These regulations are principle based and have been made taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction.

Provisions of Companies Act 2013- Issue of Debentures

Issue of Debentures to be approved by special resolution

Section 71 (1) states that a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

No debenture shall carry voting rights

Section 71 (2) states that no company shall issue any debentures carrying any voting rights.

Secured Debentures to comply with terms and conditions prescribed

Section 71 (3) states that Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

Rule 18(1) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions

(1) The company shall not issue secured debentures, unless it complies with the following conditions, namely:-

- (a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;
- (b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;
- (c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for

subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and

- (d) the security for the debentures by way of a charge or mortgage shall be treated in favour of the debenture trustee on-
 - (i) any specific movable property of the company (not being in the nature of pledge); or
 - (ii) any specific immovable property wherever situate, or any interest therein.

Let us remember!

The date of Redemption of debenture shall not exceed 10 years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures upto redemption period of thirty years.

Creation of debenture redemption reserve account

Section 71(4) states that when debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions:

The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

- (a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- (b) the company shall create Debenture Redemption Reserve equivalent to at least fifty percent of the amount raised through the debenture issue before debenture redemption commences.
- (c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-
 - (i) in deposits with any scheduled bank, free from any charge or lien;
 - (ii) in unencumbered securities of the Central Government or of any State Government;
 - (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
 - (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
 - (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above: Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen percent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;
- (d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect

of non-convertible portion of debenture issue in accordance with this sub-rule.

- (e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

Appointment of Debenture Trustees

Section 71 (5) states that no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

Rule 18(2) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions

The company shall appoint debenture trustees under sub-section (5) of section 71, after complying with the following conditions, namely:-

- (a) the names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;
- (b) before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;
- (c) A person shall not be appointed as a debenture trustee, if he-
 - (i) beneficially holds shares in the company;
 - (ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;
 - (iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
 - (iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
 - (v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;
 - (vi) has any pecuniary relationship with the company amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
 - (vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.
- (d) the Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act.

When such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

- (e) any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

Duties of debenture trustees

Section 71(6) A debenture trustee shall take steps to protect the interests of the debentureholders and redress their grievances in accordance with such rules as may be prescribed.

Rule 18(3) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions

It shall be the duty of every debenture trustee to-

- (a) satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;
- (b) satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;
- (c) call for periodical status or performance reports from the company;
- (d) communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor;
- (e) appoint a nominee director on the Board of the company in the event of-
 - (i) two consecutive defaults in payment of interest to the debenture holders; or
 - (ii) default in creation of security for debentures; or
 - (iii) default in redemption of debentures.
- (f) ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;
- (g) inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;
- (h) ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;
- (i) ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
- (j) do such acts as are necessary in the event the security becomes enforceable;
- (k) call for reports on the utilization of funds raised by the issue of debentures-
- (l) take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;
- (m) ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;
- (n) perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

Central Government to prescribe rules as to trust deed, quantum of debenture redemption reserve etc

Section 71(13) states that the Central Government may prescribe the procedure,

- for securing the issue of debentures,

- the form of debenture trust deed,
- the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof,
- quantum of debenture redemption reserve required to be created and such other matters.

Rule 18 of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions

(i) *With regard to trust deed and its inspection*

Rule 18(5) states that for the purposes of sub-section (13) of section 71 and sub-rule (1) a trust deed in Form No.SH.12 or as near thereto as possible shall be executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.

Rule 18 (8) states that a trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company. Further a copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee.

(ii) *Creation of debenture redemption reserve*

As discussed earlier, Rule 18(7)(b) states that (b) the company shall create Debenture Redemption Reserve equivalent to at least fifty percent of the amount raised through the debenture issue before debenture redemption commences.

(iii) *Rule 18(1) describes the process of securing debentures which are already discussed earlier.*

Exemptions clauses in the trust deed

Section 71 (7) states that any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee therefrom, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion. The liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than threefourths in value of the total debentures at a meeting held for the purpose.

Section 71 (12) states that a contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

CASE LAWS

Judicial Pronouncement about Debentures

The following kinds of documents have been held to be treated as debentures:

- (A) A legal mortgage of freehold and leasehold land [*Knightsbridge Estates Trust Ltd. v. Byrne*, 1940 AC 613: (1940) 2 All 401];
- (B) A series of income-bonds by which a loan to the company was repayable only out of its profits [*Lemon v. Austin Friars Investment Trust Ltd.* 1926 Ch 1 (CA)];
- (C) A note by which a company undertook to pay a loan but gave no security [*British India Steam Navigation Co. v. IRC*, (1881) 7 QBD 165];
- (D) A receipt or a certificate for a deposit made with a company (other than a bank) when the deposit

was repayable after a fixed period after it was made, [*United Dominions Trust Ltd. v. Kirkwood*, (1966) 2 QB 43].

- (E) The definition of debenture is so wide as to include any security of a company whether constituting a charge on the company's assets or not [Cf. *Pearl Assurance Co. Ltd. v. West Midlands Gas Board*, (1950) 2 All ER 844 (ChD)].

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A debenture is necessarily secured by a charge.

- True
- False

Correct Answer: False

REGISTER OF DEBENTUREHOLDERS

Section 88(1)(b) of the Companies Act, 2013 requires every company to keep a register of debenture-holders. The register of debenture-holders shall also include an index of the names included therein. The register shall be in the form prescribed by the Central Government and contain the prescribed particulars. Further the Central Government may prescribe separate registers for each type of debentures. The register can be closed by the company after giving at least 7 days previous notice by advertisement for a period not exceeding 45 days in a year but not exceeding 30 days at a time. However, the Securities and Exchange Board may prescribe lesser notice period for listed companies or companies which intend to get their securities listed in the prescribed manner. As per section 94(2), the register and its indices, except when they are closed under the provisions of the Act is open to inspection by the members and debenture holders, other security holder or beneficial owner during business hours without payment of any fees and by any other person on payment of nominal charges.

REMEDIES OPEN TO DEBENTUREHOLDERS

Pursuant to Sub-section (8) of Section 71, the company is bound to pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Under Sub-section (10) of section 71, if a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

Sub-section (11) of section 71 provides that if any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both. (Section 71(9) to Section 71(11) are yet to be notified)

This remedy is made available to the holders of debentures whether they are secured or unsecured. Any debentureholder can apply to the Tribunal for passing an order of payment the company which has defaulted. The Tribunal shall, while issuing order to the company, take into account the circumstances under which it has failed to redeem the debentures and the order of the Tribunal shall mention about the ways and means for redemption of the debentures by the company.

Besides, Section 164(2)(b) imposes a disqualification on the directors of a company which has failed to redeem its debentures on due date and such failure continues for one year or more. Such person shall not be eligible to be re-appointed as a director of that company or appointed as a director of any other public company for period of five years from the date from which the company has failed to redeem the debentures.

Secondly, the unsecured debentures amount to deposits under Section 73 of the Act. Section 186(8) provides that the company, which has defaulted in the repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon shall give any loan or give guarantee or provide any security or make an acquisition till such default is subsisting.

PUBLIC SECTOR BONDS

Pursuant to the announcement made by the Finance Minister in the Budget Session of Parliament in 1985, the Government evolved a scheme for flotation of bonds by telecommunication and power sector. Under the Scheme such of the Government corporate bodies as may be specified in area of telecommunication and power and any other section, as might be notified by the Government, were permitted to issue bonds for—

- (a) setting up of new projects; and/or
- (b) expansion or diversification of existing project; or
- (c) meeting normal capital expenditure for modernisation; or
- (d) for augmenting the long term resources of the company for working capital requirements.

In July 1986 the scheme was extended to other public sector enterprises. In pursuance of the announcement made by the Finance Minister in the Budget Session of Parliament in 1986, the Government introduced the scheme for issue of tax free bonds in addition to the earlier series of power and telecom bonds. In the new series the maximum rate of interest was 10% and the period of redemption upto 10 years which could be increased in suitable cases, as may be approved by the Government. The interest income from these bonds is completely free from income-tax. The bonds were also exempt from Wealth Tax without any limit. These bonds were also transferable by endorsement and delivery. The scheme provided for facility of buy back also. These bonds were required to be listed on Stock Exchanges.

The SEBI guidelines for debentures equally apply to bonds as well. Besides, PSEs have to comply with the other administrative instructions issued by the Ministry of Finance from time to time.

FOREIGN BONDS

Companies have now started floating issues in the Euro-bond market on borrowing instead of obtaining funds solely by issue of bonds in specific capital market.

Indian business enterprises can tap this source of raising foreign currency funds by issue of foreign bonds. In 1986, a new development in India's participation in global market was the floating of the India's Fund in the United Kingdom by the Unit Trust of India in collaboration with Merrill Lynch International Capital Managers. The India's fund was established to enable non-resident Indians and other persons or firms resident outside India to invest in the securities market in India through subscription to the shares of the fund.

Indian company can, with the approval of the Ministry of Finance, issue American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds.

RECENT TRENDS IN CORPORATE DEBT FINANCING

The instruments used by the corporate sector to raise funds are selected on the basis of—

- (i) Investor's preference for a given instrument;

- (ii) the regulatory framework, where under the company has to issue the security.

Convertible debenture is the most popular instrument in the current scenario to raise funds from the markets. The tax liability of the company, the purpose for which the funds are required, debt servicing ability and willingness to broad base the shareholding of the company, all influence the choice of the instrument.

The salient features of new financial instrument which have emerged in the financial markets in recent years are given below:—

- (1) **Convertible capital issue:** - means the issue made in the form of partly or wholly convertible issue, with varying conversion terms and premium on par value of equity.
- (2) **Zero coupon bonds:** - refer to those bonds which are sold at a discount from its eventual maturity value and have zero interest rate.
- (3) **Shares with differential rights:** - signifies a share with differential right to vote, dividend etc. The investor is compensated for renouncing the voting right through a higher rate of dividend than that on the conventional voting share.
- (4) **Secured Premium Notes with Detachable Warrants:** - SPN, which is issued along with detachable warrant, is redeemable after a notified period, say 4 to 7 years. The warrants attached to it ensure the holder the right to apply to get allotted equity shares, provided SPN is fully paid.
- (5) **Non-convertible Debentures with Detachable Equity Warrants:** - The holder of NCDs with detachable equity warrants is given an option to buy a specific number of shares from the company at a predetermined price within a definite time frame.
- (6) **Zero Interest fully Convertible Debentures:** - The investors in zero interest fully convertible debentures will not be paid any interest.
- (7) **Equity Shares with Detachable Warrants:-** In this category, along with fully paid equity shares, detachable warrants are issued which will entitle the warrant holder to apply for a specified number of shares at a predetermined price.
- (8) **Fully Convertible Cumulative Preference Shares (Equipref):-** Equipref is a recent introduction in the market. It has two parts: A and B. Part A, is convertible into equity shares automatically and compulsorily on the date of allotment without any further act or application by the allottee and Part B will be redeemed at part-converted into equity shares after a lock-in-period at the option of the investors.
- (9) **Preference shares with warrants attached:-** Under this instrument, each preference share should carry certain number of warrants entitling the holder to apply for equity shares for cash at 'premium' at any time in one or more stages between the third and fifth year from the date of allotment. If the warrant holder fails to exercise his option, the unsubscribed portion will lapse.
- (10) **Secured zero interest Partly Convertible Debentures with Detachable and separately tradeable warrants:-** The instrument has two parts - Part A is convertible into equity shares at a fixed amount on the date of allotment and Part B - non-convertible to be redeemed at par at the end of a specific period from the date of allotment. Part B will carry a detachable and separately tradeable warrant which will provide an option to the warrant holder to receive equity share for every warrant held at a price as worked out by the company.
- (11) **Fully convertible Debentures with interest (optional):-** This instrument will not yield any interest for a short period, say 6 months. After this period, option is given to the holders of FCDs to apply for

equities at 'premium' for which no additional amount needs to be payable. This option needs to be indicated in the application form itself. However, interest on FCDs payable at a determined rate from the date of first conversion to second/final conversion and in lieu of it equity shares will be issued.

(12) **Deep discount bond**:- It refers to those bonds which are sold at discount value by the company and on maturity face value is paid to the investors.

(13) **Option bonds**:- It covers those cumulative and non-cumulative bonds where interest is payable on maturity periodically and redemption premium is offered to attract investors.

(14) **Global depository receipts**:- It is a form of depository receipt on certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investor against the issue of ordinary shares on foreign currency convertible bonds of issuing company.

It is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world.

(15) **External Commercial borrowings** - are defined to include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds etc. credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington, ADB, AFIC, CDC etc). It is permitted by the Government as a source of finance for Indian corporates for expansion of existing capacities and fresh investments.

(16) **Derivatives**: Derivatives are contracts which derive their values from the value of one or more other assets known as underlying assets. Some of the most commonly traded derivatives are futures, options and swaps.

(a) **Futures**: Futures is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.

(b) **Options**: An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time. The right to buy is referred to as a 'call option' whereas the right to sell is known as 'put option'.

Instruments in Money Market

- (1) **Certificate of deposit**: Certificate of deposit is a document of title to a time deposit. Being a bearer document, CDs are readily negotiable and are attractive, both to the banker and to the investors in that, the banker is not required to encash the deposits prematurely, while the investor can sell the same in the secondary market. This ensures ready liquidity. Minimum size of issue of a CD is ₹ 1 lakh.
- (2) **Commercial paper**: CP refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis. It can be issued in denominations of ₹ 5 lakh or multiples thereof.

LESSON ROUND-UP

- All companies are given power to borrow by their articles which fix the maximum limit of borrowings.
- The power to borrow monies and to issue debentures (whether in or outside India) can only be exercised by the Directors at a duly convened meeting.
- Where the company borrows without the authority conferred on it by the Articles or beyond the amount set out in the

Articles, it is an ultra vires borrowing and hence void. Ultra vires borrowings cannot even be ratified by a resolution passed by the company in general meeting. In case of ultra vires borrowings the lender has the following remedies: (a) Injunction and Recovery, (b) Subrogation, (c) Suit against Directors.

- A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge.
- Debentures may be of different kinds, viz. redeemable debentures, registered and bearer debentures, secured and unsecured or naked debentures, convertible debentures.
- A debenture stock is a borrowed capital consolidated into one mass for the sake of convenience.
- A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money.
- A debenture trust deed is one of the several instruments required to be executed to secure redemption of debentures and payment of interest on due dates.
- Section 71(4) of the Act required every company to create a debenture redemption reserve account to which adequate amount shall be credited out of its profits available for payment of dividend until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only.
- Certificate of deposit is a document of title to a time deposit.
- Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis.
- The convertible debentures are regulated by SEBI (ICDR) Regulations, 2009.
- The non-convertible debentures are regulated by SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

GLOSSARY

<i>Ultra Vires</i>	Beyond the powers
<i>Intra vires</i>	Within the powers
<i>Pari passu</i>	On equal footing or proportionately
Bonds	A bond is an instrument of indebtedness of the bond issuer to the holders. It is a debt security, under which the issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay them interest (the coupon) and/or to repay the principal at a later date, termed the maturity. Interest is usually payable at fixed intervals (semiannual, annual, sometimes monthly). Very often the bond is negotiable, i.e. the ownership of the instrument can be transferred in the secondary market.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. What are the restrictions imposed on the borrowing powers of the Board of directors? If a company borrows beyond its powers, examine the remedies open to such creditor:
 - (i) When the money has not been spent;
 - (ii) When the money has been spent to pay the debts of the company.

2.What is the difference between debenture and a loan? Is fixed deposit a Debenture or Loan?

3. What is debenture? What are the kinds of debentures?
 4. What is a convertible debenture? What are the provisions of the Companies Act, 2013 regarding convertible debentures or loans?
 5. What is underwriting?
 6. Summarise the SEBI guidelines pertaining to the issue of Debentures.
 7. Is it compulsory to maintain a Debenture Redemption Reserve Account? If yes, how?
 8. Write short notes on the following:
 - (i) Ultra vires borrowings
 - (ii) Intra vires borrowings
 - (iii) Security for borrowings
 - iv) Types of borrowings
 - (v) Raising loans from financial institutions.
 9. Who is a debenture trustee? Why is it compulsory to appoint a trustee in connection with the issuance of debentures? What are the duties of a trustee?

Lesson 10

Creation and Registration of Charges

LESSON OUTLINE

- Definition of charge
- kinds of a charge viz. fixed charge, floating charge
- Judicial pronouncements on different types of charges
- Crystallization of floating charge
- Registration of charges
- Condonation of delay by Registrar
- Register of charges
- Satisfaction of charges
- Modification of charges
- Purchase or Acquisition of a Property Subject to Charge
- Condition of delay by Central Government.
- Application for Registration of charge by charge holder.

LEARNING OBJECTIVES

Borrowings by companies are often backed by securities on the strength of which loans are given by the banks or FIs. A charge is created when security is given for securing loans or debentures by way of a mortgage on the assets of the company. The charge may be fixed or floating. The Companies Act covers the provisions relating to registration, modification, satisfaction of charges, consequences of failure in Registration, delay if any in this regard etc.

The purpose of registration of a charge is to give notice to the Registrar of Companies ("RoC") and to people who intend to advance money to the company about the encumbrance created on the assets of the company. The lender may inspect the RoC files in the MCA Portal. Non registration of charges does not make the transaction invalid, but such charge shall not be taken into account by the liquidators and any other creditors of the company. Section 77-87 read with Companies (Registration of Charges) Rules 2014 deals with Regulatory and Procedural aspects covering registration of charges, condonation of delay by Central Government/Registrar etc. Maintenance of Register of Charges etc.

After reading this lesson you will be able to understand the procedure of creation of charges, their registration, modification, satisfaction etc., and their registration aspects.

DEFINITION OF A CHARGE

A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. A company, like a natural person, can offer security for its borrowings. Normally, the debentures and other borrowings of the company are secured by a charge on the assets of the company. Where property, both existing and future, is agreed to be made available as a security for the repayment of debt and creditors have a present right to have it made available, there is a charge created. The legal right of the creditor can only be enforced at some future date if certain conditions governing the loan are not met. The creditor gets no legal right either absolute or special to the property charged. He only gets the right to have the security made available / enforced by an order of the Court.

According to Section 2(16) of the Act, "charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Charge also includes a lien and an equitable charge whether created by an instrument in writing or by the deposit of title deed (*Dublin City Distillery Co. v. Deherty, 1914 AC 823*).

Kinds of Charges

A charge on the property of the company as security for debts may be of the following kinds, namely:

- (i) Fixed or specific charge;
- (ii) Floating charge.

Fixed or Specific Charge

A charge is called fixed or specific when it is created to cover assets which are ascertained and definite or are capable of being ascertained and defined, at the time of creating the charge e.g., land, building, or plant and machinery. A fixed charge, therefore, is a security in terms of certain specific property, and the company gives up its right to dispose off that property until the charge is satisfied. In other words, the company can deal with such property, subject to the charge so that the charge holder's interest in the property is not affected and the charge holder gets priority over all subsequent transferees except a *bona fide* transferee for consideration without notice of the earlier charge. In the winding-up of the company, a debenture holder secured by a specific charge will be placed in the highest ranking class of creditors.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

A charge secured against stock-in-trade is called a fixed charge

- True
- False

Correct Answer: False. It is a floating charge as stock keeps varying.

Floating Charge

A floating charge, as a type of security, is peculiar to companies as borrowers. A floating charge is not attached to any definite property but covers property of a fluctuating type e.g., stock-in-trade and is thus necessarily equitable. A floating charge is a charge on a class of assets present and future which in the ordinary course of business is changing from time to time and leaves the company free to deal with the property as it sees fit until the holders of charge take steps to enforce their security. "The essence of a

floating charge is that the security remains dormant until it is fixed or crystallised". But a floating security is not a future security. It is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder of such charge cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor i.e. the company can deal with them without the concurrence of the mortgagee.

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged. The company may sell, mortgage or lease such property in the ordinary course of its business if it is authorised by its memorandum of association.

CASE LAWS

Some Judicial pronouncements about different types of charges

1. ***Official Liquidator v. Sri Krishna Deo, (1959) 29 Com Cases 476: AIR 1959 All 247 and Roy & Bros. v. Ramnath Das, (1945) 15 Com Cases 69, 75 (Cal).*** The plant and machinery of a company embedded in the earth or permanently fastened to things attached to the earth became a part of the company's immovable property and therefore apart from the registration under the Companies Act, registration under the Indian Registration Act would also be necessary to make the charge valid and effective.
3. ***Cosslett (Contractors) Ltd., Re, (1996) 1 BCLC 407 (Ch D)*** A construction company's washing machine which was in use at the site was declared under the terms of the contract to be the employer's property during the period of construction. This was held to have created a fixed charge and not a floating charge on the machine because the machine was only one fixed item and was not likely to change.
4. A "floating security", observed **Lord Macnaghten in *Government Stock Investment Company Ltd. v. Manila Rly. Company Ltd., (1897) A.C. 81***, "is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes".
5. ***Illingworth & Another v. Holdsworth & Another, (ibid)***. "A floating charge is ambulatory and shifting in its nature hovering over and so to speak floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.
6. ***Maturi U. Rao v. Pendyala A.I.R. 1970 A.P. 225*** When the floating charge crystallizes it becomes fixed and the assets comprised therein are subject to the same restrictions as the fixed charge.
7. ***Wheatly v. Silkstone & High Moor Coal Co. Ltd., (1885) 54 L.J. Ch 78***. Unless specifically precluded, the company can create fixed charge subsequent to floating charges over the same property.
8. ***[In Smith v. Bridgend County Borough Council (2002) 1 BCLC 77 (HC)]***, the agreement was held to constitute a floating charge, in so far as it allowed the employer, in various situations of default by the contractor, to sell the contractor's plant and equipment and apply the proceeds in discharge of its obligations. A right to sell an asset belonging to a debtor and appropriate the proceeds to payment of the debt could not be anything other than a charge. It was a floating charge because the property in question was a fluctuating body of assets which could be consumed or removed from the site in the ordinary course of the contractor's business.

- 9. An assignment of book debts as scrutiny is a mortgage requiring registration. (Ranjit Ray v. David (1935) 5 Comp. Cas 281 (cal)**
- 10. Absolute assignment of future debt is not a charge. (Ashby Warner & Co. v. Simmons (1938) 8 Com Cases 111 (CA)**

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

1. The security remains dormant in case of a floating charge until it is crystallized.
2. The owner of a property secured against a floating charge can not deal with the property.
 - True
 - False

Correct Answer: 1. True 2. False

The advantage of a floating charge is that the company may continue to deal in any way with the property which has been charged.

Crystallisation of Floating Charge

A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets over which a floating charge has been created till the happening of some event which determines this right. A floating charge crystallises and the security becomes fixed in the following cases:

- (a) when the company goes into liquidation;
- (b) when the company ceases to carry on its business;
- (c) when the creditors or the debenture holders take steps to enforce their security e.g. by appointing receiver to take possession of the property charged;
- (d) on the happening of the event specified in the deed.

In the aforesaid circumstances, the floating charge is said to become fixed or to have crystallised. Until the charge crystallises or attaches or becomes fixed, the company can deal with the property so charged in any manner it likes.

Although a floating charge is a present security, yet it leaves the company free to create a specific mortgage on its property having priority over the floating charge. In *Government Stock Investment Co. Ltd. v. Manila Railway Co. Ltd.*, (1897) A.C. 81, the debentures were secured by a floating charge. Three months' interest became due but the debenture holders took no steps and so the charge did not crystallize but remained floating. The company then made a mortgage of a specific part of its property. Held, the mortgagee had priority. The security for the debentures remained merely a floating security as the debenture holders had taken no steps to enforce their security.

Effect of Crystallisation of a Floating Charge

On crystallization, the floating charge converts itself into a fixed charge on the property of the company. It has priority over any subsequent equitable charge and other unsecured creditors. But preferential creditors

who have priority for payment over secured creditors in the winding-up get priority over the claims of the debenture holders having floating charge.

Postponement of a Floating Charge

The creation of a floating charge leaves the company free to create a legal and equitable mortgage on the same property until the floating charge crystallises. Where such a mortgage is created it has priority over the floating charge which gets postponed. The floating charge is postponed in favour of the following persons if they act before the crystallization of the security:

- (a) a landlord who distrains for rent;
- (b) a creditor who obtains a garnishee order absolute^{*};
- (c) a judgement creditor who attaches goods of the company and gets them sold (But if the goods are not sold and the debenture holders take action in the meantime, the floating charge has priority);
- (d) the employees of the company, as well as other preferential creditors in the event of winding-up of the company;
- (e) the supplier of goods to the company under a hire-purchase agreement on terms that goods are to remain the property of the seller until they are paid for in full, has priority over the floating charge, whether such hire-purchase agreement is made before or after the issue of the debentures with a floating charge.

Debenture-holders with a floating charge do not, therefore, enjoy the same rights as the secured creditors, for claims against the company. The deed creating the floating charge may, however, contain a clause restricting the power of the company to create charges in priority to or *pari passu* with it. But even in such a case a person who takes mortgage without notice of floating charge gets priority. But such a contingency can be safeguarded by registering the charge. In terms of Section 80 of the Act, where a mortgage or charge on any property or assets of a company or any of its undertakings required to be registered under Section 77 of the Act has been so registered, any person acquiring such property, assets, undertakings or any part thereof or any interest or share therein shall be deemed to have notice of the charge as from the date of such registration.

Restraint on the Power to Create Charges with Priority to a Floating Charge

As the floating charge allows wide powers to the company to deal with its property subject to the floating charge, it is common to insert a clause restricting the powers of the company to create charge with priority to or *pari passu* with it. Thus, if the company creates a mortgage in favour of any person who has notice of the floating charge and restriction, such person ranks after the floating charge. But a person who obtains a valid mortgage, and can show either (i) that he was not aware of the existence of the floating charge; (ii) that though he was aware of the charge, he was not aware of the restriction, is entitled to priority by virtue of the legal estate. Furthermore, where a specific charge is created expressly subject to a floating charge, the specific charge is postponed as from the date when the floating charge crystallises by the appointment of a receiver.

Invalidity of Floating Charge

A floating charge remains afloat until a winding up commences, unless it has already crystallised through the intervention of the debenture holders or the creditors. Also, a floating charge is valid only against the unsecured creditors, whether in a winding- up or otherwise. But the Act prevents an unsecured creditor to get

* A garnishee order absolute is an order directed at the garnishee, requiring him to release to the judgement creditor any moneys which he owes the judgement debtor.

priority over the other creditors by obtaining a floating charge when he learns that the company's liquidation is imminent.

Accordingly, Section 332 of the Act provides that a floating charge on the undertakings or property of the company, which is created within 12 months immediately preceding the commencement of the winding up proceedings of a company shall be invalid, unless it is proved that the company was solvent immediately after the creation of the charge. But the charge will be valid to the extent of the amount of any cash paid to the company at the time of or after the creation of, and in consideration for the charge, together with interest on that amount at 5 per cent per annum or such other rate as may be notified by the Central Government.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

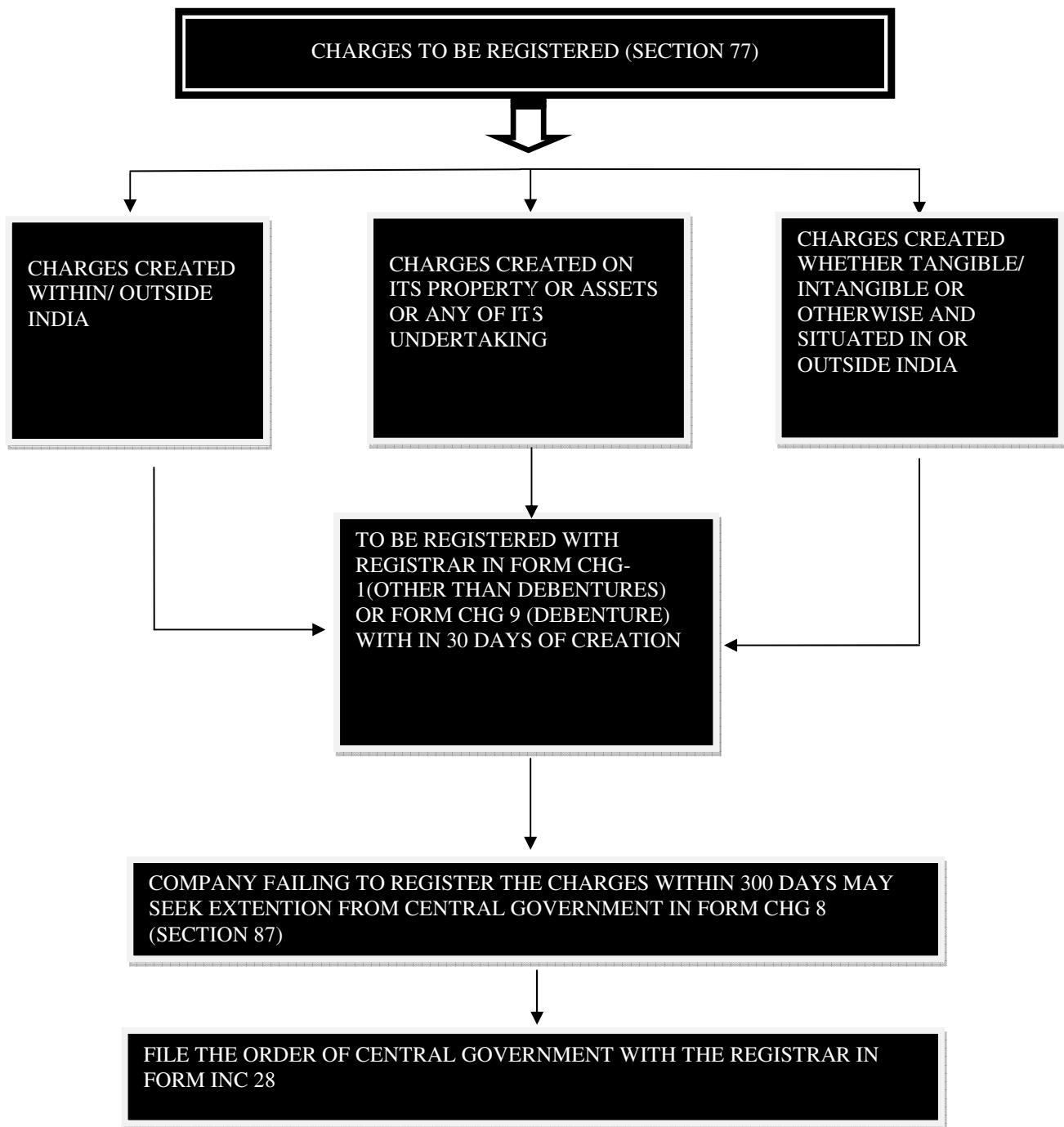
Floating charge which is created within 12 months immediately preceding the commencement of winding up proceedings of the company shall be invalid though the company was solvent immediately after the creation of charge.

Correct Answer: False

Debenture holders with a floating charge do not enjoy the same rights as the secured creditors for claims against the company.

Difference between Mortgage and Charge

S.No	Mortgage	Charge
1	A mortgage is created by the act of the parties.	A charge may be created either through the act of parties or by operation of law.
2	A mortgage requires registration under the Transfer of Property Act, 1882.	A charge created by operation of law does not require registration. But a charge created by act of parties requires registration.
3	A mortgage is for a fixed term.	The charge may be in perpetuity.
4	A mortgage is a transfer of an interest in specific immovable property.	A charge only gives a right to receive payment out of a particular property.
5	A mortgage is good against subsequent transferees.	A charge is good against subsequent transferees with notice.
6	A simple mortgage carries personal liability unless excluded by express contract.	In case of charge, no personal liability is created. But where a charge is the result of a contract, there may be a personal remedy.
7	A mortgage is a transfer of an interest in a specific immovable property.	There is no such transfer of interest in the case of a charge. Charge does not operate as transfer of an interest in the property and a transferee of the property gets the property free from the charge provided he purchases it for value without notice of the charge.

REGISTRATION OF CHARGES- PROVISIONS OF COMPANIES ACT 2013**Registration of charges- To be filed with the registrar within 30 days of creation**

Section 77(1) states that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the

instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation.

Points to be remembered

- (i) Any charge created
 - (a) within or outside India,
 - (b) on its property or assets or any of its undertakings,
 - (c) whether tangible or otherwise, and situated in or outside India
- Shall be registered.
- (ii) Particulars of charges that is being filed with Registrar of Companies is to be signed by the company creating the charge and the charge holder in form CHG-1 or Form CHG-9 as the case may be.
 - (iii) The Charge has to be registered within 30 days of its creation.

According to Rule 3 of Companies (Registration of Charges) Rules, 2014 e-forms prescribed for the purpose of creating or modifying the charge is Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification).

Condonation of delay by Registrar- within 300 days from the date of creation of charge/its modification

Proviso to Section 77(1) states that the Registrar may on an application by the company allow registration of charge within three hundred days of creation or modification of charge on payment of additional fee. The Registrar may, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within a period of thirty days of the date of creation of the charge, allow the registration of the same after thirty days but within a period of three hundred days of the date of such creation of charge or modification of charge on payment of additional fee.

The application for delay shall be made and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company.

Condonation of delay by the Central Government beyond 300 days from the date of creation

If company fails to register the charge even within this period of three hundred days, it may seek extension of time in accordance with Section 87 from the Central Government.

Section 87 (1) states that the Central Government on being satisfied that—

- (i) (a) the omission to file with the Registrar the particulars of any charge created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or
- (b) the omission to register any charge within the time required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time required under this Chapter; or
- (c) the omission or mis-statement of any particular with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made, was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of

- creditors or shareholders of the company; or
- (ii) on any other grounds, it is just and equitable to grant relief,

it may on the application of the company or any person interested and on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

Section 87 (2) states that when the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

Rule 12 of Companies (Registration of Charges) Rules, 2014

When the instrument creating or modifying a charge is not filed within a period of three hundred days from the date of its creation (including acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

The application for condonation of delay and for such other matters covered in sub-clause (a),(b) and (c) of clause (i) of sub-section (1) of section 87 of the Act shall be filed with the Central Government in Form No.CHG-8 along with the fee.

The order passed by the Central Government under sub-section (1) of section 87 of the Act shall be required to be filed with the Registrar in Form No.INC.28 along with the fee as per the conditions stipulated in the said order.

SUBSEQUENT REGISTRATION SHALL NOT PREJUDICE ANY RIGHT

Third Proviso to Section 77(1) states that any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Application for registration of charge by the charge-holder, when company fails to register a charge

According to Section 78 where a company fails to register the charge within the period specified above, the person in whose favour the charge is created may apply to the Registrar for registration of the charge alongwith the instrument created for the charge in Form No.CHG-1 or Form No.CHG-9, as the case may be, duly signed along with fee.

The registrar may, on such application, give notice to the company about such application. The company may either itself register the charge or shows sufficient cause why such charge should not be registered.

On failure on part of the company, the Registrar may allow registration of such charge within fourteen days after giving notice to the company. shall allow such registration.

Where registration is affected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company, the amount of any fee or additional fees paid by him to the Registrar for the purpose of registration of charge.

Certificate of Registration of Charge

According to Section 77(2) read with rule 6 of Companies (Registration of Charges) Rules, 2014, when a charge is registered with the Registrar, Registrar shall issue a certificate of registration of charge in Form No.CHG-2 and for registration of modification of charge in Form No.CHG-3 to the company and to the

person in whose favour the charge is created.

The certificate issued by the Registrar whether incase of registration of charge or registration of modification, as the case may be shall be conclusive evidence that the requirements of Chapter VI of the Act(Registartion of Charges) and the rules made thereunder as to registration of creation or modification of charge, as the case may be, have been complied with.

Further Section 77(3) of the Act provides that no charge created by the company shall be taken into account by the liquidator or any other creditor unless it is duly registered and a certificate of registration is given by the Registrar. However, this does not prejudice any contract or obligation for the repayment of the money secured by a charge.

Acquiring Property under Charge and Modification of Charge

Section 79 of the Act makes it clear that the requirement of registering the charge shall also apply to a company acquiring any property subject to charge or any modification in terms and conditions of any charge already registered.

It provides that the provisions of Section 77 relating to registration of charge shall apply to:

- (a) A company acquiring any property subject to a charge within the meaning of that section; or
- (b) any modification in the terms or conditions or the extent or operation of any charge registered under that section.

The provisions relating to condonation of delay shall apply, mutatis mutandis, to the registration of charge on any property acquired subject to such charge and modification of charge under section 79 of the Act.

Verification of Instruments

According Rule 3(4), a copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar in pursuance of section 77, 78 or 79 shall be verified as follows-

- (a) where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal of the company, or under the hand of any director or company secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;
- (b) where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

Satisfaction of Charges

According to section 82 read with the rules, the company shall give intimation to the Registrar of the payment or satisfaction in full of any charge within a period of thirty days from the date of such payment or satisfaction in Form No.CHG-4 along with the fee. Where the satisfaction of the charge is not filed within thirty days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government, which is later discussed in this chapter.

On receipt of such intimation, the Registrar shall issue a notice to the holder of the charge calling a show cause within such time not exceeding fourteen days, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges maintained by the registrar under section 81 and shall inform the company. If the cause is shown to the registrar shall record a

note to that effect in the register of charges and shall inform the company accordingly.

However the aforesaid notice shall not be sent, in case intimation to the registrar is in specified form and is signed by the holder of charge. [Proviso to Section 82(2)]

Power of registrar to make entries of satisfaction in absence of intimation from the company:

There may be times where a company may fail to send intimation of satisfaction of charge to the Registrar but according to section 83 of the Act, registrar may on receipt of satisfactory evidence of satisfaction register memorandum of satisfaction. The evidences may be –

- (a) The debt for which the charge was given has been paid or satisfied in whole or in part; or
- (b) Part of the property or undertaking charged has been released from the charge;
- (c) Part of the property or undertaking ceased to form part of the company's property or undertaking.

The Registrar may enter in the register of charges a memorandum of satisfaction.

Section 83(2) states that the Registrar shall inform affected parties within thirty days of making the entry in the registrar of charges.

Certificate of registration of satisfaction of charge: Where the Registrar enters a memorandum of satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge in Form No.CHG-5.

Notice of Charge

According to section 80, where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration. The section clarifies that if any person acquires a property, assets or undertaking for which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date the charge is registered.

Register of Charges Maintained In Roc's Office

In accordance with section 81 and the rules the Registrar of Companies shall maintain a register containing particulars of the charges registered in respect of every company. The particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges for the purposes of section 81 of the Act.

This charge register shall be open to inspection by any person on payment of fee for each inspection.

Intimation of appointment of receiver or manager

Section 84 provides that if any person obtains an order for the appointment of a receiver of, or of a person to manage, the property, subject to a charge, of a company or if any person appoints such receiver or person under any power contained in any instrument, he shall, within a period of thirty days from the date of the passing of the order or of the making of the appointment, give notice of such appointment to the company and the Registrar along with a copy of the order or instrument and the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

Section 84(2) states that any person so appointed shall, on ceasing to hold such appointment, give to the company and the Registrar a notice to that effect and the Registrar shall register such notice.

As per Rule 9 the notice of appointment or cessation of a receiver of, or of a person to manage, the property, subject to charge, of a company shall be filed with the Registrar in Form No. CHG.6 along with fee.

Company's Register of Charges

Section 85 read with rule 10 provides that every company shall keep at its registered office a register of charges in Form No. CHG.7 which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed.

The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.

Such register of charges shall contain the particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

All the entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company.

A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

Inspection of Charges: The register of charges and instrument of charges shall be kept open for inspection during business hours by members, creditors or any other person subject to reasonable restriction as the company by its article impose. The register of charges and the instrument of charges kept by the company shall be open for inspection- (a) by any member or creditor of the company without fees; (b) by any other person on payment of fee.

Liquidator or any other creditor take into account the unregistered charges.

Section 77(3) states that notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator or any other creditor unless it is duly registered under Sub-section (1) of Section 77 and a certificate of registration of such charge is given by the Registrar.

LESSON ROUND-UP

- The power of the company to borrow includes the power to give security also. A charge is a security given for securing loans or debentures by way of a mortgage on assets of the company.
- There are two kinds of charges, fixed or specific charge and floating charge.
- A charge is fixed when it is made to cover assets which are ascertained and definite or capable of being ascertained and defined at the time of creating charge. Whereas floating charge is not attached to any definite property but covers property of a fluctuating type.
- When floating charge crystallizes, it becomes fixed.
- The floating charge allows wide powers to the company to deal with its property until such charge crystallizes.
- The particulars of charge is to be registered within 30 days of its creation

- The registrar can condone the delay till 300 days from the date of creation of charges.
- If the company fails to register particulars of charges within 300 days of its creation, it should make an application to Central Government for condonation of delay.
- The particulars of charges are to be signed by the company and the charge holder. If the company fails to register the charge, the charge holder can register the charge.
- The registrar can make entries for satisfaction of charge in absence of information from the company.

GLOSSARY

Garnishee	An individual who holds money or property that belongs to a debtor subject to an attachment proceeding by a creditor.
Charge	A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company. As mentioned earlier, the power of the company to borrow includes the power to give security also.
Crystallization of Floating Charge	A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets having a floating charge till the happening of some event which determines this right.
Mortgage	A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an agreement which may give rise to pecuniary liability.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Define mortgage. State the various types of mortgages.
2. What are the essentials of a mortgage?
3. What is a charge? Enumerate the statutory provisions for their registration. State the circumstances under which certain charges may be void against the liquidator or the creditors of company.
4. What information must be entered in the register of charges maintained by the company? What is the effect of a failure to register a charge?
5. Can a floating charge become a fixed charge? If so, under what circumstances?
6. Distinguish between :
 - (a) Fixed and Floating Charge
 - (b) Mortgage and Charge
7. Under what circumstances a Floating Charge is crystallised?
8. Discuss various types of registerable charges.

9. What are consequences of non-registration of charges?
 10. Write short notes on:
 - (a) Satisfaction of Charges
 - (b) Modification of Charges.

Lesson 11

Allotment of Securities and Issue of Certificates

LESSON OUTLINE

- Allotment of securities
- General principles regarding allotment
- Judicial pronouncements relating to allotment of shares
- Statutory provisions regarding allotment
- Return of allotment
- Share certificate
- Issue of duplicate share certificate
- Calls and forfeiture
- Requisite of a valid call
- Reissue of forfeited shares
- Surrender of shares

LEARNING OBJECTIVES

Allotment is an act of appropriation of certain number of securities to those persons who have applied for it. The Certificate conveys the title to the security and is issued subsequent to allotment. The Companies Act, 2013, SEBI (Issue of Capital and Disclosure Requirements), Regulations, 2009 ("SEBI ICDR Regulations"), Securities (Contracts) Regulations, etc. provide for procedural aspects as to allotment and issue of Certificates for securities.

In fact, in the present era of compulsory Dematerialization, physical share certificate is a rare phenomenon especially for listed companies which are also governed by Securities and Exchange Board of India ("SEBI") Regulations, listing agreement etc.. Companies Act 2013(the Act) also mandates public offer of companies and such class of companies as may be prescribed should issue securities only in dematerialized form.

After reading this lesson, you will be able to understand the concepts, regulatory and procedural aspects relating to allotment and issue of certificates in the light of Companies Act 2013 read with Companies (Prospectus and Allotment of Securities) Rules, 2014 and Companies (Share Capital and Debentures) Rules, 2014 .

SECURITIES

According to 2(81) of Companies Act, 2013 "securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

According to 2(84) of the Act, "share" means a share in the share capital of a company and includes stock.

As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956 "securities" include—

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;]

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

[Explanation.-- For the removal of doubts, it is hereby declared that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938(4 of 1938).]

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receiveable including mortgage debt, as the case may be;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;

Thus, the word "securities" includes shares and other instruments.

GENERAL PRINCIPLES REGARDING ALLOTMENT

"Allotment" of shares means the act of appropriation by the Board of directors of the company out of the previously un-appropriated capital of a company of a certain number of shares to persons who have made applications for shares (In Re Calcutta Stock Exchange Association, AIR 1957 Cal. 438). It is on allotment that shares come into existence.

The following general principles should be observed with regard to allotment of securities:

- (1) **The allotment should be made by proper authority**, i.e. the Board Directors of the company, or a committee authorised to allot securities on behalf of the Board.
- (2) **Allotment of securities must be made within a reasonable time** (As per Section 6 of the Indian

Contract Act, 1872, an offer must be accepted within a reasonable time). What is a reasonable time is a question of fact in each case. An applicant may refuse to take securities if the allotment is made after a long time.

- (3) **The allotment should be absolute and unconditional.** Securities must be allotted on same terms on which they were applied for and as they are stated in the application for securities. Allotment of securities subject to certain conditions is also not valid. Similarly, if the number of securities allotted is less than those applied for, it cannot be termed as absolute allotment.
- (4) **The allotment must be communicated.** As mentioned earlier posting of letter of allotment or allotment advice will be taken as a valid communication even if the letter is lost in transit.
- (5) **Allotment against application only** — No valid allotment can be made on an oral request. Section 2(55) of the Act requires that a person should agree in writing to become a member.
- (6) **Allotment should not be in contravention of any other law** — If securities are allotted on an application of a minor, the allotment will be void.

CASE LAWS

Judicial pronouncement relating to allotment

- (A) Allotment made without proper authority will be invalid. Allotment of shares made by an irregularly constituted Board of directors shall be invalid [Changa Mal v. Provisional Bank (1914) ILR 36 All 412].
- (B) It is necessary that the Board should be duly constituted and should pass a valid resolution of allotment at a valid meeting [Homes District Consolidated Gold Mines Re (1888) 39 Ch D 546 (CA)].
- (C) An allotment may be valid even if some defect was there in the appointment of directors but which was subsequently discovered.(Section 290 and the Rule in Royal British Bank v. Turquand (1856) 6 E & B 327 : (1843-60) All ER Rep 435)
- (D) An allotment by a Board irregularly constituted may be subsequently ratified by a regular Board [Portuguese Consolidated Copper Mines, (1889) 42 Ch. D 160 (CA)].
- (E) A director who has joined in an allotment to himself will be estopped from alleging the invalidity of the allotment [Yark Tramways Co. v. Willows, (1882) 8 QBD 685 (CA)].
- (F) The interval of about 6 months between application and allotment was held unreasonable [Ramsgate Victoria Hotel Company v. Montefione (1866) LR 1 EX 109].
- (G) Grant applied for certain shares in a company, the company dispatched letter of allotment to him which never reached him. It was held that he was liable for the balance amount due on the shares. [Household Fire And Carriage Accident Insurance Co. Ltd. Grant (1879) 4 E.D. 216]
- (H) The mere entry of a shareholder's name in the company's register is insufficient to establish that an allotment was in fact made [Official Liquidator, Bellary Electric Supply Co. v. Kanni Ram Ramwoothmal (1933) 3 Com Cases 45; AIR 1933 Mad 320].
- (I) There can be no proper allotment of shares unless the applicant has been informed of the allotment [British and American Steam Navigation Co. Re. (1870) LR 10 Eq 659].
- (J) A formal allotment is not necessary. It is enough if the applicant is made aware of the allotment. [Universal Banking Corpn. Re. Gunn's Case (1867) 3 Ch App 40].

Provisions relating to allotment of securities – Companies Act 2013

Allotment of Securities – Conditions

Section 39(1) states that no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

Minimum Application Money [Section 39(2)]

The amount payable on application on every security shall not be less than five per cent. of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

Money to be returned if minimum application money is not received

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount so received shall be returned within 15 days from the closure of the issue. If any such money is not so repaid within such period the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at 15% P.A.

Company to file Return of allotment

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in Form PAS-3.

Companies (Prospectus and Allotment of Securities) Rules, 2014- Rules relating to allotment of securities

- Rule 12 states that whenever company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form PAS-3, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014. There shall be attached to the Form PAS-3 a list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form PAS-3 as being complete and correct as per the records of the company.

Further, in the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form PAS-3 a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration. When a contract is not reduced to writing, the company shall furnish along with the Form PAS-3 complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899 (2 of 1899), and the Registrar may, as a condition of filing the particulars, require that the stamp duty payable thereon be adjudicated under section 31 of the Indian Stamp Act, 1899. Further a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract as mentioned in sub-rule (3) and sub-rule (4).

- In the case of issue of bonus shares, a copy of the resolution passed in the general meeting

authorizing the issue of such shares shall be attached to the Form PAS-3.

- In case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form PAS-3, the valuation report of the registered valuer.

Explanation.- Pending notification of sub-section (1) of section 247 of the Act and finalisation of qualifications and experience of valuers, valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.

Let us remember!

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in Form PAS-3 within thirty days from the date of allotment.

Penalty for default

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

CASE LAWS

Judicial Pronouncement about return of Allotment

1. In Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd. 1963-(033)-Com Cases-0862-SC, the Supreme Court held that the exchange was not liable to file any return of the forfeited shares under Section 75(1) of the Companies Act, 1956 [Corresponds to section 39 of the Companies Act, 2013] when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital and approved the observations of Harries C.J. in S.M. Nandy's case that: "On such forfeiture all that happened was that the right of the particular shareholder disappeared but the shares considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it".
2. Alote Estate v. R.B. Seth Hiralal Kalyanmal Kasliwal [1970] 40 Com Cases 1116 (SC), In case of inadequacy of consideration, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full, unless the contract is fraudulent.
3. Harmony and Montage Tin and Copper Mining Company; Spargo's case (1873) 8 Ch. App. 407. Any payment which is presently enforceable against the company such as consideration payable for property purchased, will constitute payment in cash.
4. Chokkalingam v. Official Liquidator AIR 1944 Mad. 87. Allotment of shares against promissory notes shall not be valid.

ISSUE OF CERTIFICATES

What is a share certificate?

A share certificate is a certificate issued to the members by the company under its common seal specifying the number of shares held by him and the amount paid on each share. According to Section 45 of the Companies Act, 2013 each share of the share capital of the company shall be distinguished with a distinct

number for its individual identification. However, such distinction shall not be required, as per proviso to Section 45, if the shares are held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

In terms of Section 46(1) of the Act, a certificate under the common seal of the company is *prima facie* evidence of the title of the person to the shares specified therein. The certificate is the only documentary evidence of title in the possession of the shareholder. But it is not a warranty of title by the company issuing it.

When can a company issue Duplicate Share Certificate?

Section 46 (2) states that a duplicate certificate of shares may be issued, if such certificate —

- (a) is proved to have been lost or destroyed; or
- (b) has been defaced, mutilated or torn and is surrendered to the company.

Manner of issuing share certificates/ Duplicate Share Certificates

Section 46(3) states that notwithstanding anything contained in the articles of a company, the manner of issue of

- a certificate of shares or
- the duplicate thereof,

the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

SHARE CERTIFICATES

**ISSUE OF SHARE CERTIFICATE
RULE 5 OF THE COMPANIES
(SHARE CAPITAL AND
DEBENTURES) RULES, 2014**

- Pass board resolution
- Letter of offer surrendered to company if the letter is lost or destroyed the board may impose reasonable terms
- Certificate shall be issued in Form No. SH-1 and shall specify the name of person in whose favour the certificate is issued
- Certificate shall be issued under the common seal of the company
- The certificate shall be signed by –
 - Two directors duly authorized by the board if the composition of board permits at least one of the aforesaid two directors shall be a person other than managing or whole time director
 - The secretary or any person authorized by the board
- Particulars of shares certificates to be entered in the Register of Members.

**ISSUE OF RENEWED OR
DUPLICATE SHARE CERTIFICATE
RULE 6 OF THE COMPANIES
(SHARE CAPITAL AND
DEBENTURES) RULES, 2014**

- Renewal to be made only on surrender of old certificate
- Company may charge fee for duplicate share certificate as the board decides but not exceeding ₹ 50 per certificate.
- Company shall not issue any duplicate share certificate in lieu of those lost or destroyed without the prior consent of Board
- If the company is listed then the duplicate share certificates shall be issued within 15 days and if the company is unlisted it shall issue the certificates in 3 months
- The particulars of renewed and duplicate share certificate to be entered in Form No. SH.2
- The register to be kept at registered office of the company
- On fraudulent issue the company shall be punishable with: fine which shall not be less than five times the face value of shares involved which may extend to ten times
- Officer in default shall be liable under section 447

Rule 5 of Companies (Share Capital and Debentures) Rules, 2014, relating issue of Certificates

Rule 5 and Rule 6 of Companies (Share Capital and Debentures) Rules, 2014 provides the following relating to issue of Securities:

What is prescribed relating to issue of share certificates?

(a) Certificate of shares (where shares are not in demat form)[(Rule 5(1)]-

(1) Where a company issues any share capital, no certificate of any share or shares held in the company shall be issued, except-

- (a) in pursuance of a resolution passed by the Board; and
- (b) on surrender to the company of the letter of allotment or fractional coupons of requisite value, save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares:

If, the letter of allotment is lost or destroyed, the Board may impose such reasonable terms, if any, as to seek supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating evidence, as it may think fit.

(b) Share Certificate Format [Rule 5(2)]

Every certificate of share or shares shall be in Form No. SH.1 or as near thereto as possible and shall specify the name(s) of the person(s) in whose favor the certificate is issued, the shares to which it relates and the amount paid-up thereon.

(c) Share certificate to be issued under the common seal of the company and signatories to share certificates [Rule 5(3)]

Every share certificate shall be issued under the seal of the company, which shall be affixed in the presence of, and signed by-

- (a) two directors duly authorized by the Board of Directors of the company for the purpose or the committee of the Board, if so authorized by the Board; and
- (b) the secretary or any person authorised by the Board for the purpose:

In companies wherein a Company Secretary is appointed under the provisions of the Act, he shall deemed to be authorised for the purpose of this rule:

If the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director:

In case of a One Person Company, every share certificate shall be issued under the seal of the company, which shall be affixed in the presence of and signed by one director or a person authorized by the Board of Directors of the company for the purpose and the Company Secretary, or any other person authorized by the Board for the purpose.

A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

(d) Particulars of Share certificates to be entered in the Register of Members [Rule 5(4)]

The particulars of every share certificate issued shall be entered in the Register of Members maintained in accordance with the provisions of section 88 along with the name(s) of person(s) to whom it has been issued, indicating the date of issue.

Rule 6 of Companies (Share Capital and Debentures) Rules, 2014 relating to issue of duplicate certificates

Issue of renewed or duplicate share certificate (Rule 6).-

(1) The certificate of any share or shares shall not be issued either in exchange for those which are subdivided or consolidated or in replacement of those which are defaced, mutilated, torn or old, decrepit, worn out, or where the pages on the reverse for recording transfers have been duly utilised, unless the certificate in lieu of which it is issued is surrendered to the company:

(a) The company may charge such fee as the Board thinks fit, not exceeding fifty rupees per certificate issued on splitting or consolidation of share certificate(s) or in replacement of share certificate(s) that are defaced, mutilated, torn or old, decrepit or worn out:

(b) when a certificate is issued in any of the circumstances specified in this sub-rule, it shall be stated on the face of it and be recorded in the Register maintained for the purpose, that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation" and also that no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government:

(c) A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered subject to compliance with the rules.

(2) (a) The duplicate share certificate shall not be issued in lieu of those that are lost or destroyed, without the prior consent of the Board and without payment of such fees as the Board thinks fit, not exceeding rupees fifty per certificate and on such reasonable terms, such as furnishing supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating the evidence produced. The Ministry of Corporate Affairs vide circular dated June 12, 2014 clarified that a committee of directors may exercise such powers.

(b) when a certificate is issued in any of the circumstances specified in this sub-rule, it shall be stated prominently on the face of it and be recorded in the Register maintained for the purpose, that it is "duplicate issued in lieu of share certificate No.....". and the word "duplicate" shall be stamped or printed prominently on the face of the share certificate:

(c) In case unlisted companies, the duplicate share certificates shall be issued within a period of three months and in case of listed companies such certificate shall be issued within fifteen days, from the date of submission of complete documents with the company respectively.

Register of renewed and duplicate share certificates

(3) (a) The particulars of every share certificate issued in accordance with sub-rules (1) and (2) shall be entered forthwith in a Register of Renewed and Duplicate Share Certificates maintained in Form No.SH.2 indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column.

(b) The register shall be kept at the registered office of the company or at such other place where the Register of Members is kept and it shall be preserved permanently and shall be kept in the

custody of the company secretary of the company or any other person authorized by the Board for the purpose.

- (c) All entries made in the Register of Renewed and Duplicate Share Certificates shall be authenticated by the company secretary or such other person as may be authorised by the Board for the purposes of sealing and signing the share certificate under the provisions of sub-rule (3) of rule 5.

Let us Remember !

Register of renewed and duplicate share certificates shall be maintained in Form SH2.

Maintenance of share certificate forms and related books and documents.- (Rule 7)

(1) All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and the blank form shall be consecutively machine-numbered and the forms and the blocks, engravings, facsimiles and hues relating to the printing of such forms shall be kept in the custody of the secretary or such other person as the Board may authorise for the purpose; and the company secretary or other person aforesaid shall be responsible for rendering an account of these forms to the Board.

(2) The following persons shall be responsible for the maintenance, preservation and safe custody of all books and documents relating to the issue of share certificates, including the blank forms of share certificates referred to in sub-rule (1), namely:—

- (a) the committee of the Board, if so authorized by the Board or where the company has a company secretary, the company secretary; or
- (b) where the company has no company secretary, a Director specifically authorised by the Board for such purpose.

(3) All books referred to in sub-rule (2) shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently, and all certificates surrendered to a company shall immediately be defaced by stamping or printing the word "cancelled" in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf:

Non applicability of Rule 7(3)

Proviso to Rule 7(3) provides that nothing in this sub-rule shall apply to cancellation of the certificates of securities, under sub-section (2) of section 6 of the Depositories Act, 1996 (22 of 1996), when such certificates are cancelled in accordance with sub-regulation (5) of regulation 54 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996, made under section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) read with section 25 of the Depositories Act, 1996 (22 of 1996).

Record of depository is prima facie evidence for shares in depository form

Section 46 (4) states that where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

Issuing duplicate share certificates to defraud

Section 46 (5) If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the

issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447, for fraud.

Time of issue of Certificate of Securities

Under Section 56(4) of the Act, every company, (unless prohibited by any provision of law or any order of any Court, Tribunal or other authority) must deliver the certificates of all securities allotted, transferred or transmitted:-

- (a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
- (b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
- (c) within a period of one month from the date of receipt by the company of the instrument of transfer or, as the case may be, of the intimation of transmission, in the case of a transfer or transmission of securities;
- (d) within a period of six months from the date of allotment in the case of any allotment of debenture.

However, where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. [See proviso to Section 56(4)].

Where any default is made in complying with the above provisions, the company shall be punishable with fine which shall not be less than Rs 25,000 but which may extend to Rs 5 lakh and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs 10,000 but which may extend to ₹1,00,000. [Section 56(6)]

Significance of Share Certificate

A certificate of shares is evidence to the effect that the allottee is holding a certain number of shares of the company showing their nominal and paid-up value and distinctive numbers. This certificate is a prime facie evidence of title to the shares in the possession of shareholders. [*Society Generale De Paris v. Walker, (1885) 11A AC 20, 29*].

Moreover, when the company issues a certificate, it holds out to the world that the facts contained therein are true. Any person acting on the faith of the share certificate of the company, can compel the company to pay compensation for any damage caused by reason of any misstatement in the share certificate as the company is bound by any statements made in the certificate.

Share certificate is the only documentary evidence of title and that the share certificate is a declaration by the company that the person in whose name the certificate is issued is a shareholder in the company. [*Ghanshyam Chhaturbhuj v. Industrial Ceramics (Pvt.) Ltd. (1995) 4 Com LJ 51*].

Also the company cannot dispute the amount mentioned on the certificate as already paid. [*Bloomenthal v. Ford (1897) AC 156 (HL)*].

Damages against Company and Directors for wrong certificates

As already mentioned, a person acting on the share certificate issued by the company may recover compensation for the damages suffered by him. The measure of damage is the value of the shares at the

time of the refusal by the company to recognise him as a shareholder together with interest from that date. [*Bahla and San Francisco Rly. Co.*, (1868) LR 3 QB 584].

Where directors issue a certificate of title of shares which the company has no power to issue, they may be held personally liable to damages on an implied warranty of authority to any person who acts on such certificate.

Split Certificate

A split certificate means a separate certificate claimed by a shareholder for a portion of his holding. The advantages of a split certificate are that the shareholder may benefit in case of a transfer by way of sale or mortgage in small lots and the right to multiply the certificates into as many shares held by the shareholder.

Purpose and Form of Share Certificate

With the help of a share certificate a member of a company may deal with his shares in the market whether it is one of sale, mortgage or pledge by showing a good *prima facie* marketable title to the shares. A share certificate is a documentary evidence of title to shares in the possession of the shareholder. It is a *prima facie* evidence of his title to the shares.

Section 46(4) provides that where a share is held in depository form, the record of the depository is the *prima facie* evidence of the interest of the beneficial owner.

Let us Remember !

Every certificate of share or shares shall be in Form No. SH.1 or as near thereto as possible.

The particulars of every share certificate issued shall be entered forthwith in a Register of Renewed and Duplicate Share Certificates maintained in Form No.SH.2

Whether Share Certificate an Official Publication

The question whether a share certificate is an official publication within the meaning of Section 12(3)(c) was considered by the Department of Company Affairs (Now, Ministry of Corporate Affairs) and the Department has clarified vide Circular No. 3/73[8/10(47)]/72-CL-V dated 3.2.1973 as follows:

"It will be seen that in terms of Section 82 [Corresponds to section 44 of the Companies Act, 2013], the shares in a company are movable property transferable in the manner provided in the articles of the company.

Section 84 [Corresponds to section 44 of the Companies Act, 2013] provides that a certificate under the common seal of the company specifying any share held by any member shall be *prima facie* evidence of the title of the member to such share.

Thus, shares are movable property transferable in the manner provided in the articles of the company and that the share certificates are certificates of title and are movable property but are not publications in the nature of prospectus, balance sheet, profit and loss account, notice or advertisement.

The conclusion reached, therefore, is that the share certificate is not an official publication within the meaning of Section 12(3)(c).

Legal Effect of Share Certificate

We have already stated that a share certificate is *prima facie* evidence to the title of the person whose name

is entered on it. It means that the share certificate is a statement by the company that the moment when it was issued, the person named in it was the legal owner of the shares specified in it, and those shares were paid-up to the extent stated. It does not constitute title but it is merely evidence of title. It is, however a statement of considerable importance, for it is made with the knowledge that other persons may act upon it in the belief that it is true and this fact brings into operation the doctrine of estoppel. As a result, a share certificate once issued by the company binds it in two ways, namely:

- (a) by estoppel as to title, and
- (b) by estoppel as to payment.

Estoppel as to Title: A share certificate once issued binds the company in two ways. In the first place, it is a declaration by the company to the entire world that the person in whose name the certificate is made out and to whom it is given is a shareholder in the company. In other words the company is estopped from denying his title to the shares.

Estoppel as to Payment: If the certificate states that on each of the shares full amount has been paid, the company is estopped as against a *bona fide* purchaser of the shares, from alleging that they are not fully paid.

If a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company *Barrow case (1880) 14 Ch D 432: 42LT 891CA*.

Despite everything, a certificate must be issued by someone who has the authority. For example, where the secretary forged the signature of two directors in a company, the company had refused to register the holder of shares as a member. Further a certificate is not evidence as to the equitable interest in shares. Also, where an individual is aware of the false statements in a certificate, he will not be entitled to claim an estoppel.

Personation of Shareholder

Section 57 of the Companies Act provides that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

CALLS AND FORFEITURE

Calls

A company issuing shares to its members may call the money due on shares at intervals depending upon the requirements for funds for implementing the project and the shareholders also prefer to pay the nominal value on their shares in installments as and when demanded by the company.

A call is a demand, by the company in pursuance of a Board resolution and in accordance with the articles of the company, upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted or held by them made at any time during the life of the company. A call may also be made by the liquidator in the course of winding up of the company. The amount payable in application on each share shall not be less than five per cent of the nominal amount of the share. The balance may be payable as and when called for in one or more calls. The prospectus and the articles of a company generally specify the amount payable at different times, as call(s).

Under Section 10(2) of the Act all moneys payable by any member to the company on the shares held by him under the memorandum or articles is a debt due from him to the company. In the event of default in payment of a valid call, the company can enforce payment of such moneys by legal process and forfeit the shares in case the call is not paid. The liability of members is enforceable only after a proper notice which is called 'call letter' or call notice as 1st, 2nd and final or so on, is given to him in accordance with the articles.

Requisites of a valid call

1. Board of Directors to make call(s) on shares

The power to make calls is exercised by the Board in its meeting by means of a resolution [Section 179(3)(a)]. The Board, in making a call, must observe the provisions of the articles, otherwise the call will be invalid, and the shareholder is not bound to pay. A proper notice must be given, and the notice must specify the amount called up and manner i.e. the date for payment and place and to whom it is to be paid. It may be emphasised that the time and place at which the call is to be paid are essential ingredients of a valid call.

Apart from this rule, "in making call, care must be taken that the directors making it are duly appointed and qualified; the meeting of the directors has been duly convened; proper quorum was present, and that the resolution making the call was duly passed and specifies the amount of the call, the time and place of payment.

2. Call(s) to be made bonafide in the interest of the company

The power to make call is in the nature of trust and must be exercised only for the benefit of the company, and not for the private ends of the directors. If the call is made for the personal benefit of directors, the call will be invalid. In *Alexander v. Automatic Telephone Co.*, (1900) 2 Ch. 56, the directors of the company paid nothing on their shares but did not disclose this fact to the shareholders and called on them to pay certain amount partly as allotment money and partly as call money. The directors were held guilty of breach of trust and the call was held invalid.

3. Call(s) must be made on uniform basis

According to Section 49 of the Act, calls on same class of shares must be made on a uniform basis. Hence a call cannot be made only on some of the members unless they constitute a separate class. In other words, there cannot be any discrimination between shareholders of the same class as regards amount and time of payment of call.

4. Notice of call(s)

The notice of call must specify the exact amount and time of payment. In *Shackleyford & Co. Dangerfield* (1868) (R3 CP 407) the notice had specified the time and amount to be paid as a call, it will be a valid call inspite of the fact that the form of notice was an inaccurate one. A call must be made by serving upon member formal notice in accordance with the provisions of Section 53 of Companies Act, 1956 (Corresponding to Companies Act, 2013).

5. Time limitations for receiving the call money

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue.

Usually Articles of association of companies provide for the manner in which calls should be made. They follow the pattern set out in Regulations 13 to 18 of Table-F of Schedule-I appended to the Companies Act,

2013:-.

- (a) For each call at least 14 days notice must be given to members.
- (b) An interval of one month is required between two successive calls and not more than one-fourth of the nominal value of shares can be called at one time. However, companies may have their own articles and raise the limit.
- (c) The Board of directors has the power to revoke or postpone a call after it is made.
- (d) Joint shareholders are jointly and severally liable for payment of calls.
- (e) If a member fails to pay call money he is liable to pay interest not exceeding the rate specified in the articles or terms of issue or such lower rate, as the Board may determine. The directors are free to waive the payment of interest wholly or in part.
- (f) If any member desires to pay the call money in advance, the directors may at their discretion accept and pay interest not exceeding the rate specified in the articles.
- (g) A defaulting member will not have any voting right till call money is paid by him.

Interest on calls due but not paid — A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table F, in this regard provides:

- "16(i) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest thereon from the day appointed for payment thereof to the time of actual payment at 10% per annum or at such lower rate, if any, as the Board may determine.
- (ii) The Board shall be at liberty to waive payment of any such interest wholly or in part."

Acceptance of uncalled capital

Section 50(1) states that if authorized by its articles, a company may accept from any member the whole or part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up.

Where section 50(2) provides that a member who has paid the whole or part of the amount remaining unpaid on the shares held by him even though the company has not made a call for it is not entitled for any voting right at a general meeting on the amount so paid until that amount has been called up

Quantum and Interval between two calls

Proviso to Regulation 13(i) to the Table 'F' of Schedule I of the Companies Act, 2013 provides that no call shall exceed 25% of the nominal value of the share or be payable at less than one month from the date fixed for the payment of the last proceeding call.

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment of the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited. However, it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 16 of SEBI (ICDR) Regulations, 2009.

Regulation 16 of ICDR provides that if the issue size exceeds five hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by

one of the scheduled commercial banks named in the offer document as bankers of the issuer. However, nothing contained in this clause shall apply to an offer for sale or an issue of specified securities made by a bank or public financial institution or an insurance company.

Forfeiture of Shares

Forfeiture may be termed as penalty for violation of terms of contract. Forfeiture of shares means taking back of shares by the company from the shareholders. If the shareholder makes default in payment of calls on shares, then the company can use the option of forfeiting the shares. For a valid forfeiture, satisfaction of following conditions is necessary: -

1. **Articles of Association must authorise the forfeiture of shares.** Where power is given in the articles, it must be exercised in accordance with the regulation regarding notice, procedure and manner stated therein; otherwise the forfeiture will be void. The power of forfeiture must be exercised *bona fide* and in the interest of the company. It should not be collusive or fraudulent. If Articles authorise, the forfeiture shall include forfeiture of all dividends declared in respect of the forfeited shares and such dividend is not actually paid before the forfeiture of the shares.
2. **Resolution for Forfeiture** - Article 30 of the Table F provides that if the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors may pass a resolution forfeiting the shares.
3. **Proper Notice** - Before the shares of a member are forfeited, a proper notice to that effect must have been served. Regulation 29 of Table F provides that a notice shall name a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. The notice must also mention that in the event of non payment, the shares will be liable to be forfeited.
4. **Power of forfeiture must be exercised bona fide and for the benefit of the company** - The power to forfeit be exercised *bona fide* and for the benefit of the company. The power must be used in order to coerce reluctant shareholders into paying their calls. The power of forfeiture cannot be exercised to relieve unwilling shareholders from the liability of making the payment. Such a shareholder continues to be responsible for the unpaid part of the shares.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Articles of Association must authorize forfeiture of shares.

- True
- False

Correct Answer: True

When forfeiture of shares takes place, shareholder ceases to be a member and the forfeited shares become the property of the company. Regulation 32(ii) of Table F further provides that the liability of a person whose shares have been forfeited ceases if and when the company receives payment in full of all such monies in respect of the shares forfeited. If liquidation takes place, the original holder shall remain liable as a past member to pay calls within one year of forfeiture. However, a company cannot recover from him more than the difference between the amount payable and the amount received on forfeited shares.

In case, the defaulting shareholder approaches the Board to cancel the forfeiture, the Board is empowered to cancel such forfeiture and claim the due amount with interest.

CASE LAWS

Some Legal Pronouncement about forfeiture of shares

1. *Shah J. in Naresh Chandra Sanyal v. Calcutta Stock Exchange Assn. Ltd.* AIR 1971 SC 422, As per Regulation 29 of Table A [Corresponds to Regulation 28 of Table F of Schedule I to the Companies Act, 2013], shares can be forfeited only against non-payment of any call, or instalments of a call. The Articles of a company may, however, lawfully incorporate any other grounds of forfeiture.
2. *Linkmen Services (P.) Ltd. v. Tapas Sinha* (2008) 83 SCL 143 (CAL), a company amended its articles of association for the purpose of (i) forfeiting the shares of any defaulting member and (ii) expelling member who desert the company by not doing business with it. The respondents challenged the above amendments on the grounds of oppression. The CLB (Replaced by the Tribunal under the Companies Act, 2013) held that the articles of company could not empower to forfeit the shares on account of dues other than unpaid calls. The appellant company appealed to the High Court. Allowing the appeal the Court held that forfeiture on grounds as mentioned in the articles of company is not alien to corporate jurisprudence as the CLB found in the impugned judgment. It is a power that the articles can confer.
3. *Hope v. International Finance Society* (1876) 4 Ch. D 598. Where the articles authorise the directors to forfeit the shares of a shareholder, who commences an action against the company or the directors, by making a payment of the full market value of his shares, it was held that such a clause was invalid as it was against the rights of a shareholder.
4. *Re Exparto Trading Co.* [1879] 12 Ch. D 191 Where two directors were allotted qualification shares, without any payment, and these shares were forfeited by a Board resolution passed at the request of those two directors, the forfeiture was held to be invalid and the directors were held liable to pay the nominal value of the shares.
5. *Public Passenger Services Ltd. v. M.A. Khader* 1966 1 Comp LJ 1: A proper notice is a condition precedent to the forfeiture, and even the slightest defect in the notice will invalidate the forfeiture.
6. *Johnson v. Lyttle's Iron Agency* 1877 Ch D 687. The notice should mention that the payment of interest should be made from the date of the call.
7. *Sparks v. Liverpool Water Works Co.*, 1807 13 Ves 428. Accidental non receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected.
8. *Sha Mulchand & Co. v. Jawahar Mills Ltd.* 1953 23 Com Cases 1 (SC). Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void. The aggrieved shareholder may bring an action for setting aside the forfeiture as well as for damages. Mere waiver or acquiescence would not deprive him of his rights against an invalid forfeiture of his shares.
9. *Sha Mulchand & Co. v. Jawahar Mills (supra)*. After shares have been forfeited, no further notice intimating forfeiture is required.

Re-issue of Forfeited Shares

Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board. This is done by a Board resolution. After the money due is received from the new member(s), the company executes a transfer deed and issues a share certificate, and if the original holder has already surrendered the share certificate, it is duly transferred, otherwise after a public notice in a newspaper, a new share certificate is issued.

If the shares are re-issued at a price more than the face value, the excess of the proceeds of sale is not payable to the former owner, if the articles provide otherwise (*Calcutta Stock Exchange Assn. Ltd Re AIR 1957 Cal 438*). The excess of the proceeds so retained shall constitute a premium and must therefore be transferred to the securities premium account. However, in the case of *Naresh Chandra Sanyal v. Calcutta Stock Exchange Ass. Ltd.*, *AIR 1971 SC 422*, Supreme Court held that, where the articles are silent with regard to such surplus, the right of a company upon the forfeiture and sale of forfeited shares is to use the proceeds for discharging the liability for which the forfeiture was effected and if there is any balance, it belongs to the defaulter and cannot be appropriated by the company.

Where the forfeited shares are re-issued, the new shareholders will not only be liable for the balance amount remaining on the shares but he will also not be entitled to voting rights so long as calls payable by the original shareholder remain unpaid, if the company's articles so provide, as stated in Section 106.

A listed company for reissuing forfeited shares should comply with the relevant clause of the listing agreement and due approval of the regional stock exchange and others as well.

Surrender of shares

A company cannot accept a surrender of its shares "as every surrender of shares, whether fully paid-up or not involves a reduction of capital which is unlawful...forfeiture is a statutory exception and is the only exception". [*Bellerby v. Rowland and Marwood's S.S. Co. Ltd.*, (1902) 2 Ch 14]. But a surrender may be dealt with in the manner indicated in *Re Castiglione's Willtrusts, Hunter v. Mackenzie*, (1958) 1 All ER 480 viz., directing that the shares be held in the name of a nominee as trustee for the company. However, a surrender can be accepted in circumstances absolutely parallel to the requirements of a forfeiture, the only difference being that instead of going to the length of the formalities of a forfeiture, the company accepts in good faith in its own interest the shares which the shareholder is voluntarily surrendering. The other advantage to the company is that the shareholder becomes estopped from questioning the validity. [*Collector of Moradabad v. Equity Insurance Co. Ltd.*, *AIR 1948 Oudh 197*].

LESSON ROUND-UP

- Allotment means the act of appropriation by the Board of directors of the company of a certain number of securities to persons who have made applications for securities.
- The allotment should be made by proper authority, within a reasonable time, should be absolute and unconditional, must be communicated, should be against application only and should not be in contravention of any other law.
- The Companies Act lays down certain conditions under various sections to be fulfilled before a company can proceed to allot securities such as making an application for getting the securities listed u/s 40, filing prospectus before allotment, minimum subscription,
- If the allotment is made without complying with the conditions as discussed above, allotment is said to be irregular and it will result to the consequences depending upon the nature of irregularity.
- After allotment of securities, a return of allotment in the Form PAS-3 is required to be filed with Registrar of Companies within 30 days of allotment of securities.
- A certificate under the common seal of the company is *prima facie* evidence of the title of the member to the shares specified therein.
- Every share certificate shall be issued under the common seal of the company affixed in presence of and signed by two directors duly authorized by the Board of Directors and the secretary or any person authorized by the Board for the purpose.

- Share certificate is not an official publication within the meaning of Section 12(3)(c).
- A call is a demand by the company upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted, made at any time during the life of the company.
- If a member fails to pay a valid call within the stipulated time, the company may exercise the power to forfeit the shares.
- Shares forfeited by a company may either be cancelled or re-issued to another person at the discretion of the Board.

GLOSSARY

Allotment of Securities	"Allotment" of securities means the act of appropriation by the Board of directors of the company out of the previously un-appropriated capital of a company of a certain number of securities to persons who have made applications for securities.
Irregular Allotment	An allotment is irregular if it is made without complying with the conditions precedent to a regular allotment.
Share Certificate	A share certificate is a certificate issued to the members by the company under its common seal specifying the number of shares held by him and the amount paid on each share.
Split Certificate	A split certificate means a separate certificate claimed by a shareholder for a portion of his holding.
Call on Share	A call is a demand, by the company in pursuance of a Board resolution and in accordance with the articles of the company, upon its shareholders to pay the whole or part of the balance still due on each class of shares allotted or held by them made at any time during the life of the company.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these are not to be submitted for evaluation).

1. What is the significance of a Share Certificate?
2. What do you mean by a Split Certificate?
3. A share certificate is lost. What are the provision under the Companies Act, 2013 for the issue of a duplicate share certificate?
4. Explain the legal effects of a share certificate citing case laws.
5. Is the share certificate an official publication? Give reasons for your answer.
6. What is allotment? State the statutory provision regarding allotment? Can allotment be made on an oral application?
7. Write short notes on:
 - (a) Return of Allotment
 - (b) Irregular Allotment
 - (c) Minimum Subscription

- (e) Share certificate

8. Write the difference between the following:

 - (i) Notice of allotment
 - (a) under allotment of Physical shares,
 - (b) under allocation in Demat mode.
 - (ii) Process of holding of shares in Physical and Demat mode.
 - (iii) Maximum time limit of allotment of shares under Physical and Demat issue of shares.

9. What is forfeiture of shares and the rules to be followed for the same? Can the forfeited shares be re-issued?

Lesson 12

Membership in a Company

LESSON OUTLINE

- Definition of member
- Modes of acquiring membership
- Subscribers to memorandum
- Allotment/transfer/transmission etc.
- Who may become member?
- Minimum number of members
- Cessation of membership
- Expulsion of members
- Personation and Penalty
- Register of members
- Power of the Central Government to Investigate into the Ownership of Company
- Rights of members
- Variation of Member's Rights
- Liabilities of members

LEARNING OBJECTIVES

The membership in a company is obtained through subscribing to the memorandum, through allotment/transfer/transmission etc. The membership rights enable the member to participate into the affairs of the company through general meeting.

The Companies Act 2013 prescribes aspects as to the mode of acquisition of membership, eligibility criteria, minimum number of members, rights and liabilities of members.

After reading this lesson you will be able to understand the status of members, membership rights, modes of acquisition of membership, register and records to be maintained, consequences of Regulatory non-compliances etc.

WHO ARE MEMBERS?

A company is composed of members, though it has its own separate legal entity. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity.

In the case of a company limited by shares, the shareholders are the members. The terms "members" and "shareholders" are usually used interchangeably, being synonymous, as there can be no membership except through the medium of shareholding. Thus, generally speaking every shareholder is a member and every member is a shareholder. However, there may be exceptions to this statement, e.g., a person may be a holder of share(s) by transfer but will not become its member until the transfer is registered in the books of the company in his favour and his name is entered in the register of members. Similarly, a member who has transferred his shares, though he does not hold any shares yet he continues to be member of the company until the transfer is registered and his name is removed from the register of members maintained by the company under Section 88 of the Companies Act, 2013.

In *Herdilia Unimers Ltd. v. Renu Jain* [1995] 4 Comp. LJ. 45 (Raj.), it was held that the moment the shares were allotted and share certificate signed and the name entered in the register of members, the allottee became the shareholder, irrespective of whether the allottee received the shares or not.

In a company limited by guarantee, the persons who are liable under the guarantee clause in its Memorandum of Association are members of the company.

In an unlimited company, the members are the persons who are liable to the company, each in proportion to the extent of their interests in the company, to contribute the sums necessary to discharge in full, the debts and liabilities of the company, in the event of its being wound-up.

Definition of 'Member'

According to Section 2(55) of the Companies Act, 2013:

- (1) The subscribers to the memorandum of a company who shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members;
- (2) Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall, be a member of the company;
- (3) Every person holding shares of a company and whose name is entered as a beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.

Accordingly, there are two important elements which must be present before a person can acquire membership of a company viz., (i) agreement to become a member; and (ii) entry of the name of the person so agreeing, in the register of members of the company. Both these conditions are cumulative. [*Balkrishan Gupta v. Swadeshi Polytex Ltd.* (1985) 58 Com Cases 563].

The person desirous of becoming a member of a company must have the legal capacity of entering into an agreement in accordance with the provisions of the Indian Contract Act, 1972. Section 11 of the Indian Contract Act lays down that

Every person is competent to contract who:-

- (i) is of the age of majority according to the law to which he is subject.
- (ii) is of sound mind.
- (iii) is not disqualified from contracting by any law to which he is subject.

MODES OF ACQUIRING MEMBERSHIP

As per Section 2(55) of the Companies Act, 2013, a person may acquire the membership of a company:

- (a) by subscribing to the Memorandum of Association (deemed agreement); or
- (b) by agreeing in writing to become a member:
 - (i) by making an application to the company for allotment of shares; or
 - (ii) by executing an instrument of transfer of shares as transferee; or
 - (iii) by consenting to the transfer of share of a deceased member in his name; or
 - (iv) by acquiescence or estoppel.
- (c) by holding shares of a company and whose name is entered as beneficial owner in the records of a depository (Under the Depositories Act, 1996),

and on his name being entered in the register of members of company. Also every such person holding shares of the company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be the member of the concerned company.

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The holder of shares of the company whose name has been entered as beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.

(a) Subscribers to the Memorandum

In the case of a subscriber, no application or allotment is necessary to become a member. By virtue of his subscribing to the memorandum, he is deemed to have agreed to become a member and he becomes *ipso facto* member on the incorporation of the company and is liable for the shares he has subscribed.

A subscriber to the memorandum cannot rescind the contract for the purchase of shares even on the ground of fraud by the promoters. *In Re. Metal Constituents Co., (1902) 1.Ch. 707.*

In accordance with the provisions of Section 10(2) of the Companies Act, 2013, all monies payable by any member to the company under the memorandum or articles shall be debt due from him to the company. Further, a subscriber to the memorandum must pay for his shares in cash even if the promoters have promised him the shares for services rendered in connection with the promotion of the company. Again, he must take the shares directly from the company, and not through transfer from other member(s). When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfills the obligation. His liability remains right up to the time when the company goes into liquidation and he is bound to bring the money for which he is liable to pay to the creditors of the company.

(b) Agreement in Writing

(i) By an application and allotment

A person who applies for shares becomes a member when shares are allotted to him, a notice of allotment is issued to him and his name is entered on the register of members. The general law of contract applies to this transaction. There is an offer to take shares and acceptance of this offer when the shares are allotted. An application for shares may be absolute or conditional. If it is absolute, an allotment and its notice to the applicant will be sufficient acceptance. On the other hand, if the offer is conditional, the allotment must be

made according to be condition as contained in the application. If there is conditional application and unconditional allotment, there is no contract.

(ii) By transfer of shares

Shares in a company are movable property as provided in Section 44 of the Companies Act, 2013 and are transferable in the manner as provided in the articles of the company and as provided in Section 56 of the Companies Act, 2013. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company, i.e. by getting his name entered in the register of members of the company.

(iii) By transmission of shares

A person may become a member of a company by operation of law i.e. if he succeeds to the estate of a deceased member. Membership by this method is a legal consequence. On the death of a member, his executor or the person who is entitled under the law to succeed to his estate, gets the right to have the shares transmitted and registered in his name in the company's register of members. No instrument of transfer is necessary in this case. If the legal representative of deceased member desires to be registered as a member in place of the deceased member, the company shall do so or in the alternative he may request the company to transfer the shares in the name of another person of his choice. The Official Assignee or Official Receiver is likewise entitled to be a member in place of the shareholder, who has been adjudged insolvent.

(iv) By acquiescence or estoppels

A person is deemed to be a member of a company if he allows his name, without sufficient cause, to be on the register of members of the company or otherwise holds himself out or allows himself to be held out as a member. In such a case, he is estopped from denying his membership. He can, however, escape his liability by taking prompt action for having his name removed from the register of members on permissible grounds.

(c) Holding Shares as Beneficial Owner in the Records of Depository.

Every person holding shares of the company and whose name is entered as a beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

WHO MAY BECOME A MEMBER

Subject to the Memorandum and Articles, any *sui juris* (a person who is competent to contract) except the company itself, can become a member of a company. However, it is important to note the following points in relation to certain organizations and persons:

(a) **Company as a member of another company:** A company is a legal person and so is competent to contract. Therefore, it can become a member of any other company. However, it must be authorised by its Memorandum of Association to invest in the shares of that company or any other company. Also a company cannot become a member of itself. As per section 19 of the Companies Act, 2013, a subsidiary company cannot become a member of its holding company. However, a subsidiary can hold shares in its holding company only under the following exceptional circumstances—

- (i) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or
- (ii) where the subsidiary company holds such shares as a trustee; or
- (iii) where the subsidiary company is a shareholder even before it became a subsidiary company of the

holding company

(b) **Partnership firm as a member:** A partnership firm is not a legal person and as such it cannot, in its own name, become a member of a company except in company registered u/s 8 of Companies Act, 2013.

(c) **Limited Liability Partnership,** being an incorporated body under the statute, can become a member of a company.

(d) **Section 8 company:** A non-profit making company licensed under Section 8 of the Companies Act, 2013 can become a member of another company if it is authorised by its Memorandum of Association to invest into shares of the other company.

(e) **Foreigners as members:** A foreigner may take shares in an Indian company and become a member subject to the provisions of the Foreign Exchange Management Act, 1999, but in the event of war with his country, he becomes an alien enemy and his power of voting and his rights to receive notices are suspended.

(f) **Minor as member:** A member who is not a *sui juris* e.g., a minor, is wholly incompetent to enter into a contract and as such cannot become a member of a company. Consequently, an agreement by a minor to take shares is void *ab-initio*.

It has been held by the Company Law Board (replaced by the Tribunal under the Companies Act, 2013) that an agreement in writing for a minor to become a member may be signed on behalf of the minor by his lawful guardian and the registration of transfer of shares in the name of the minor, acting through his or her guardian, especially where the shares are fully paid cannot be refused on the ground of the transferee being a minor [*Miss Nandita Jain v. Bennett Coleman and Co. Ltd.*, Appeal No. 27 of 1972 dated 17.2.78].

After attaining majority, the minor, if he does not want to be a member, must repudiate his liability on the shares on ground of minority, and if he does so, the company can not plead estoppel on the ground of his having received dividends during his minority or that he had fraudulently misrepresented his age in his application for shares [*Sadiq Ali v. Jai Kishori*, (1928) 30 Bom. L.R. 1346].

If shares are transferred to a minor, the transferor will remain liable for all future calls on such shares so long as they are held by the minor even if the transferor was ignorant of his minority. If the company knows of his minority it may refuse to register the transfer, unless the transfer was made through the guardian.

(g) **Insolvent as member:** An insolvent may be a member of a company as long as he is on the register of members. He is entitled to vote, but he loses all beneficial interest in the shares and company will pay dividend on his shares to the Official Assignee or Receiver [*Morgan v. Gray*, (1953) All E.R. 213].

(h) **Pawnee:** A pawnee has no right of foreclosure since he never had the absolute ownership at law and his equitable title cannot exceed what is specifically granted by law. In this sense, a pledge differs from a mortgage. In view of the above, a pawnee cannot be treated as the holder of the shares pledged in his favour, and the pawnor continues to be a member and can exercise the rights of a member [*Balakrishna Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Com Cases 563 (S.C.)].

(i) **Receiver:** A receiver whose name is not entered in the register of members cannot exercise any of the membership rights attached to a share unless in a proceeding to which company is a party and an order is made therein. Mere appointment of a receiver in respect of certain shares of a company without more rights cannot, deprive the holder of the shares whose name is entered in the register of members of the company, the right to vote at the meeting of the company [*Balakrishna Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Com Cases 563 (S.C.)].

(j) **Persons taking shares in fictitious names:** A person who takes shares in the name of a fictitious person, becomes liable as a member besides incurring criminal liability under Section 38 of the Act, wherein punishment is provided for commission of fraud. As per section 447, any person who is found guilty of fraud, is punishable with imprisonment which shall not be less than six months but which may extend to ten years and also liable to pay fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. However, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

(k) **Trade Union as member:** A trade union registered under the Trade Union Act, can be registered as a member and can hold shares in a company in its own corporate name [*All India Bank Officers Confederation v. Dhanlakshmi Bank Ltd.*, (1997) 90 Com Cases 225].

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Partnership cannot become a member of a company, whereas Limited Liability Partnership, being an incorporated body can become member of a company.

Clarification regarding status of a holder of Global Depository Receipts (GDRs):

It is clarified by the Ministry of Corporate Affairs, vide Circular No.1/2009 No.17/67/2009 CL-V dated 16/6/2009 that:

(a) As per section 41(1) and (2) of the Companies Act, 1956, [Corresponds to section 2(55) (i) & (ii) of the Companies Act, 2013] a person is a member of the company, (i) who is a subscriber to the Memorandum or (ii) whose name has been entered in the register of members. Since, holder of Global Depository Receipts is neither the subscriber to the Memorandum nor a holder of the shares, his name cannot be entered in the Register of Members. Therefore, a holder of Global Depository Receipts cannot be called a member of the company.

(b) As per Section 41(3) of the Companies Act, 1956, [Corresponds to section 2(55) (i) & (ii) of the Companies Act, 2013] a person holding a share capital of the company and whose name is entered as beneficial owner in the records of the depository, is deemed to be a member of the company. Since the Overseas Depository Bank as referred in the ‘Scheme’ is neither the Depository as defined in the Companies Act, 1956 and the Depository Act, 1996 nor holding the share capital, therefore, it cannot be deemed to be a member of the company.

(c) A holder of Global Depository Receipts may become a member of the company only on transfer/redemption of the GDR into underlying equity shares after following the procedure provided in the “Scheme”/provisions of the Companies Act.

(d) Since the underlying shares are allotted in the name of Overseas Depository Bank, the name of such Overseas Depository Bank is to be entered in the Register of Members of the issuing company. However, until transfer/redemption of such GDR’s into underlying shares, Overseas Depository Bank cannot be considered a nominee of the holder of GDR for the purpose of Section 42 read with Section 41 of the Companies Act, 1956 [Corresponds to section 19 read with section 2(55) of the Companies Act, 2013].

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When the holder of GDR redeems the same into underlying shares, he/she becomes the member.

Joint Members

If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member (*Narandas v. India Mfg. Co.*, A.I.R. 1953 Bom. 433]. Unless the Articles of the

company otherwise provide, joint members can insist on having their names registered in any order they may require. They may also have their holding split into several joint holdings with their names in different orders so that all of them may have a right to vote as first named holding in one or the other joint holdings. *Burns v. Siemens Brothers Dynamo Works Ltd.* (1919) 1 Ch. 225.

Registration of Shares in the name of Public Office

The Companies Act, 2013 contains no provisions with regard to the registration of shares in the name of a public office. Shares cannot, therefore, be registered in the names of public offices like the Collector of Central Excise or the Commissioner of Income-tax etc. Similar observations apply to the holder of any other public office which is not a corporation sole constituted by statute, e.g., the Administrators General Act, 1963) (Clarification issued by the Department of Company Affairs).

Section 2(55)(ii) provides that a ‘person’ (other than a subscriber of the memorandum) can become a member. The term ‘person’ has been held to include, among others, a corporation sole.

A “corporation sole” is a corporation constituted in a single person who in the right of some office or function and has corporate status. The object of corporation sole is to make it possible to distinguish the holder of an office or function in his official and in his private capacity. By this fiction of law, it is possible to attach rights and duties to the holder, for the time being, of the office or functions to convey real or personal property to him in his official name and style. In short, a corporation sole has the same characteristics of perpetual succession and separation of rights and duties of the corporate body from those of the corporate as all corporations possess.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Shares can be registered in the name of Public Offices.

- True
- False

Correct answer: False

MINIMUM NUMBER OF MEMBERS

Section 3(1) of the Companies Act, 2013 provides that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company; or two or more persons, where the company to be formed is to be a private company; or one person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

Restriction on Membership

By virtue of Section 2(68)(ii) of the Companies Act, 2013, the maximum number of members of a private company except in the case of One Person Company is limited to two hundred_excluding the present and past employees of the company who continue to be members of the company. There is no restriction with regard to the maximum number of members of a public company.

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The maximum number of members in case of a private company is limited to two hundred.

REVIEW QUESTIONS

State whether the following statement is “True” or “False”

A public company does not have any restriction regarding the maximum number of members.

- True
- False

Correct answer: True

5. CESSATION OF MEMBERSHIP

A person ceases to be a member of a company when his name is removed from its register of members, which may occur in any of the following situations:

- (a) He transfers his shares to another person, the transfer is registered by the company and his name is removed from the register of members;
- (b) His shares are forfeited;
- (c) His shares are sold by the company to enforce a lien;
- (d) He dies; (his estate, however, remains liable for calls);
- (e) He is adjudged insolvent and the Official Assignee disclaims his shares;
- (f) His redeemable preference shares are redeemed;
- (g) He rescinds the contract of membership on the ground of fraud or misrepresentation or a genuine mistake;
- (h) His shares are purchased either by another member or by the company itself under an order of the Tribunal under Section 242 of the Companies Act, 2013;
- (i) The member is a company which is being wound-up in India, and the liquidator disclaims the shares;
- (j) The company is wound up; or

Though one ceases to be a member, he remains liable as a contributory and is also entitled to share in the surplus, if any.

Expulsion of a Member

A controversy had arisen as to whether a public limited company had powers to insert an article in its Articles of Association relating to expulsion of a member by the Board of Directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company.

The Department of Company Affairs (now, Ministry of Corporate Affairs) clarified that an article for expulsion of a member is opposed to the fundamental principles of the Company Jurisprudence and is *ultra vires* the company, the reason being that such a provision against the provisions of the Companies Act relating to the rights of a member in a company, the powers of the Central Government as an appellate authority under

Section 111 of the Act and the powers of the Court under Sections 107, 395 and 397 of the Companies Act, 1956. [These sections correspond to sections 58, 48, 235 and 241 of the Companies Act, 2013 respectively.]

According to Section 6 of the Companies Act, 2013, the Act overrides the Memorandum and Articles of Association and any provision contained in these documents repugnant to the provisions of the Companies Act, is void.

The Department of Company Affairs (now MCA) has, therefore, clarified that any assumption of the powers by the Board of Directors to expel a member by alteration of Articles of Association shall be illegal and void.

The Supreme Court in the case of *Bajaj Auto Ltd. v. N.K. Firodia* [1971] 41 Com Cases 1 has laid down the law as to the conditions on the basis of which directors could refuse a person to be admitted as a member of the company. The principles laid down by the Supreme Court in this case, even though pertain to the refusal by a company to the admission of a person as a member of the company, are applicable even with greater force to a case of expulsion of an existing member. As, under Article 141 of the Constitution, the law declared by the Supreme Court is binding on all courts within the territory of India, any provision pertaining to the expulsion of a member by the management of a company which is against the law as laid down by the Supreme Court will be illegal and *ultra vires*. In the light of the aforesaid position, it is clarified that assumption by the Board of directors of a company of any power to expel a member by amending its articles of association is illegal and void [Circular: Letter No. 32/75, dated 1.11.1975].

PERSONATION AND PENALTY

Section 57 of the Companies Act, 2013 provides for penalty for personation of a shareholder. The section reads:

"If any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.."

The punishment provided by Section 57 is for obtaining or attempting to obtain or receiving or attempting to receive a security, interest in a company, share warrant, coupon due to the rightful owner. According to the criminal law, personation is one of the means of cheating.

The offence is committed whether the individual personated is a real or imaginary person".

REGISTER OF MEMBERS ETC.

Section 88 of the Companies Act, 2013 lays down:

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

- (a) register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India;
 - (b) register of debenture-holders; and
 - (c) register of any other security holders.
- (2) Every register maintained under sub-section (1) shall include an index of the names included therein.
- (3) The register and index of beneficial owners maintained by a depository under section 11 of the

Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

(4) Foreign register.

(5) If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (1) or sub-section (2), the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues."

Rule 3 of Companies (Management and Administration) Rules, 2014

(1) Every company limited by shares shall from the date of its registration maintain a register of its members in Form No. MGT.1.

In the case of existing companies, registered under the Companies Act, 1956, particulars shall be compiled within six months from the date of commencement of these rules.

(2) In the case of a company not having share capital, the register of members shall contain the following particulars, in respect of each member, namely:-

- (a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/Mother's/Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;
- (b) date of becoming member;
- (c) date of cessation;
- (d) amount of guarantee, if any;
- (e) any other interest if any; and
- (f) instructions, if any, given by the member with regard to sending of notices etc:

In the case of existing companies, registered under the Companies Act, 1956, particulars shall be compiled within six months from the date of commencement of these rules.

Rule 5 of Companies (Management and Administration) Rules, 2014

Every company shall maintain the registers under clauses (a), (b) and (c) of sub-section (1) of section 88 in the following manner namely:-

(1) The entries in the registers maintained under section 88 shall be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

(2) The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.

(3) Consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of

shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.

(4) If any change occurs in the status of a member or debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries thereon explaining the change shall be made in the respective register.

(5) If any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.

(6) If any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.

(7) In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.

(8) If promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within fifteen days from such an event.

Rule 8 of Companies (Management and Administration) Rules, 2014

(1) The entries in the registers maintained under section 88 and index included therein shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose, and the date of the board resolution authorising the same shall be mentioned.

(2) The entries in the foreign register shall be authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

CASE LAW

Judicial Pronouncement relating to register of members

1. A person who claims to have purchased the shares of a member will be entitled to have his name entered in the register by satisfying the requirement of either Section 108 or 109 [Corresponds to section 56 of the Companies Act, 2013]. [Lalithamba Bai v. Harrisons Malayalam Ltd., (1988) 2 Comp LJ 41 (Ker)].
2. No company should enter in the register a statement that it has a lien on the shares of a member, [W. Key & Son Ltd., (1902) 1 Ch 467].
3. A company cannot insist upon putting in the register anything except that which is required by the section to be inserted in it. [T.H. Saunders & Co. Ltd. Re, (1908) 1 Ch 415].
4. In a voluntary winding up, the liquidator may accept share transfers and alter the register accordingly. [Taylor, Phillips and Richard's Case, (1897) 1 Ch 298].

5. A firm in its own name cannot be registered as a member, as a firm is not a legal person like a company incorporated under the Act. Only the partners can be recognised and registered as joint holders. [See *Re Vagliano & Anthracite Collieries Ltd.*, (1910) 79 LJ Ch 769].

Index of Members

Section 88(2) of the Companies Act, 2013 requires that every register maintained under section 88(1) shall include an index of the names included therein.

Rule 6 of Companies (Management and Administration) Rules, 2014

Index of names to be included in Register

(1) Every register maintained under sub-section (1) of section 88 shall include an index of the names entered in the respective registers and the index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found:

Provided that the maintenance of index is not necessary in case the number of members is less than fifty.

(2) The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

Inspection must be allowed of the Index in the same manner as applicable to the register of members.

Place of keeping and inspection of the Registers

Section 94 of the Companies Act, 2013 fixes the place for maintaining a company's registers, returns etc. and for allowing their inspection.

Registers (including Register of members) and copies of Annual Return to be kept at the Registered office

According to Section 94(1), the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company:

Such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company and the Registrar has been given a copy of the proposed special resolution in advance:

Companies (Management and Administration) Rules, 2014

A copy of the proposed special resolution in advance to be filed with the registrar as required in accordance with first proviso of sub-section (1) of section 94, shall be filed with the Registrar, at least one day before the date of general meeting of the company in Form No.MGT.14.(Also refer to Rule 5(2) which was already discussed.

LET US REMEMBER!!!!!!

To keep the Register of Members at any other place (instead of the registered office of the company) in India in which more than one-tenth of the total number of members entered in the register of members reside:-

- (i) **Special Resolution is required, and**
- (ii) **Registrar has to be given advance copy of the proposed Special Resolution atleast one day before in MCT 14.**

Inspection of Registers

According to section 94(2) states that the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be specified in the articles of association of the company but not exceeding ₹ 50 for each inspection.

As per Section 94(3) any such member, debenture-holder, other security holder or beneficial owner or any other person may—

- (a) take extracts from any register, or index or return without payment of any fee; or
- (b) require a copy of any such register or entries therein or return on payment of such fees as may be specified in the Articles of Association of the company but not exceeding Rs 10 for each page.

Rule 14 of Companies (Management and Administration) Rules, 2014

(1) The registers and indices maintained pursuant to section 88 and copies of returns prepared pursuant to section 92, shall be open for inspection during business hours, at such reasonable time on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding fifty rupees for each inspection.

Explanation.- For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

(2) Any such member, debenture holder, security holder or beneficial owner or any other person may require a copy of any such register or entries therein or return on payment of such fee as may be specified in the articles of association of the company but not exceeding ten rupees for each page. Such copy or entries or return shall be supplied within seven days of deposit of such fee.

Let us Remember!!!!!!

Every company limited by shares shall, from the date of its registration, maintain a register of its members in Form No. MGT.1

Copies of the registers and annual return.-

Rule 16 provides copies of the registers maintained under section 88 or entries therein and annual return filed under section 92 shall be furnished to any member, debenture-holder, other security holder or beneficial owner of the company or any other person on payment of such fee as may be specified in the Articles of Association of the company but not exceeding rupees ten for each page and such copy shall be supplied by the company within a period of seven days from the date of deposit of fee to the company.

Consequences if inspection is refused

According to Section 94(4), if any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.

Further section 94(5) provides that “the Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.”

Register *prima facie* evidence

Section 95 of the Companies Act, 2013 provides that the registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be *prima facie* evidence of any matter directed or authorised to be inserted therein by or under this Act.

A register of members is *prima facie* evidence of the truth of its contents. Accordingly, if a person's name, to his knowledge, is there in the register of members of a company, he shall be deemed to be a member and onus lies on him to prove that he is not a member. He must promptly appeal to the Tribunal or a competent court outside India specified by the Central Government by notification, in respect of foreign members or debenture holder residing outside India for rectification of the register under Section 59 of the Act to take his name off the register, failing which the doctrine of holding out will apply.

CASE LAW

In Re. *M.F.R.D. Cruz*, A.I.R. 1939 Madras 803, the plaintiff applied for 4,000 shares in a company but no allotment was made to him. Subsequently 4,000 shares were transferred to him without his request and his name was entered in the register of members. The plaintiff knew it but took no steps for rectification of the register of members. The company went into liquidation and he was held liable as a contributory. The Court held "when a person knows that his name is included in the register of shareholders and he stands by and allows his name to remain, he is holding out to the public that he is a shareholder and thereby he loses his right to have his name removed".

Rectification of a Register of Members

The register of members of a company contains names, addresses, occupations, if any etc. only of members of the company. Any person, whose name is entered in the register of members of a company, considered to be its member, although he may not own the shares which are shown in his name in the register of members. On the contrary, a person, whose name is not entered in the register of members is not considered as member of the company even though he may have done everything to entitle him to be put on the register of members. Injustice may, therefore, result from such omission or commission.

Section 59 of the Companies Act, 2013 confers powers on the Tribunal or a competent court outside India specified by the Central Government by notification in respect of foreign members or debenture-holders residing outside India to order rectification of register of members of a company if an appeal is made by the aggrieved person or by any member of the company or the company on any of the following grounds:

- (a) where the name of a person is without sufficient cause, entered in the register of members of a company;
- (b) where his name, after having been entered in the register, is omitted without sufficient cause; or
- (c) where default is made or unnecessary delay takes place in entering in the register of members the fact of any person having become, or ceased to be, a member of company.

This may happen where a person has transferred his shares according to law and the company either refuses or delays registration of transfer in the transferee's name.

The Tribunal may, after hearing the parties to the appeal for rectification of register of members either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within ten days or direct for rectification of records of the depository or the register and in the latter case also direct the company to pay damages if any, sustained by the party aggrieved.

It is pertinent to note that though the time limit for filing an application for rectification of register of members

has not been specified in the Act, the provisions of Article 137 of the Limitation Act would apply and in consequence, the application for rectification must be made within three years from the date on which the right occurs [Ref. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.*, (1983) 54 Com Cases 301 (Delhi)].

The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal. [Section 59(3)]

Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned. [Section 59(4)]

If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both. [Section 59(5)]

Foreign Register

Section 88(4) of the Companies Act, 2013 empowers companies to keep foreign registers of members or debenture-holders, other security holders or beneficial owners residing outside India. It states:

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

If a company does not maintain foreign register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of section 88(1) or section 88(2), the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues. [Section 88(5)]

A foreign register is deemed to be a part of the company's principal register and it should be kept in the same manner as the principal register and be likewise open to inspection.

A duplicate of such register should be maintained at the registered office in India and all entries made in the foreign register should be made in the duplicate register at the registered office as soon as possible.

A company may discontinue a foreign register at any time but all the entries made in it must be transferred to the principal register.

The decision of a competent Court in the State or Country in which a foreign register is kept, with regard to its rectification, shall be as effective as if it were a decision of a competent Court in India, if the Central Government, by notification in the *Official Gazette*, so directs.

Rule 7 of Companies (Management and Administration) Rules, 2014

(1) A company which has share capital or which has issued debentures or any other security may, if so

authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country (hereafter in this rule referred to as the "foreign register").

(2) The company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office in Form No.MGT.3 along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice in Form No.MGT.3 with the Registrar of such change or discontinuance.

(3) A foreign register shall be deemed to be part of the company's register (hereafter in this rule referred to as the "principal register") of members or of debenture holders or of any other security holders or beneficial owners, as the case may be.

(4) The foreign register shall be maintained in the same format as the principal register.

(5) A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, mutatis mutandis, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.

(6) If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.

(7) Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

(8) The company shall—

(a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and

(b) keep at such office a duplicate register of every foreign register duly entered up from time to time.

(9) Every such duplicate register shall, for all the purposes of this Act, be deemed to be part of the principal register.

(10) Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered in any other register.

(11) The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

Closing of Register of Members

Section 91 of the Companies Act, 2013 contains guidelines for closing the register of members. It lays down:

"(1) A company may close the register of members or the register of debenture-holders or the register of

other security holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time, subject to giving of previous notice of at least 7 days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in the prescribed manner.

- (2) If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided above, or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default shall be liable to a penalty of 5000 rupees for every day subject to a maximum of one lakh rupees during which the register is kept closed..”

The provisions contained in Section 154 (Corresponds to section 91 of the Companies Act, 2013) are permissive and not mandatory. The section has application only when a company desires to close its register of members and in such a situation, the requirements of the section are to be complied with. *Talyar Tea Co. v. Union of India*, (1991) 71 Com Cases 95

The power in this section is intended for the convenience of the company in order to enable the register of members to be brought up to date for the purpose of calculating dividend and bonus, etc. However, even if the register of members is closed, the company is obliged to make certain entries during the period of closure, such as entries relating to registration and probates and letters of administration, notices of change of name and address and court orders, such as changing orders, etc. [*Killick Nixon Ltd. v. Dhanraj Mill Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

The closure of the register is cloaked with the right to refuse the transfer of shares/debentures. Record date is an alternate for closing the registers. The purpose of closing the registers is to get the registers updated and to fix a cut-off date for the purpose of payment of dividend or issue of rights and bonus shares. This purpose can also be achieved by fixing a record date for a day.

The companies, whose shares are listed on one or more stock exchange(s) are required under the Listing Agreement to fix dates for closure of the register in consultation with the concerned stock exchange(s). Companies are required to give to the concerned stock exchange(s) advance notice as required by the Listing Agreement.

Rule 10 of Companies (Management and Administration) Rules, 2014

Closure of register of members or debenture holders or other security holders.-

(1) A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India, if such company is a listed company or intends to get its securities listed, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

(2) The provisions contained in sub-rule (1) shall not be applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders.

Rule 15 of Companies (Management and Administration) Rules, 2014

Preservation of Registers, etc.

- (1) The register of members along with the index shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose; and
- (2) The register of debenture holders or any other security holders along with the index shall be preserved for a period of eight years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.
- (3) Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of eight years from the date of filing with the Registrar.
- (4) The foreign register of members shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of eight years from the date of redemption of such debentures or securities.
- (5) The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.

Power of the Central Government to Investigate into the Ownership of Company

Sometimes, the registered holder of shares in a company may be a nominee for some other person, who really owns the shares. This enables persons, who in fact control a company, to conceal their real status from the shareholders and from the public and practice fraud with regard to the management of the company. To check such a practice, Sections 216 empowers the Central Government to appoint an inspector to investigate into and report on the ownership of a company.

Declaration by Persons not holding Beneficial Interest in any Share

The main purpose of Sections 216 which empowers the Central Government to investigate the ownership of the shares of the companies is to know the *benami* shareholding. However, this section may not be effective every time. Therefore, Section 89 of the Companies Act, 2013 makes it obligatory on the part of a person, whose name is entered in the register of members of a company as the holder of a shares in that company but who does not hold beneficial interest in such shares to make a declaration to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares [Sub-section (1)].

Sub-section (2) of the Section 89 makes it obligatory for any person who, holds or acquires beneficial interest in a share of a company to make a declaration to the company specifying the nature of his interest, the particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.

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

The Central Government may make rules to provide for the manner of holding and disclosing beneficial

interest and beneficial ownership under this section. [Sub-section (4)]

Sub-section (5) provides that if any person fails, to make a declaration as required under sub-section (1) or sub-section (2) or sub-section (3), without any reasonable cause, he shall be punishable with fine which may extend to fifty thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

Sub-section (6) makes it obligatory on the part of the company to make a note of such a declaration in the register concerned and to file within thirty days with the Registrar of Companies a return in the prescribed form with regard to such a declaration.

If a company, required to file a return under sub-section (6), fails to do so before the expiry of the time specified under the first proviso to sub-section (1) of section 403, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than five hundred rupees but which may extend to one thousand rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues. [Sub-section (7)]

No right in relation to any share in respect of which a declaration is required to be made under this section but not made by the beneficial owner, shall be enforceable by him or by any person claiming through him. [Sub-section (8)]

Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged. [Sub-section (9)]

Rule 9 of Companies (Management and Administration) Rules, 2014

Declaration in respect of beneficial interest in any shares.-

(1) A person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the beneficial interest in such shares (hereinafter referred to as "the registered owner"), shall file with the company, a declaration to that effect in Form No.MGT.4 in duplicate, within a period of thirty days from the date on which his name is entered in the register of members of such company:

When any change occurs in the beneficial interest in such shares, the registered owner shall, within a period of thirty days from the date of such change, make a declaration of such change to the company in Form No.MGT.4 in duplicate.

(2) Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name (hereinafter referred to as "the beneficial owner") shall file with the company, a declaration disclosing such interest in Form No. MGT.5 in duplicate, within thirty days after acquiring such beneficial interest in the shares of the company:

Provided that where any change occurs in the beneficial interest in such shares, the beneficial owner shall, within a period of thirty days from the date of such change, make a declaration of such change to the company in Form No.MGT.5 in duplicate.

(3) Where any declaration under section 89 is received by the company, the company shall make a note of such declaration in the register of members and shall file, within a period of thirty days from the date of receipt of declaration by it, a return in Form No.MGT.6 with the Registrar in respect of such declaration with fee.

8. RIGHTS OF MEMBERS

When once a person becomes a member he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Act. The appointment of a receiver, the attachment of the shares, the pledge of the shares or taking over of the management of a company which is holding shares in another company under Section 18A of the Industries (Development & Regulation) Act, 1951 will not alter the position. So long a person's name stands registered in the books as a member, even if he has sold the share and has given the share certificates and the blank transfer deed duly signed, he alone is entitled to exercise the rights of membership [*Balakrishna Gupta & Others v. Swadeshi Polytex Ltd. and Others* (1985) 58 Com Cases 563 (S.C.); and *Life Insurance Corporation of India v. Escorts Ltd. & Others* (1986) 59 Com Cases 548 (S.C.)]. These rights are derived by virtue of the membership contract between the company and the member and the general law. Some of these rights can be exercised by him individually and others alongwith other members unless member himself holds shares equivalent to the minimum holding prescribed under the various provisions of the Companies Act, 2013.

Individual Rights

Members of a company enjoy certain rights in their individual capacity, which they can enforce individually. These rights are contractual rights and cannot be taken away except with the written consent of the member concerned. These rights can be categorised as under:

- (1) Right to receive copies of the following documents from the company:
 - (i) Abridged financial statement and auditor's report in the case of a listed company (Section 136).
 - (ii) Report of the Cost Auditor, if so directed by the Government.
 - (iii) Notices of the general meetings of the company (Sections 101-102).
- (2) Right to inspect statutory registers/returns and get copies thereof without payment on any fee or on payment of prescribed fee.
The members have been given right to inspect the following registers etc.:
 - (i) Debenture trust deed (Section 71);
 - (ii) Register of Charges and instrument of charges (Section 85 & 87);
 - (iii) Copies of contract of employment with Managing or Whole-time directors);
 - (iv) Shareholders' Minutes Book (Section 119);
 - (v) Register of Contracts, Companies and Firms in which directors are interested (Section 189);
 - (vi) Register of directors and key managerial personnel and their shareholding (Section 170);
- (3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 96, 100, 105 and 107).
- (4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

- (i) To transfer shares (Sections 44 and 56 and Articles of Association of the company).
- (iii) To resist and safeguard against increase in his liability without his written consent.
- (iv) To receive dividend when declared.

- (v) To have rights shares (Section 62).
- (vi) To appoint directors (Section 152).
- (vii) To share the surplus assets on winding up (Section 320).
- (viii) Right of dissentient shareholders to apply to Tribunal (Section 48).
- (ix) Right to be exercised collectively by passing a special resolution and intimating the same to the Central Government for investigation of the affairs of the company (Section 210).
- (x) Right to make application collectively to the Tribunal for relief in cases of oppression and mismanagement (Sections 241).
- (xi) Right to file class action suits before the Tribunal (Section 245)
- (xii) Right of Nomination. (Section 72)
- (xiii) Right to file a suit or take any other action in case of any misleading statement or the inclusion or omission of any matter in the prospectus. (Section 37)

Collective Membership Rights

Members of a company have certain rights which can be exercised by members collectively by means of democratic process, i.e. by majority of members usually unless otherwise prescribed. This involves the principle of submission by all members to the will of the majority, provided that the will is exercised in accordance with the law and the Memorandum and Articles of Association of the company. Thus, the shareholders in majority determine the policy of the company and exercise control over the management of the company.

However, if and when the majority becomes oppressive or is accused of mismanagement of the affairs of the company, Section 241* read with section 244* confers right, to not less than one hundred members of a company or not less than one-tenth of the total number of its members whichever is less or any member or members holding not less than one-tenth of the issued share capital of the company (but they must have paid all calls and others sums due on their shares) and in the case of a company not having a share capital, not less than one-fifth of the total number of its members, to apply to Board under Section 241 for relief in cases of oppression or for relief in cases of mismanagement respectively.

Section 100 of the Companies Act, 2013 confers on members, holding not less than one-tenth of the paid-up share capital of a company, right to make a requisition to the Board of directors to call an extraordinary general meeting of the company. The section also confers on members having not less than one-tenth of the total voting power in a company not having a share capital, to make a requisition to the Board to call an extraordinary general meeting of the company. If the Board of directors of the company does not, within twenty-one days from the date of the deposit of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of those matters on a day not later than forty-five days from the date of deposit of the requisition, the meeting may be called and held by the requisitionists themselves within a period of 3 months from the date of the requisition.

Voting Rights of Members

The right of attending shareholders' meetings and voting thereat is the most important right of a member of a company, as shareholders' meetings play a very important role in the company's life. Directors are appointed by the shareholders, who direct the affairs of the company, formulate short-term plans and long-term policies

* Yet to be notified.

of the company, appoint management personnel to constitute organisation to implement their plans and policies in order to achieve the objects of the company.

In view of the importance of the general meetings of a company, the Companies Act has not left the members to the will of the directors to call general meetings. If the members feel that the affairs of the company are not being properly managed by the directors and the directors are avoiding to call a general meeting of the company, Section 100 of the Companies Act confers right on members specified therein to deposit a requisition setting out the matters for the consideration of which the meeting is to be called and if the Board of directors does not proceed within twenty-one days of the requisition to call a meeting within forty-five days of the requisition, the requisitionists may themselves call the meeting.

Section 47 provides that every member of a company limited by shares ad holding equity share capital therein, shall have right to vote on every resolution placed before the company and his voting right on a poll shall be in proportion to his share in the paid up equity share capital of the company.

Section 43 of the Companies Act, 2013 provides that a company limited by shares shall be entitled to issue (i) equity share capital with voting rights or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed by the Central Government.

Preference shareholders ordinarily vote only on matters directly affecting the rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital. The voting right of a preference shareholder on poll shall be in proportion to his share in the paid-up preference share capital of the company. In respect of a resolution on a matter affecting both equity shareholders and preference shareholders, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares. However, where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company (Section 47).

Section 50 of the Act lays down that a company may, if authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him although no part of that amount has been called up. Such advance payment, however, shall not confer on the member concerned any voting rights.

Shareholders' Pre-emptive Rights with regard to further issue of share capital (Right Shares)

To preserve the shareholders' proportionate dividend, liquidation and voting rights, pre-emptive rights are often recognised, but their existence and scope can be effected by provisions in the articles. However, Section 62 of the Companies Act, 2013 secures shareholders' pre-emptive rights with regard to the further issue of share capital by the company. The Section lays down:

"(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the condition that unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person and the notice of offer shall contain a statement of this right [Sub-clause (a)].

Variation of Member's Rights (Section 48 dealing with variation of member's rights is yet to be notified)

Member's rights are determined by the Companies Act, Memorandum of association, Articles of association of the company and the terms of issue of shares. Rights attached to a class of shares are known as "class rights".

Member's rights relate to dividend, voting at members' meetings and return of capital. Preference shareholders may have rights to a fixed amount or a fixed rate of dividend or to cumulative dividend. Where the ordinary shareholders are conferred the right to participate in the surplus assets on winding up of a company, it is not deemed to be a class right as it is implied even in the absence of any express provision in the articles.

Section 48 (1) of the Companies Act, 2013 lays down that the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. Further, the variation of rights of shareholders can be effected only:

- (i) if provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or
- (ii) in the absence of any such provision in a Memorandum or Articles of association of the company, if such a variation is not prohibited by the terms of issue of the shares of that class.

However, if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

Rights of Dissentient Members

Section 48(2) of the Companies Act, 2013 confers certain rights upon the dissentient shareholders. According to section 48(2), where the rights of any class of shares are varied, the holders of not less than ten per cent of the issued shares of that class, being persons who did not consent to such variation or vote in favour of the special resolution for the variation, can apply to the Tribunal to have the variation cancelled. Where any such application is made to the Tribunal, the variation will not be effective unless and until it is confirmed by the Tribunal.

The above application shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

Nomination by Security holders(including members) (Section 72)

Section 72(1) states that every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.

Section 72(2) states that when the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

Section 72(3) states that notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of the securities of a company, where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of

the company, the nominee shall, on the death of the holder of securities or, as the case may be, on the death of the joint holders, become entitled to all the rights in the securities, of the holder or, as the case may be, of all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.

Section 72 (4) states that when the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

What is prescribed under Rule 19 of Companies (Share Capital and Debentures) Rules, 2014 with respect to nomination?

Nomination by securities holders:-

- (1) Any holder of securities of a company may, at any time, nominate, in Form No. SH.13, any person as his nominee in whom the securities shall vest in the event of his death.
- (2) On the receipt of the nomination form, a corresponding entry shall forthwith be made in the relevant register of securities holders, maintained under section 88.
- (3) Where the nomination is made in respect of the securities held by more than one person jointly, all joint holders shall together nominate in Form No.SH.13 any person as nominee.
- (4) The request for nomination should be recorded by the Company within a period of two months from the date of receipt of the duly filled and signed nomination form.
- (5) In the event of death of the holder of securities or where the securities are held by more than one person jointly, in the event of death of all the joint holders, the person nominated as the nominee may upon the production of such evidence as may be required by the Board, elect, either-
 - (a) to register himself as holder of the securities ; or
 - (b) to transfer the securities, as the deceased holder could have done.
- (6) If the person being a nominee, so becoming entitled, elects to be registered as holder of the securities himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased share or debenture holder(s).
- (7) All the limitations, restrictions and provisions of the Act relating to the right to transfer and the registration of transfers of securities shall be applicable to any such notice or transfer as aforesaid as if the death of the share or debenture holder had not occurred and the notice or transfer were a transfer signed by that shareholder or debenture holder, as the case may be.
- (8) A person, being a nominee, becoming entitled to any securities by reason of the death of the holder shall be entitled to the same dividends or interests and other advantages to which he would have been entitled to if he were the registered holder of the securities except that he shall not, before being registered as a holder in respect of such securities, be entitled in respect of these securities to exercise any right conferred by the membership in relation to meetings of the company:

The Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the securities, and if the notice is not complied with within ninety days, the Board may thereafter withhold payment of all dividends or interests, bonuses or other moneys payable in respect of the securities, as the case may be, until the requirements of the notice have been complied with.

(9) A nomination may be cancelled, or varied by nominating any other person in place of the present nominee, by the holder of securities who has made the nomination, by giving a notice of such cancellation or variation, to the company in Form No. SH.14.

(10) The cancellation or variation shall take effect from the date on which the notice of such variation or cancellation is received by the company.

(11) When the nominee is a minor, the holder of the securities, making the nomination, may appoint a person in Form No. SH.14 specified under sub-rule (1), who shall become entitled to the securities of the company, in the event of death of the nominee during his minority.

Let us Remember!!!!

Any holder of securities of a company may at any time nominate in Form No. SH.13 any person as his nominee in whom the securities shall vest in the event of his death.

LIABILITY OF MEMBERS

The liability of a member depends on the nature of the company. If the company is registered with unlimited liability, every member is liable in full for all the debts of the company contracted during the period of his membership. Where the company is limited by guarantee, each member will be bound to contribute in the event of winding up a sum specified in the liability clause of the memorandum of association. In case of company limited by shares, each member is bound to contribute the full nominal value of shares and his liability ends there. If before the full nominal value of the shares is paid, the company goes into liquidation, the member becomes liable as contributory to pay the balance when called upon to pay, by the liquidator of the company.

Where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members shall be unlimited. [Section 7(7)]

If a member ceased to be member of a company within one year prior to the commencement of the winding up of the company he is liable to pay on the shares which he held to the extent of the amount unpaid thereon, if:

- (i) on the winding up, debts exist which were incurred while he was a member, and
- (ii) it appears to the Tribunal that the present members are not able to satisfy the contribution required from them in respect of their shares.

A person is liable as member in spite of a valid transfer of shares by him, if the name of the transferee is not placed on the register of members, in place of the transferors' name. If a person applies for shares in the name of a fictitious person or a person not in existence or uses another person's name for himself, or uses an alias, and shares are allotted in that name or alias, he will be liable as a member.

LESSON ROUND-UP

- A Company is composed of members, though it has its own entity distinct from members.
- Every shareholder is a member and every member is a shareholder, however, there may be exceptions to this statement.
- Section 2(55) of the Companies Act, 2013 provides the modes by which a person may acquire membership of a

- Company.
- by subscribing to the Memorandum,
 - by agreeing in writing to become a member,
 - by holding equity share capital of a Company as beneficial owner in the records of a depository.
- A non-profit making Company licensed under Section 8 of the Companies Act can become member of any other company.
 - Foreigners, trade unions can hold shares in a company, and consequently become its members.
 - Insolvent and bankrupt may be members of a company as long as they are on the register of members.
 - Pawnee and Receiver cannot be treated as members.
 - Persons taking shares in fictitious names become liable as a member besides incurring criminal liability.
 - Person ceases to be a member when his name is removed from register of members of a company.
 - In accordance with Section 88, every Company shall keep register of its members. This register shall be kept at the registered office of the Company subject to the provisions of Section 94 of the Companies Act, 2013.
 - Every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company. On the other hand, preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital.
 - Rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class.

GLOSSARY

Ipso facto	By that very fact or act.
Minor	Person below the age of majority.
Estoppe	The principle that precludes a person from asserting something contrary to what is implied by a previous action or statement of that.
Cessation of membership	A person ceases to be a member of a company when his name is removed from its register of members.
Joint Members	If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member.
Insolvent	Insolvency is the inability of a debtor to pay their debt. If a person is unable to pay his debt, he is said to be insolvent.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

1. Every shareholder of a company is known as a member while every member may not be known as a shareholder. Comment.
2. Define a 'member'. Distinguish him from a shareholder. In what ways a person can become and cease to be a member of the company?
3. Who can become a member of the company? Can the following persons or institutions become member of a company:
 - (a) Minor; (b) Company; (c) Partnership firm; (d) Foreigner; (e) Insolvent.

4. Describe the circumstances under which a register of members may be rectified? Illustrate your answer in the light of the relevant provisions of the Companies Act, 2013.
 5. What are the particulars to be recorded in a register of members of a company? Where is the register to be maintained and who has to maintain it? Can a member have access to the register?
 6. The name of X is found entered in the register of a company. But X contends that he is not a member of the company. The company maintains that X had orally agreed to become a member and hence his name was entered in the register and so he is a member. Is the contention of the company valid?
 7. What are the individual and group rights of a member?
 8. When does the liability of a member of a limited company become unlimited?
 9. Write short notes on:
 - (a) Cessation of membership of a company;
 - (b) Index of members;
 - (c) Variation of members' rights;
 - (d) Registration of shares in the name of public office.
 - (e) Nomination by security holders.

Lesson 13

Transfer and Transmission of Securities

LESSON OUTLINE

- Introduction
- Provision regulating transfer of Securities
- Stamp duty payable and Affixation/ Cancellation of shares
- Transfer of Debentures
- Power of Board of Directors to refuse registration
- Statutory Remedy against Refusal under Section 58
- Rectification of Register of Members under Section 59
- Transmission of securities
- Legal framework for Depository Systems.
- Safeguards on transfer of Securities in Dematerialized mode

LEARNING OBJECTIVES

Transferability feature of securities enables the company, to get permanent capital, the shareholder, to get liquid investments.

Securities of a Public Company are freely transferable. However, a Private Company is required to restrict the right to transfer its securities by its articles.

Earlier, the securities were transferred only through physical mode, but, now after the advent of depository system, the securities are transferred in dematerialized form, to a large extent.

Section 56-59 of Companies Act 2013 deals with the transfer/transmission of shares. After reading this lesson you will be able to understand the concept of transfer of securities in a company, various provisions of company law regulating transfer of securities, powers of Board to refuse registration, transfer during winding up, transmission of securities, transfers under depository system, etc.

TRANSFERABILITY- A BRIEF ON PROVISIONS OF COMPANIES ACT 2013

- One of the most important characteristics of a company is that its shares are transferable.
- Section 44 of the Companies Act, 2013 states that the shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company.
- As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable.
- Proviso to section 58(2) provides that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.
- In terms of Section 2(68), a private company is required to restrict the right to transfer its shares by its articles.
- Section 56 of the companies act deals with transfer and transmission of securities.

TRANSFER OR TRANSMISSION OF SECURITIES

Free transferability of securities

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. The Board of directors of a Company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.

However, proviso to section 58(2) provides that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. It is now possible to contractually agree on terms such as right of first refusal, right of first offer, tag along, call option, put option, etc in the shareholder agreements/ investment agreements, in the case of a public company as well. These terms would now be binding on the investors. Therefore, private arrangements or contracts between two or more persons would be enforceable contracts.

Instruments of transfer to be presented to the company

As per Section 56(1) of the Companies Act, 2013, a company, shall not register a transfer of securities of, the company, unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company by the transferor or transferee within a period of sixty days from the date of execution along with the certificate relating to the securities, or if no such certificate is in existence, then along with the related letter of allotment of securities.

However, nothing in section 56(1) shall prejudice any power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. (Section 56(2)).

Test yourself !!

Within what time a duly executed instrument of transfer(i.e. Form no SH. 4) is to be presented/delivered to the company by a transferor or transferee?

Ans: within 60 days

Rule 11(1) and (2) of Companies (Share Capital and Debentures) Rules, 2014

(1) An instrument of transfer of securities held in physical form shall be in Form No.SH.4 and every instrument of transfer with the date of its execution specified thereon shall be delivered to the company within sixty days from the date of such execution.

(2) In the case of a company not having share capital, provisions of sub-rule (1) shall apply as if the references therein to securities were references instead to the interest of the member in the company.

Transmission of securities

According to Section 56(2), a company shall have power to register on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

MCA General Circular No. 19/2014

The Ministry of Corporate Affairs has issued clarification vide general circular no. 19/2014, regarding Share Transfer Form as per Form SH-4 executed before 1st April, 2014: in view of prescription of new Securities Transfer Form as per Form SH-4 with effect from 1st April, 2014, the companies and other stakeholders have sought clarity with regard to Share Transfer Forms executed before 1st April, 2014 as per earlier Form 7B but which are yet to be accepted /registered by companies.

The matter has been examined and it is clarified that since transaction relating to transfer of shares is a contract between two or more persons/shareholders, any share transfer form executed before 1st April, 2014 and submitted to the company concerned within the period prescribed under relevant section of the Companies Act 1956 needs to be accepted by the companies for registration of transfers. In case any such share transfer form, executed prior to 1st April, 2014, is not submitted within the prescribed period under the Companies Act 1956, the concerned company may get itself satisfied suitably with regard to justification of delay in submission etc. in case a company decides not to accept the share transfer forms It shall convey reasons for such non-acceptance within time provided under section 56(4) (c) of the Act

Registration of partly paid up shares – Notice to the transferee

According to section 56(3), where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.

Rule 11(3) of Companies (Share Capital and Debentures) Rules, 2014

A company shall not register a transfer of partly paid shares, unless the company has given a notice in Form No. SH.5 to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.

Time Limit for Delivery of certificates

Section 56(4)(3) states that every company, unless prohibited by any provision of law or any order of court, tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted, within a period of one month from the date of receipt by the company of the instrument of transfer or as the case may be of the intimation of transmission, in case of transfer or transmission of shares.

Intimation to depository

- Proviso to Section 56(4) states that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

Transfer of securities by legal representative

As per section 56(5) of the Companies Act, 2013 the transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

Penalties

According to 56(6), when any default is made in complying with the provisions of sub-sections (1) to (5), the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

Transfer to shares by depository with an intent to defraud, is liable under Section 447 for fraud

As per section 56(7), without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447 for fraud which is a severe punishment.

Transmission of securities

According to Section 56(2) A company shall have power to register on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Let us Remember!

Rule 11(3) of Companies (Share Capital and Debentures) Rules, 2014

A company shall not register a transfer of partly paid shares, unless the company has given a notice in Form No. SH.5 to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.

Punishment for Personation of Shareholders [Section 57]

Where any person deceitfully personates an owner of any share or interest in a company, or of any share warrant or coupon issued in pursuance of this Act. And

- (i) thereby obtains or attempts to obtain any such share or interest or any such share warrant or coupon, or
- (ii) receives or attempt to receive any money due to any such owner

He shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to 3 years and with fine which shall not be less than one lakh rupees but which may extend to 5 lakh rupees.

POWER TO REFUSE REGISTRATION AND APPEAL AGAINST REFUSAL

According to section 58(1) of the Companies Act, 2013, if a private company limited by shares refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of,

or the transmission by operation of law of the right to, any securities or interest of a member in, the company, it shall, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be, giving reasons for such refusal.

According to section 58(4) of the Companies Act, 2013, a public company may on sufficient cause, refuse, to register the transfer of, securities within a period of thirty days from the date on which the instrument of transfer, or the intimation of transmission, as the case may be, is delivered to the company. In such a case the public company may send an intimation of the refusal.

STATUTORY REMEDY AGAINST REFUSAL UNDER SECTION 58

One of the fundamental features of joint stock companies is that their securities are capable of being transferred. The right of the holder of securities to transfer his securities in a company is absolute as it is inherent in the ownership of the securities subject to provisions of the Act and restrictions, laid down in the articles, if any.

If a private company limited by shares refuses to register the transfer or transmission, the transferee may appeal to the Tribunal against the refusal within 30 days from the date of receipt of the notice or in case no notice has been sent by the company, within 60 days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company. [Section 58 (3)]

If a public company without sufficient cause refuses to register the transfer of securities within 30 days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, is delivered to the company, the transferee may, within 60 days of such refusal or where no intimation has been received from the company, within 90 days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal. [Section 58 (4)]

The Tribunal, while dealing with an appeal made as stated above may, after hearing the parties, either dismiss the appeal, or by order—

- (a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within 10 days of the receipt of the order; or
- (b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved. [Section 58 (5)]

If a person contravenes the order of the Tribunal, he shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees. [Section 58 (6)]

Case Laws- Refusal to transfer

Refusal to register share transfer on suspicion that the employee if admitted as a member will attend general meetings of the company and may create nuisance by raising irrelevant issues and also obtain access to the records to the company as a shareholder is not a valid reason. (Appeal to the CLB No. 27, of 1975 dated 17th August, 1976, *Shri Nirmal Kumar v. Jaipur Metal and Electrical Limited*).

The mere attempts of a person to wind up a company more than once cannot be a ground for refusing to register transfer by the directors [*Rangpur Tea Association Ltd. v. Makkan Lal Samaddar* (1979), 43 Com Cases 58].

The power to refuse registration of shares which is conferred on the directors by the articles, is a discretionary power and must be exercised reasonably, and in good faith for the benefit of the company. Unless the contrary is proved, the power is deemed to have been exercised properly (*Berry & Stewart v. Tottenham Hotspur Football and Athletic Co. Ltd.*, 1936, 3 A11 E.R. 554).

Where the articles of association of a company confers a discretion on the directors with regard to acceptance of transfers, this discretion is a fiduciary one to be exercised bona fide in what the Board considers to be in the interest of the company. If on a true construction of the articles, the directors are only given the powers to reject on certain prescribed grounds and it is proved that on these grounds the request for transfer was rejected, the Court cannot substitute the opinion of the Board. If the articles of association give an unfettered discretion, the court would interfere with it only on proof of bad faith. [*M.J. Amirthalingam v. Gudiyatham Textiles Pvt. Ltd.*, (1972) 42 Com Cases 350].

The Supreme Court, in *Bajaj Auto Limited v. N.K. Firodia*, AIR 1971, S.C. 321, observed, "discretion implies just and proper consideration of the proposal under the facts and circumstances of the case. In the exercise of that discretion, the directors will act in the paramount interest of the company and in the general interest of the shareholders because the directors are in a fiduciary position both towards the company and towards every shareholder. The directors are, therefore, required to act bona fide and not arbitrarily and not for any collateral motive". It was observed further that where the articles permitted the directors to decline to register transfer of shares without stating reasons, the Court would not draw unfavourable inferences against the directors because they did not give reasons. The Court would assume that the directors acted reasonably and bona fide and those who allege to the contrary would have to prove and establish the same by evidence. However, if the directors gave reasons, the Court would consider whether they were legitimate and whether the directors proceeded on right or wrong principle. The Court has also laid down three tests to determine the proper exercise of power by the Board of directors. The tests are:

1. Whether the directors acted in the interest of the company;
2. Whether they acted on a wrong principle; and
3. Whether they acted on oblique motive or for a collateral purpose.

If the directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the Court would consider whether the reasons were legitimate or the directors acted on a wrong principle, or from corrupt motive. If the reasons for refusal given by the directors were legitimate, the Court would not over-rule that decision merely on the ground that the court would not have come to the same conclusion. The discretion of the directors was to be tested as the opinion of any fair and sensible man in the interest of the company.

Where the appellant transferee and respondent company were in the same line of business and were rivals, the refusal on the ground of rivalry will be justified in terms of the decision rendered by the Supreme Court in the Bajaj Auto Case. Under these circumstances, the investment cannot be considered to have been made bona fide with the intention of making profits. The respondent company is entitled to refuse the registration even in the absence of an enabling provision in articles in view of the provisions of Section 111(2) [Corresponds to section 58(3) and 58(4) of the Companies 2013] [*Modi Carpets Ltd. v. Trans-Asia Carpets Ltd.*, Appeal No. 2 of 1980 decided on 26.12.1981 (CLB)].

In *Shri T.N. Kuriakos v. Premier Tyres Ltd.*, decided on 13.6.1983 (CLB), the appeal against the refusal by the respondent company to register transfer of shares was allowed by the Company Law Board (Now Tribunal) on the ground that the refusal of the respondent to register transfer of shares in favour of the appellant was based on the decision of the Transfer Committee, a sub-committee of the Board of directors

and not that of the Board of directors as such, and, therefore, the said decision was not a valid and legal decision.

RECTIFICATION OF REGISTER OF MEMBERS (SECTION 59)

- Section 59(1) provides that if the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register, is, without sufficient cause, omitted therefrom, or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or the company may appeal in prescribed form, to the Tribunal, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register.
- The Tribunal may, after hearing the parties to the appeal, by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within 10 days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved. [Section 59 (2)]
- During the pendency of the appeal before the Tribunal, the holder of securities can transfer such securities and such further transfer would entitle the transferee to voting rights also, unless the voting rights in case of transferee have also been suspended by the Tribunal. [Section 59 (3)]
- As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. The Board of directors of a Company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.

However, where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned [Section 59(4)].

- If any default is made in complying with the order of the Tribunal, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both [Section 59(5)].

STAMP DUTY PAYABLE AND AFFIXATION/ CANCELLATION OF STAMPS

Before the transfer is lodged with the company, it should be duly stamped. The transfer of securities attracts stamp duty under the Indian Stamp Act, 1899 (Act 2 of 1899). Only the Central Government can levy stamp duty on share transfers. Stamps at the rate of twenty five paise for consideration of ₹ 100 or part thereof is payable. The duty chargeable shall, wherever necessary, be rounded off to the next five paise. [S.O. 130(E) dated 28.1.2004 issued by Department of Revenue].

The stamp duty payable on transfer of debentures is, however, governed by Article 62(b) of Schedule I to the Indian Stamp Act, 1899, and also varies from State to State. In this case, the duty would be:

- (i) The duty applicable where the deed is executed, or
- (ii) The duty applicable where the registered office of the company is situated, whichever is higher.

The amount of consideration is required to be mentioned in the share transfer deed as otherwise the companies cannot verify whether share transfer stamp duty has been correctly charged thereby attracting the penal provisions of the Stamp Act in case of a default. Thus, in case where question of consideration does not arise like in the case of a gift of shares, stamp duty will be paid on the basis of the market value of shares and in case of unquoted shares or where quotations are not available at the face value of the shares.

Under Section 56(1), a company cannot register the transfer of securities unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company along with the certificate relating to the securities in question. The expression 'duly stamped' has not been defined in the Companies Act. Under Section 2(11) of the Indian Stamp Act, 1899 'duly stamped' as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in India. Under Section 12(1) of the Stamp Act, whoever affixes an adhesive stamp to an instrument which has been executed by any person shall, when affixing such stamp, cancel the same so that it cannot be used again. Sub-section (2) thereof makes it clear that any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall, so far as such stamp is concerned, be deemed to be unstamped. Sub-section (3) thereof provides the manner in which the adhesive stamp can be cancelled and provides that the stamp be cancelled by writing on or across the stamp his name or initials or the name or initials of his firm. Section 17 of the Indian Stamp Act, 1899 makes it clear that all instruments chargeable with duty and executed shall be stamped before, or at the time of execution. Therefore, the legal requirement is that the stamp must be cancelled either before or at the time of execution [*Babulal Choukhani v. Western Indian Theatres Ltd.* (1958) 28 Com Cases 565; *Canara Bank v. Ballarpur Paper and Strawboard Mills Ltd.*, CLB decision, p.137].

Case Laws

A company cannot register transfer of shares unless the instrument of transfer is duly stamped and is delivered to the company. The expression "duly stamped" has to be construed with reference to the provisions of Section 2(11) of the Indian Stamp Act, 1899 and the document in question would be an invalid one if the stamp affixed thereon has not been cancelled. Under Section 108(1) of the Companies Act, 1956 [Corresponds to section 56(1) of the Companies Act, 2013], it is mandatory that the company shall not register the transfer of shares unless a properly executed instrument of transfer duly stamped has been delivered to the company [*Shri Parveen Sharda v. Chopsani Ice Aerated Water and Oils Mills Ltd.*, Appeal No. 1 of 1982 decided on 10.1.1983 (CLB)].

In *Vardhaman Publishers Ltd. v. Mathrubhumi Printing & Publishing Co. Ltd.* (1990), the Kerala High Court held that affixing stamps on a separate sheet of paper and attaching it to the transfer application or cancellation of stamps by drawing a line across the stamp was not improper and would not invalidate the said application. On the question of whether a newly added Article empowering the Board to reject transfer of shares would affect transactions of sale of shares entered into before the insertion of the Article, the Court held that the property in the shares passes on the date of transfer and the right to have the shares registered in the transferee's name becomes crystallised on that day itself. Any alteration of articles will not affect concluded transactions and in respect of such transactions, the existing articles would prevail. So, if the original (unaltered) Articles as on the date of transfer permit free transfer of shares, the Board cannot refuse registration of the transfer.

LOST TRANSFER DEEDS

It is sometimes found that the transfer documents sent to companies are lost, say, in transit. In such a case, the proviso to section 56(1) of the Act provides that where the instrument of transfer has been lost or the

instrument of transfer has not been delivered within the prescribed period (within 60 days from the date of execution of the instrument of transfer), the company may register the transfer on such terms as to indemnity as the Board may think fit.

The Board of directors of the company should be satisfied that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee has been lost. The proof may be in the form of an affidavit from the transferor or the transferee and supported by the purchase or sale note of the broker and the registration receipt issued by the postal authorities.

In addition, the Board can take an indemnity on such terms as it may think fit to safeguard its position and after that company may register the transfer.

DELEGATION OF POWERS FOR TRANSFER

It is the articles of the company which authorise the Board of directors to accept or refuse transfer of securities, at their discretion. The Board further have the power to delegate all or any of their powers to any of the directors of the company or any person even not in the employment of the company. Therefore, the articles of association should authorise the Board of directors to delegate the powers suitably. Only in the case of refusal to register a transfer, the directors are required to exercise their discretion.

TRANSFER OF DEBENTURES

In case of transfer of debentures, a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee should be delivered to the company by the transferor or transferee within a period of sixty days from the date of execution along with the certificate relating to the debentures or if no such certificate is in existence with the letter of allotment of debentures.

Stamp duty is payable for transfer of debentures and the duty varies from State to State, as explained above.

After registering the transfer, the particulars thereof have to be recorded in the Debenture Transfer Register and should be initialed by the appropriate authority. After making appropriate endorsements, the debenture certificate may be sent to the party concerned.

TRANSFER OF SHARES TO A MINOR

In India, a minor is not competent to enter into any contract, as under Section 11 of the Indian Contract Act, 1872, a person who has attained the age of majority is only competent to contract. Since a minor cannot enter into a contract or agreement except through a guardian, and since as per Section 153, no notice can be taken of the fact that the guardian holds a share in trust for a minor, it follows that his name cannot be entered in the Register of Members and therefore, he cannot become a member of a company. There is, however, no objection in law to the guardian of a minor entering into a contract on behalf of a minor, by virtue of the statutory right conferred on the guardian of a minor under Section 8 read with Section 4 to 6 of the Hindu Minority and Guardianship Act, 1956. Since Section 56 of the Companies Act, 2013 enables execution of transfer deed by or on behalf of the transferor or the transferee, the transfer deed can be executed by a minor through his natural guardian as transferee, and the contract so entered into by a minor through his natural guardian is a binding and valid contract under Section 8 of the Hindu Minority and Guardianship Act, 1956.

The articles of association of a company cannot impose a blanket ban prohibiting transfer of shares in favour of a minor, as such a restriction is unreasonable and not sustainable. Section 44 of the Companies Act, 2013 provides that shares in a company are movable property and are transferable in the manner provided by the Articles. The expression 'in the manner provided by the articles of association of the company' can only be interpreted to mean the procedure to be adopted for transfer and impose restrictions, which are meaningful

and reasonable. In case, the restriction imposed on transfer to a minor is accepted, it would mean that the shares of a deceased member can never be inherited by the legal heir who might be a minor. This would lead to a highly unjust situation and cannot be accepted as tenable. Accordingly, if the shares can be transmitted in favour of a minor, there is no reason why the shares which are fully paid-up and in respect of which no financial liability devolves on the minor are to be held as not transferable merely because of the ban imposed in the articles of association [*Saroj v. Britannia Industries Ltd.*, Appeal No. 5/80 decided on 14.12.81 by CLB].

TRANSFER OF SHARES TO PARTNERSHIP FIRM

A firm is not a person and as such is not entitled to apply for membership. The Department of Company Affairs (Now, Ministry of Corporate Affairs) has in its Circular No. 4/72 dated 9.2.1972 stated that a firm not being a person cannot be registered as a member of a company except where the company is licensed under Section 25 (Corresponds to section 8 of the Companies Act, 2013).

TRANSFER OF SECURITIES TO A BODY CORPORATE

An incorporated body being a legal person can acquire securities in its own name. Where a company is a transferee, the following documents are required to be submitted to the company:

- (a) A certified true copy of the Board resolution and/or power of attorney authorizing the signatory of the instrument of transfer to execute the instruments;
- (b) A certified true copy of a Board resolution passed under Section 179(3)(e) of the Companies Act; and
- (c) A certified true copy of Memorandum and Articles of Association of a company.

TRANSMISSION OF SECURITIES

Transmission of securities has not been defined by the Companies Act. 'Transmission by operation of law' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the holder of securities or by purchase in a Court-sale.

Thus, transmission of securities takes place when the registered holder of securities dies or is adjudicated as an insolvent, or if the holder of securities is a company, it goes into liquidation. Because a deceased person cannot own anything, the ownership of all his property passes, after his death, to those who legally represent him. Similarly, when a person is declared insolvent, his entire property vests in the Official Assignee or Official Receiver. Upon the death of a sole registered holder of securities, so far as the company is concerned, the legal representatives of the deceased holder of securities are the only persons having title to the securities unless securities-holder had appointed a nominee, in which case he would be entitled to the exclusion of all others.

Secretarial Standard SS-6 on transmission of shares and debentures by ICSI provides for the procedure to be followed for transmission.

Section 56(1) of the Companies Act, 2013 states that the transfer of securities must be effected by a proper instrument of transfer and that a provision in the articles of an automatic transfer of securities of a deceased securities-holder is illegal and void. Such transfer does not amount to transmission which takes place by operation of law. Section 56(2) of the Act provides that nothing in the sub-section(1) shall prejudice the powers of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. It follows that, for such

transmission, instrument of transfer is not required, and, merely an application addressed to the company by the legal representative is sufficient.

Articles of companies generally provide for formalities to be observed for transmission of shares. In the absence of such provision in the articles of the company, Regulations 23 to 27 of Table F of Schedule I to the Act will govern the procedure for transmission. According to these regulations, the legal representatives are entitled to the shares held by deceased member and the company must accept the evidence of succession e.g., a succession certificate or letter of administrations or probate or any other evidence properly required by the Board of directors. He is, however, not a member of the company by reason only of being the legal owner of the shares. But he may apply to be registered as a member. On the contrary, instead of being registered himself as a member, he may make such transfer of the shares as the deceased or insolvent member could have made. The Board of directors also have the same right to decline registration as they would have had in the case of transfer of shares before death. But if the company unduly refuses to accept a transmission, the same remedies are available to the legal representative as in the case of a transfer namely, an appeal to the Tribunal under Section 58.

DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

S.No.	<i>Transfer of Securities</i>	<i>Transmission of securities</i>
1.	Transfer takes place by a voluntary act of the transferor.	Transmission is the result of the operation of law.
2.	An instrument of transfer is required in case of transfer.	No instrument of transfer is required in case of transmission.
3.	Transfer is a normal course of transferring property.	Transmission takes place on death or insolvency of a holder of securities .
4.	Transfer of securities is generally made for some consideration.	Transmission of securities is generally made without any consideration.
5.	Stamp duty is payable on transfer of securities by a holder of securities.	No stamp duty is payable on transmission of securities.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Board of Directors of a company or the concerned depository has discretion to refuse or withhold transfer of any security.

- True
- False

Correct answer: False

The Board of Directors of a company or the concerned depository has no discretion to refuse or withhold transfer of any security.

Rejected Documents

Documents which are not duly stamped or where stamps are not cancelled should be returned to the person lodging them pointing out the errors so as to enable them to rectify the error. In Federal Bank Ltd. v. Smt. Sarla Devi Rathi (1997) CLA 183 (Raj.), the company had not registered 100 shares that Smt. Sarla Devi

Rathi, the respondent, had purchased and neither they returned the share certificates to her. The company urged that since the respondent had not become a shareholder of the company, no cognizance of the complaint could be taken. The High Court held that there was a *prima-facie* case against the company.

The CLB [Replaced by the Tribunal by the Companies Act, 2013] has pointed out that the company on not registering the transfer should have returned the documents to the party who lodged them (the transferee in this case) and not the transferor as the transferor loses his right in the shares as soon as he executes the transfer in blank.

Time for pointing out insufficiency of stamps

Where a company by mistake or otherwise registers a transfer which should have been refused because of insufficient or uncancelled stamps, or because of the instrument being unstamped, it should point out the error to the transferee within such time (within one year from the date of execution) that the transferee can have the matters rectified through the orders of the Collector. Afterwards it would be too late. [Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd., (1994) 1 Comp LJ 178 (CLB – Mad)].

Impounding of Documents Relating to Share Transfer

The Board of directors are not persons to impound or regularise an instrument of transfer which is not duly stamped, *Mathrubhumi Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80 93 (Ker) as they have no authority under Sections 33 and 42 of the Stamp Act.

JUDICIAL PRONOUNCEMENT ABOUT TRANSFER OF SHARES

(A) *In Dove Investments P. Ltd. v. Gujarat Industrial Investment Corpn. Ltd. [(2005) 60 SCL 604 (MAD)]*, the respondent company lodged with the appellant company shares pledged with it for effecting transfer of the same in its name. The appellant registered some of the shares and refused to register the balance on the ground that the respondent had failed to comply with the provisions of Section 108(1A) and 108(1C) [Corresponds to section 56 of the Companies Act, 2013]. The respondent was successful before the CLB (Now Tribunal) which held that provisions of Section 108(1C) [Corresponds to section 56 of the Companies Act, 2013] are directory and directed the appellant to register the shares. The appellant challenged the order of the CLB (Now Tribunal) before the High Court. The Appeal was dismissed. According to the High Court, in so far as Sub-section (1C) is concerned, if the transfer of shares falls within any one of the exempted cases mentioned in that Sub-section, the requirements as to presentation of the instrument of transfer in favour of the prescribed authority and delivery thereof to the company within the prescribed time limit, as contemplated in Sub-section (1A) are not applicable, provided the conditions stipulated in Sub-section (1C) are satisfied. In view of the same, if any bank or financial institution or the Central Government or a State Government or any corporation owned or controlled by the Central Government or a State Government, or a corporation granting a loan against the security of shares, intends to get such shares registered in its own name, in the event of failure on the part of the borrower to repay the amount of loan, it shall complete the instrument of transfer and lodge it with the company for registration of the transfer in its own name. In such a circumstance, they will have to stamp or otherwise endorse on the instrument of transfer the date on which the bank or financial institution decides to get such share registered in its own name and the instrument so stamped or endorsed will have to be delivered to the company, together with the share certificate, for registration of the transfer within two months from the date so stamped or endorsed. It was not in dispute that the instruments of transfer were neither stamped nor endorsed by the petitioner, as required under Sub-section (1C) however, stamped by the prescribed authority contemplated under Sub-section (1A).

- (B) *Mukundlal Manchanda v. Prakash Raodlines Ltd.* (1971) Com Cases 575**, it was held that the requirement of Sub-section 1A(b)(ii) has to be read reasonably, so as to enable its smooth functioning; a delivery of instrument of transfer within a reasonable time should be held as a proper delivery. Further, where the company opines that the instrument of transfer has become stale and that it is improper to act upon it, the instrument of transfer has to be held as liable to be ignored. Further, even the belated delivery can be acted upon under certain circumstances while moving the Central Government under Sub-section (1) of Section 108(1A) [Corresponds to section 56 of the Companies Act, 2013]. In the light of the said provision, even though the discretion lies in the company either to recognize the transfer or not to recognize it depending upon the staleness of the instrument, the affected person can very well move the Central Government under Sub-section (1D) by explaining the circumstances under which the delay occurred and the hardship that resulted by the non-recognition of the transfer. It was rightly concluded that in the light of the scheme of Section 108 [Corresponds to section 56 of the Companies Act, 2013], particularly after the insertion of Sub-section (1A), (1B), (1C) and (1D), the Court have to bear in mind that the trivialities would not render an act futile and technical formalities required to be complied with for a valid transaction cannot outweigh the importance to be given to the substance of the transaction. Though the matter was taken up by way of appeal before the Divisional Bench of the Karnataka High Court, the Division Bench had not gone into the said aspect, namely, whether mandatory or directory, however, confirmed the judgment of the Single Judge in Mukundlal Manchanda's case was to be upheld and accordingly it was held that except Section 108(1) [Corresponds to section 56 of the Companies Act, 2013] other provisions namely Sub-sections (1A) and (1C) are directory and not mandatory in nature.
- (C) *Letheby & Christopher Ltd., Re* (1904) 1 Ch 815.** A transfer deed executed by the transferor alone does not pass the title in the shares to the transferee. Where the transferor's address and the distinctive numbers of the shares were not mentioned in the transfer form, the same was held to be not void because those particulars were verifiable from the accompanying share certificate.
- (D) *CIT v. Ramaswamy* (1985) 57 Com Cases 7, 10 (Mad).** A transfer is complete as between the transferor and transferee when all the formalities such as execution of the transfer deed and handing over the share certificates are completed
- (E) *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 AIR 1986 SC 1370,** the Supreme Court held that "a transfer effective between transferor and the transferee is not effective as against the company and any person without notice of the transfer being registered in the company's register.
- (F) *Vickers System International Ltd. v. Mahesh P. Keshwani* (1992) 73 Com Cases 317: (1991) 2 Comp LJ 444 (CLB).** Transfer of shares by HUF Section 108 [Corresponds to section 56 of the Companies Act, 2013] enables the execution of a transfer deed by or on behalf of the transferor or the transferee. In the case of a joint family, the transfer form would be executed by the holding member or, in his absence, by the manager (Karta) of the family who represents the family. The same would be true when the family is transferee. The CLB directed the company to register shares in the name of the Hindu undivided family showing Mahesh P. Keshwani as its Karta.
- (G) *Mohideen Pichai Taraganar v. Tinnevilly Mills Co. Ltd.*, AIR 1928 Mad 571.** Section 108 [Corresponds to section 56 of the Companies Act, 2013] not to apply to Auction Sales/Sale of Forfeited Shares. A transfer by a registered holder of shares cannot have any application to a Court auction sale or sale of forfeited shares for non payment of calls etc.

- (H) ***Castrol India Ltd. v. S.S. Transfer of Mehta*** (1993) 78 Com Cases 146 (1993) 2 Comp LJ 8 (CLB). Where special permission is necessary, the transfer in question could be effected only with the permission of Special Court, (Trial of Offences Relating to Transactions in Securities Ordinance, 1992), it was held that the refusal by the company to accept the transfer without such permission was justified.
- (I) ***Choukhani v. Western India Theatres Ltd.***, A.I.R. 1957 Cal. 709. If the director refuse the request for transfer of shares with *mala fide* intent i.e. if they act oppressively, capriciously, or corruptly, the Company Law Board (Now NCLT) will interfere and order registration of the transfer of shares.
- (J) ***Re. Wahib Bus and Mails Transport Co.***, (1947) 17 Com Cases 182 The onus of proving bad faith on the part of directors rests on the plaintiff. However, the directors cannot refuse to register transfer of shares effected by a Court sale, in spite of powers given by the articles.
- (K) ***Vallur Mohammad Saheb v. Golden Agro-Tech Industries Ltd.*** (2008) 83 SCL 391(CLB-CHENNAI), the transferee purchased 2700 shares of the company and lodged the transfer deed along with the original share certificates to the Registrar and Share Transfer Agent (RSTA) of the company. The company did not register the shares in the name of the transferee inspite of the transferor taking up the matter with the company. The transferee, therefore, filed petition under section 111/111A [Corresponds to section 58 & 59 of the Companies Act, 2013] to direct the company as well as its RSTA to pay damages with future interest from the date of filing the petition till the date of realization, or to issue duplicate share certificates to the petitioner. Allowing the petition, it was held that the bar embodied in section 22 of the SICA does not extend to any direction which may be issued by the CLB (Tribunal) under section 111/111A [Corresponds to section 58 & 59 of the Companies Act, 2013] for rectification of the register of members of the company. In view of this legal position, the resistance of the company for not registering the transfer of shares constituting minuscule 2700 shares only in favour of the transferee was not tenable.
- (L) ***Hindustan Mercantile Bank Ltd. v. D.N.Choudhury Cotton Mills Ltd.*** (2008) 83 SCL 399 (CLB-KOL.), the legal opinion on which the transferor company had relied upon was on the basis that the transferee company along with a few other companies was acting in concert to acquire shares in violation of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 [Replaced by SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011]. To come to the conclusion that the transferee along with others was acting in concert, reliance had been placed on commonality of directors both in the transferee-company and other companies. Since the company was not a listed company, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, were not applicable. Further, it was found that neither the transferee company nor other companies had acquired shares of the transferor company. Accordingly, the company was to be directed to register the transfer of shares in favour of the transferee.
- (M) ***Sham Sunder Kukreja v. Hindustan Lever Ltd.*** (2001) 44 CLA 38 (CLB). If, by virtue of Section 111A(3) of the Companies Act, 1956 [Corresponds to section 59(1) of the Companies Act, 2013], the petition should have been filed within 2 months of the registration of the securities submitted for transfer, and where on the basis of facts and circumstances of the case, the transfer was effected in a fraudulent manner, the period of limitation (2 months) shall not apply.
- (N) ***Dr. Rajiv Das v. The United Press Ltd.*** (2001) (CLB). In the case, where the shares of a company are held in joint names and one of these joint holders requests the company to split the shares equally between the joint holders by issuing fresh certificates, the company shall not be legally

bound to do so unless the share transfer deeds executed by both the joint holders duly completed and stamped are lodged with the company together with the relevant share certificates, in terms of the provisions of Section 108 of the Companies Act, 1956 [Corresponds to section 56 of the Companies Act, 2013].

- (O) ***T.S. Premkumar v. Tamil Nadu Mercantile Bank Ltd.* 2001 (CLB).** There shall be no justification, if a company/bank asks for information on Income Tax Returns (including that of the nominees of the transferee), the sources of the consideration paid for the purchase of shares, the details of the group to which the transferee is attached, for the purposes of registration of transfer of shares, if the number of the shares which are subject matter of transfer, is insignificant, and after the registration of which the controlling of interest in the company/bank is not changing.
- (P) **Transferor Holds Bonus Shares Only as a Trustee for the Transferee.** ***Charanjiv Lal v. ITC Ltd. and Another*** (2005) 5 COMP LJ 138 (CLB), the petitioner-transferee purchased 100 equity shares of ITC limited of bearing and lodged the same through post, which were received by the company on 10th December, 1991. However, the company did not take any action to register the shares in the name of the petitioner and informed him that it had not received the share certificates and the transfer instrument. To prevent any unauthorized transfer of the shares, he obtained a *status quo* order from Senior Civil Judge, Delhi. In the meanwhile, the company declared 60 bonus shares on two occasions against the impugned 100 shares of which the certificate relating to first 60 bonus shares had been sent to the transferor. The suit filed by the transferee-petitioner was dismissed for want of jurisdiction and hence the petitioner-transferee approached the Company Law Board. The Petition was allowed. The view expressed by the Judge was that the bonus shares always go with the original shares and the transferor holds bonus shares only as a trustee for the transferee. Considering that the original shares have been sold before the record date, in the absence of denial by the transferor nearly a month before the record date, it is the petitioner transferee who is entitled to the bonus shares and not the transferor.

TRANSFER OF SECURITIES REGISTERED WITH A DEPOSITORY

As stated earlier, in terms of Section 56 of the Act, the transfer of securities of, a company (other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository), cannot be registered unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and transferee along with the certificate relating to the securities has been delivered to the company. Therefore, the requirements of section 56 are not applicable in respect of transfer of securities where both the transferor and transferee are entered as beneficial owners in the records of a depository. Besides, no stamp duty is payable for registration of transfer of shares in depository form. However, transaction charges are payable to depository participants.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A transfer is said to be completed only after all the formalities such as execution of the transfer deed and handing over the share certificates are completed.

- True
- False

Correct answer: True

COMPLIANCE WITH SECTION 56 – A MANDATORY PROVISION

The Allahabad High Court had held that the provisions of Sub-section (1) are not mandatory but only directory and, therefore, the registration of a transfer of shares without an instrument of transfer is not void. *Maheshwari Khetan Sugar Mills v. Ishwari Khetan Sugar Mills*, (1963) 2 Comp LJ 74 : (1963) 33 Com Cases 1142 (DB) (All). But Section 108 [Corresponds to section 56 of the Companies Act, 2013] mentions the words 'shall not register' which have the effect of forbidding the act of transfer except on the fulfilment of certain conditions precedent.

The above decision of the Allahabad High Court has since been reversed by the Supreme Court in *Mannalal Khetan v. Kedar Nath Khetan* (1977) 47 Com Cases 185: AIR 1977 SC 536 where the mandatory nature of the provisions of Sub-section (1) of Section 108 [Corresponds to section 56 of the Companies Act, 2013] has been elaborately discussed and emphasised. The result is that without production of the share certificate along with the application for transfer, the transfer cannot be registered and if registered, the registration will be void.

In *Vasant Investment Corporation Ltd. v. Company Law Board* (1999) 19 SLL 502 (Bom), it was held that it is for the party making an appeal to the CLB (Now Tribunal) to prove that the decision of the Board of directors is initiated by an ulterior motive in case of a refusal by the Board to register a transfer.

The Section 59 assimilates in its fold the provisions for rectification of register of members empowering the Tribunal to order rectification of register of members. Sub-section (1) of Section 59 provides that if the name of any person is without sufficient cause entered in the register of members of a company, or after having been entered in the register is without sufficient cause omitted therefrom, or if a default is made or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved or any member of the company, or the company may appeal to the Tribunal or to a competent court outside India specified by the Central Government by notification in respect of foreign members or debenture-holders residing outside India, for rectification of the register.

The Tribunal may, after hearing the parties to the appeal, by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within 10 days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved. [Sub-section (2) of section 59].

CASE LAW

In *Ratnesh H. Bagga v. Central Circuit Cine Association* [(2005) 128 Com Cases 370 (CLB)], decided on 10.9.2004, respondent is a Section 25 company [Section 8 company under the new Companies Act, 2013]. The petitioner applied for membership of the respondent and his application was rejected. The petitioner filed a petition under Section 111 of the Companies Act, 1956 [Corresponds to section 59 of the Companies Act, 2013] seeking rectification of the register of members by putting his name in the register of members of the respondent company.

The petition was dismissed.

The reason stated was that Sub-sections (1), (2) and (3) of Section 111 [Corresponds to section 59 of the Companies Act, 2013] apply only to transfer or transmission of shares and has no application in the present case. Sub-section (4) [Corresponds to section 59(1) of the Companies Act, 2013] would apply only in a case of rectification of something in the register which should not be there or something omitted from the register which should rightly be there. The complaint of the petitioner is that the association had rejected his

application for membership and thereby refused to put his name in the register of members. The two conditions prescribed in Section 41 of the Act [Corresponds to section 2(55) of the Companies Act, 2013] are cumulative in nature in the sense that there should not only be an agreement in writing but the name also should be entered in the register of members to become a member of a company. Merely agreeing to become a member of a company and on that basis to claim that the refusal of the company to enter his name in the register would entitle a petitioner to file a petition under Section 111 [Corresponds to section 59 of the Companies Act, 2013] is not sustainable. Whether the refusal by the association was *mala fide* or whether the articles giving power to the association to reject an application of membership are valid etc. are beyond the scope of Section 111 [Corresponds to section 59 of the Companies Act, 2013].

It is, however, pertinent to note that though time limits for filing of an appeal in circumstances stated in sub-section (3) & (4) of section 58 the Companies Act, 2013 have been specified, however no limit has been laid down for preferring an appeal for rectification of the register of members in Sub-section (1) of section 59 of the Companies Act, 2013]. But in regard to rectification to register of members provisions of Article 137 of the Limitation Act would apply and in consequence the application for rectification of register of members must be preferred within three years from the date on which the right occurs. [*Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.* (1983) 54 Com Cases 301 (Delhi)].

The provisions stated above regarding rectification of the register of members shall apply in relation to the rectification of the register of debentureholder as they apply in relation to the rectification of the register of members.

If a person contravenes the order of the Tribunal under section 58, he shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees. In addition, where any default is made in complying with the order of the Tribunal under section 59, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

BLANK TRANSFER

When a shareholder signs the transfer form without filling in the name of the transferee and the date of execution and hands it over with the share certificate to the transferee thereby enabling the transferee to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'. Shares are usually transferred in blank when a shareholder borrows money on its security, e.g., by pledging the shares; the pledgor make default in payment of the amount due at the time appointed for repayment, the pledgee or the holder of the share certificate and the blank transfer instrument has implied power to fill up the blanks in the instrument by inserting the date and his own name as transferee and to get himself registered as a member of the company. The pledgor is under an implied obligation not to prevent or delay such registration. This right to get himself registered as a member is available to the transferee even after the death of the transferor [*In Re. Bengal Silk Mills Co. Ltd.*, (1942) Com Cases 206].

A blank transfer accompanied by the delivery of the share certificates vests in the transferee both equitable as well as legal rights in the shares. But until the registration of his name in the register of members, the transferee does not acquire a title and thus he cannot exercise any right as shareholder in respect of those shares.

In all cases only a bona fide holder will have the right to fill in his name or the name of a person for whom he

is acting under an authority and apply for registration of the transfer. [*Colonial Bank v. Hepworth*, (1887) 36 ChD 26]. Where share scrips accompanied by duly executed transfer forms came into the hands of a bona fide purchaser, it was held that the original owner who signed in blank was estopped from questioning the validity of the title of the bona fide purchaser. [*Sumitra Debi Jalan v. Satya Narayan Prahladka*, AIR 1965 Cal 355].

In *Howrah Trading Co. Ltd. v. C.I.T.* (1959) 29 Com Cases 282 : AIR 1959 SC 775, the Supreme Court recognised the validity of "blank transfers" viz., where the name of transferor is entered and the transferor signs the transfer with the share scrip annexed, and hands it over to the transferee who, if he chooses, may complete the transfer by entering his name and then apply to the company to register his name in the place of that of the transferor.

FORGED TRANSFER

It may happen that a forged instrument of transfer is presented to the company for registration. In order to avoid the consequences which will follow a forged transfer, companies normally write to the transferor about the lodgement of the transfer instrument so that he can object if he wishes. The company informs him that if no objection is made by him before a day specified in the notice, it would register the transfer. The consequences of a forged transfer are detailed hereunder:

- (a) A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder and the company is bound to restore his name on the register of members [*People's Ins. Co. v. Wood and Co.*, 1961 (31) Com Cases 61]. A forged document never has any legal effect. It can never move ownership from one person to another, however, genuine it may appear. Thus, a forged instrument of transfer leaves the ownership of the shares exactly where it always was in the so-called transferor. It follows that if a company registers a forged transfer, the true owner can apply so as to be replaced on the register and his name will be restored. But the company does not incur any liability in damages by putting the name on the register.
- (b) However, if the company issues a share certificate to the transferee and he sells the shares to an innocent purchaser, the company is liable to compensate such a purchaser, if it refuses to register him as a member, or if his name has to be removed on the application of the true owner.
- (c) If the company is put to loss by reason of the forged transfer, as it may have paid damages to an innocent purchaser, it may recover the same independently from the person who lodged the forged transfer.

EXAMPLE

Let us take an example to illustrate the consequences of forged transfer. Suppose, 'A' is a registered shareholder and his name is entered on the register of members in respect of certain number of shares. By fraud or theft, B obtains possession of 'A's share certificate and having forged a document purporting to be a transfer of shares to himself from A, succeeds in getting himself registered as a member and obtains from the company a new shares certificate made out in his name. In spite of this, A does not cease to be the owner of the shares and a member of the company, as a forged document, being a nullity, does not move ownership from him to B or any other person. Producing the new certificate as evidence of his title, B purports to sell the shares to C, an innocent purchaser, who in reliance upon B's certificate, buys the shares in good faith and without notice of B's fraud. The company then registers C as a member and issues the share certificate to him in respect of the shares purchased by him. When A discovers the fraud, he being entitled for the rectification of register, has C's name struck off the register of members and has his own name restored as the registered holder of the shares. A never ceased to be the owner of the shares, although the company issued successive

certificates to B and C. The company will be liable in damages to C and for other incidental loss. But it would be entitled to indemnity as against B, and if the forged transfer were lodged by a broker acting for B, against the broker also, even though the broker was innocent to the fraud for a person who brings a transfer to the registering authority and requests him to register it, impliedly warrants that it is a genuine document.

A forged transfer can pass no title and is a nullity. In *Simm v. Anglo-American Telegraph Co.*, (1879) 5 QBD 188, CA; *France v. Clark*, (1884) 26 ChD 257 CA; when shares transferred under a forged signature and the transferee received a share certificate, the title does not pass to him.

The fact that the transferee was a *bona fide* purchaser for value did not make any difference and the transferee was bound to return the scrips to the person to whom the same rightfully belong. [*Kaushalya Devi v. National Insulated Cable Company of India* 1977 Tax LR 1928 (Del)]

A person acting in good faith, sends in and procures registration of the transfer and the issue of a fresh certificate on the basis of a forged deed is bound to indemnify the company against the untoward consequences. [See *Welch v. Bank of England*, (1955) Ch 508 : (1955) 1 All ER 811]. This happens when a stock broker, trusting his clients innocently forwards forged document to the company. [*Yeung v. Hongkong and Shanghai Banking Corp.*, (1980) 2 All ER 599].

Further Section 57 states that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A forged transfer can pass title.

- True
- False

Correct answer: False

A forged transfer cannot pass any title and is a nullity.

TRANSPOSITION OF NAME

In the case of joint-shareholders, one or more of them may require the company to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint-holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. Since no transfer of any interest in the shares takes place on such transposition, the question of insisting on filling transfer deed with the company, may not arise. Transposition does not also require stamp duty.

The Stock Exchange Division of the Department of Economic Affairs has clarified that there is no need of execution of transfer deed for transposition of names if the request for change in the order of names was

made in writing, by all the joint-holders. If transposition is required in respect of a part of the holding, execution of transfer deed will be required.

DEATH OF TRANSFEROR OR TRANSFeree BEFORE REGISTRATION OF TRANSFER

Where the transferor dies and the company has no notice of his death the company would obviously register the transfer. But if the company has notice of his death, the proper course is not to register until the legal representative of the transferor has been referred to.

Where the transferee dies and company has notice of his death, a transfer of shares cannot be registered in the name of the deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the names of the later. But if there is a dispute, an order of Court will have to be insisted upon.

In Killick Nixon Ltd. v. Dhanraj Mills Ltd., it was held that the company is not bound to enquire into the capability of the transferee to enter into a contract. The company has to act on the basis of what is presented in the transfer deed.

Proof in a transfer by representative

Where a transfer is executed by a person in a representative capacity such as an officer of a body corporate or by an attorney, proof of the authority, must be produced, before the transfer can be registered.

Relationship between Transferor and Transferee

Pending registration, the transferee has only an equitable right to the shares transferred to him. He does not become the legal owner until his name is entered on the Register of Members in respect of the shares. But as between the transferor and the transferee, immediately after the transfer is made, the contract of transfer will subsist and the transferee becomes the beneficial owner of the shares so transferred to him. A relation of trustee (transferor) and beneficiary (transferee) is thereby established between them. The transferor is under obligation to comply with all reasonable directions of the transferee. The transferee should, however, take prompt steps to get himself registered as a member.

Section 126 of the Companies Act, 2013 provides that where the transferor gives a mandate to pay the dividend to the transferee pending registration of transfer, the same should be paid to the transferee, otherwise the dividend in relation to such shares should be transferred to the Unpaid Dividend Account mentioned in Section 124. It is further provided that in the case of offer of right shares or fully paid bonus shares, the same should be kept in abeyance till the title to the shares is decided.

RIGHTS OF TRANSFEROR

In *JRRT (Investments) Ltd. v. Haycraft*, (1993) BCLC 401 (Ch.D) it was held that, the transferor is not deprived off his valuable rights, the right to dividend and the right to vote even where the purchaser has failed to make payment. An unpaid vendor has the right to exercise voting rights in respect of shares registered in his name. He is not obliged to comply with the directions of the purchaser in respect of the shares taken by him.

But on the other hand, the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his directions and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on a consideration which has failed. However, after the transfer form has been executed the transferor cannot be compelled to undertake any additional financial burden in respect of the

shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members, the Supreme Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor. [*Mathalone (R) v. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385 : (1954) 24 Com Cases 1 See also *Life Insurance Corporation of India v. Escorts Ltd.* (1986) 59 Com Cases 548 : AIR 1986 SC 1370]. But where, due to the transferee's own default, the transfer of shares is not registered the transferor cannot be held to be a trustee for the defaulting transferee simply because the share continues to remain in the transferor's name in the books of the company.

The seller's duty is complete when he hands over to the transferee a duly executed transfer form. [*Skinner v. City of London Marine Insurance Corp.*, (1885) 14 QBD 882].

Where a transferor transfers his share for consideration and delivers along with the share certificate the transfer form duly signed by him, but the transferee, instead of completing the transfer by signing his own name as transferee and presenting it for registration to the company, chooses to keep the transfer in blank and passes it on to others along with the share certificate, it cannot be said that the transferor, simply because the share continues to stand in his name, should be treated as a trustee for a series of unknown holders of the blank transfer.

When he sold his share to the original transferee he could not be deemed to have represented to the transferee anything more than that the share was transferable nor to have agreed to the transferee keeping or passing on the transfer in blank from hand to hand for an indefinite duration, without its being presented to the company for registration.

Where a shareholder executes a blank transfer to enable another to deal with the shares, he is bound not to do anything to obstruct registration of the transfer and if he improperly intervenes he is liable in damages, *Hooper v. Herts*, (1906) 1 Ch 549: (1904-7) ALL ER Rep 849 (CA).

Transferor's right to indemnity for calls - Where a transferor has paid for calls to the company after the shares are transferred, there arises an implied promise by the transferee to indemnify the transferor. Such a promise to indemnify can be implied even in the case of blank transfers [*Ashworth Partington & Co.*, (1925) 1 K].

Transferee's right to Dividends, Bonus and Rights Shares - Where the transferor, by reason of the shares standing in his name, has received after the transfer, any dividend on shares, bonus or other benefit accruing in respect thereof, the transferee being the person lawfully entitled thereto, can recover the same from the transferor, provided that he has not allowed his claim to become time barred under the provisions of the Limitation Act. [*Chunnilal Khushaldas Patel v. H.K. Adhyaru*, (1956) 26 Com Cases 168 : AIR 1956 SC 655].

Dividend to transferee after transfer - In one case the transfer was registered and dividends paid to the transferee. Later, the register was rectified by removing the transferee's name from the register on the ground of a technical nature, like inadequacy of stamps, it was held that the transferee was not bound to handover the dividend amount to the transferor. [*Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.*, (1994) 1 Comp LJ 178 (CLB-Mad)]. However the Madras High Court held in this case that the company should not be allowed to rectify the register on a technical ground after transferring the shares.

Position under the Securities Contracts (Regulation) Act, 1956 - As regards the position of a transferor after transfer, Section 27 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) may also be noted. It provides as follows:

Title to dividends - (1) It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee, who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation: The period specified in this section shall be extended -

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
- (ii) in case of loss of transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

(2) Nothing contained in Sub-section (1) shall affect -

- (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or
- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

EFFECTS OF TRANSFER

Once a transfer form has been executed, the transfer is complete as between the transferor and the transferee and the transferee acquires the right to have his name entered in the register of members. No further application is necessary for having the name of the transferee entered in the register of members and the transferee perfects his title to the share after the entry in the Register of Members. Once the transferee becomes a member of the company, a contractual relationship arises with the company, [*Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.*, (1983) 54 Com Cases 432 (DB) (Bom)].

A company cannot refuse to register a transfer on the ground that the transfer was without consideration or that there was a collusion and connivance between the transferor and transferee. Any objection about inadequate consideration can be raised only by the transferor himself and not by the company particularly where the shares are fully paid. Where the transfer is in a spot delivery contract, Section 108 [Corresponds to section 56 of the Companies Act, 2013] is not applicable. [*Sanatan Investment Co. Pvt. Ltd. v. Prem Chand Jute Mills Ltd.* (1983) 54 Com Cases 186 (Cal)].

Priority among Transferees

It was held in *Society General De Paris v. Jonet Walker and other* (1886) 11 Ac 20 that where a shareholder has fraudulently sold his shares to two different transferees, the first purchaser will, on the ground of time alone, be entitled to the shares in priority to the second.

For example, a person assigned his property, including some shares, for the benefit of his creditor. The assignee failed to get the share certificates registered in his name, but gave notice of assignment to the company. The assignor sold the shares to another who applied for registration. It was held that the assignee's claim was prior in time and therefore, entitled to registration. [*Peat v. Clayton*, (1906) 1 Ch. 659].

Pledging of Shares

Shares of a company can be a subject matter of a valid pledge. Section 2(7) of the Sale of Goods Act, 1930, defines the term 'goods' as meaning every kind of moveable property other than actionable claim and money and includes stocks and shares. Shares are goods under the Sale of Goods Act, 1930 and therefore can be a subject matter of pledge under the Indian Contract Act, 1872. In *Kanhaiyalal Jhanwar vs Pandit Shirali And Co. And Ors* [AIR 1953 Cal 526], the Calcutta High Court held that the deposit of share certificates themselves is sufficient to create a pledge thereon.

On the death of a sole owner of shares, the rights and liabilities goes in favour of the legal heirs. They are entitled to be registered as the holder of the shares. But the company can register them as members with only their consent and when they apply for it. *Re Cheshire Banking Co., Duff's Executor's case* (1886) 32 Ch D 301.

Transmission of shares to widow

If a widow applies for transmission of the shares standing in the name of her deceased husband without producing a succession certificate and if the articles of association of the company so authorises, the directors may dispense with the production of succession certificate, probate or letter of administration upon such terms as to indemnity as the directors may consider necessary, and transmit the shares to the widow of the deceased by obtaining an indemnity bond.

Transmission of joint holdings

In case some shares are registered in joint names and the articles of the company provide that the survivor shall be the only person to be recognised by the company as having any title to the shares, the company is justified in refusing to register the transmission of title by operation of law in favour of the son of the deceased holder even though he may obtain succession certificate from the Court.

COMPANY'S LIEN ON SHARES

Articles 9 to 12 of Table F of Schedule I to the Act carry the rules as to lien. These articles are not compulsory. A company may adopt its own articles regarding the subject matter of lien as also regarding any money due to it from the shareholder either originally or subsequently by a special resolution. The fact to be noted is that unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on the shares of members. [*Canara Bank Ltd. v. Tribhuvandas Jetha Bhai*, AIR 1957 Trav. C. 183 : (1957) 27 Com Cases 647]. But in the case of listed company, one of the requirements is that the articles of the company shall provide that the fully paid shares will be free from all lien, while in the case of partly paid shares, the company's lien, if any, will be restricted to monies called or payable at a fixed time in respect of such shares [Rule 19(2)(ii) of the Securities Contracts (Regulation) Rules, 1957]. In a lien the company shall have first and paramount lien on the shares of each member for his debts and liabilities to the company. Such a provision is fully effective for private as well as public companies. [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656: (1900-3) All ER 746 (CA)]

Where lien is acquired by a subsequent amendment of the articles, it will not allow the company to upset any rights which might have been acquired. But otherwise the right of a lien subsequently brought in, shall be binding on all the members even if they became shareholders before the alteration [*Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch 656 : (1900-3) All ER 746 (CA)].

Extent and waiver of lien

The right of lien extends to any monies receivable by the shareholder in respect of the shares even in the winding up of the company. A lien on the proceeds of sale of shares is a lien on the shares.

Where the articles of association of a private limited company gave the company a first and paramount lien over the shares of any shareholder indebted to it, and the shareholder created an equitable charge on the shares in favour of a third party, the company's lien was held to have priority over the equitable charge. [*Champagne Perrier-Janet S.A. v. H.H. Finch Ltd.*, (1982) 3 All ER 713].

The company can waive the lien either expressly or by doing anything which has the effect of waiving the right.

Where a company registers a transfer of shares over which it has a lien, the registration will operate as a waiver of the lien. [See *Turner Morrison & Co. Ltd. v. Hungerford Investment Trust Ltd.*, (1972) 42 Com Cases 512 : AIR 1972 SC 1311].

Enforcement and postponement of lien

The usual method of enforcing a lien is a refusal by the company to register a transfer of shares until the dues of the company in respect of those shares are first paid.

An article merely giving a right of lien is not enough to confer a right to bring the property to sale in exercise of such right. [See *Bank of India Ltd. v. Rustom Fakirji*, AIR 1955 Bom 419].

In the absence of a provision in the articles giving power to the company to enforce a lien by sale, the lien cannot be enforced except through Court. [*New London & Brazilian Bank v. Brockle Bank*, (1882) 21 Ch D 302].

A lien cannot be enforced by forfeiture, even if the articles provide that it may be so enforced. For, a lien is in the nature of an equitable mortgage and a clause for forfeiture in a mortgage is invalid as a clog on the equity of redemption.

In a case, certain shares which were subject to a first and paramount lien were given to bank as security for an overdraft and the bank gave notice to the company, the Court held that the bank's claim was prior to that of the company which arose subsequently. Notice to the company means notice to any director or officer who is authorised in the matter. [*United India Sugar Mills Ltd., Re* AIR 1933 ALL 607].

TRANSFER OF SHARES IN DEPOSITORY MODE

Depository system maintains the ownership records of securities in the book entry form while in physical mode every share transfer is required to be accomplished by physical movement of share certificates to, and registration with the company concerned. The process of physical movement of share certificates often involves long delays and a significant portion of transactions end up as bad deliveries due to the faulty completion of paperwork, or signature differences with the specimens on record with the companies, or for other procedural lapses. Investors also face problems on account of loss of share certificates, forgery and mutilation. The significant time involved in effecting ownership changes also impounds a substantial volume of shares at any given time leading to lower trading volumes.

As part of capital market reform, the Government promulgated on September 20, 1995, the Depositories Ordinance, 1995 to provide for legal framework for setting up of depositories to record the ownership details in book entry form. Later, on November 28, 1995, the Government introduced in Parliament the Depositories Bill, 1995 to replace the said Ordinance. The Bill was enacted as the Depositories Act, 1996.

Legal Framework for Depository Systems

The legal framework for depository system in the Depositories Act provides for the establishment of single or multiple depositories. Anybody to be eligible for providing depository services must be formed and registered

as a company under the Companies Act, 2013 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfilment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

In the depository system, share certificates belonging to the investors are dematerialised and their names are entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies register are replaced by the name of depository as the registered owner of the securities. The depository however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and be subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and do not have distinctive numbers. The ownership changes in, the depository are done automatically on the basis of *delivery v. payment*.

The companies which enter into an agreement with the depository will give an option to the holders of eligible securities to avail the services of the depository through participants. The investors desiring to join the depository are required to surrender the certificates of securities to the issuer company in the specified manner and on receipt of information about dematerialisation of securities by the issuer company, the depository enters in its records the names of the investors as beneficial owners. Similarly, the beneficial owner has right to opt out of a depository in respect of any security and claim the share certificates and get his name substituted in the register of members as the registered owner in place of the depository.

There has to be regular, mandatory flow of information about the details of ownership in the depository record to the company concerned. In case of any reservation about the acquisition of securities on the ground that the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, SEBI, Act, 1992 or Companies Act, 2013 or any other law for the time being in force, the depository, company, depository participants, the holder of securities or SEBI shall have a right to make an application to the Tribunal for rectification of register or records concerned. Pending decision of the Tribunal, the holder of securities can transfer such securities and the transferee concerned shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal..

The Act provides for detailed regulations to be framed by SEBI and detailed bye-laws to be framed by depositories with the approval of SEBI. The bye-laws have to provide for rights and obligations of participants, beneficial owners and procedure for ensuring adequate safeguards to protect the interests of investors. The Act requires the depository to indemnify for loss caused to beneficial owner due to negligence of depository or its participants.

How does an investor avail services of a depository?

(a) In the case of existing securities:

An investor before availing the services of a depository, shall enter into an agreement with the depository through a participant and then shall surrender security certificates to the issuer. The issuer on receipt of security certificate shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall thereafter enter the name of the investor in its records as beneficial owner.

(b) In the case of fresh issue:

At the time of initial offer the investor would indicate his choice in the application form. If the investor opts to

hold a security in the depository mode, the issuer shall intimate the concerned depository about the details of allotment of a security made in the favour of investors and records the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the names of allottees as the beneficial owners. In such case a prior agreement by the investor with the depository as well as an agreement between the issuer company and depository may be necessary.

(c) In the case of exit from the depository:

If a beneficial owner or a transferee of a security desires to take away a security from depository, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and inform the issuer. The issuer shall make arrangements for the issue of certificate of securities to the investor within 30 days of the receipt of intimation from the depository.

(d) In the case of transfer within the depository:

The depository shall record all transfers of securities made among the beneficial owners on receipt of suitable intimation to the effect that a genuine purchase transaction has been settled.

(e) In the case of pledge:

Before creation of any pledge or hypothecation in respect of a security, the beneficial owner is required to obtain prior approval of the depository and on creation of pledge or hypothecation, the beneficial owner shall give intimation of such pledge or hypothecation to the depository. The depository shall make appropriate entries in its records which will be admissible as evidence.

What is free transferability of securities?

It refers to a situation where on receipt of intimation regarding settlement of purchase transaction, the transfer of a security is effected immediately and the transferee enjoys all the rights and obligations associated with the securities. Once a genuine purchase transaction is settled, nobody including the issuer, depository, participant, any intermediary or regulatory authority can withhold the transfer of security.

Types of securities freely transferable

Only securities i.e. the shares, debentures, any other securities and any interest therein of a public limited company (listed as well as unlisted companies) have been made freely transferable. The Board of directors of such a company or the concerned depository shall not have any discretion to refuse or withhold a transfer of such security. Any other security, for example, shares or debentures of a private company or any unit of a mutual fund, or any security issued by any issuer other than a public limited company are not freely transferable and would be subject to the restrictions contained in the articles of association or the bye-laws of the concerned issuer and terms of issue.

Safeguards to address the concerns of the Investors on Transfer of Securities in Dematerialized Mode

The concerns arising out of transfer of securities from the Beneficial Owner (BO) Accounts without proper authorization by the concerned investor have been brought to the notice of SEBI by some Investors' Associations. Accordingly SEBI has decided to put in place the following safeguards to address the concerns of the Investors on electronic transfer.

- (a) The depositories shall give more emphasis on investor education particularly with regard to careful preservation of Delivery Instruction Slip (DIS) by the Bos. The Depositories may advise the Bos not to leave "blank or signed" DIS with the Depository Participants (DPs) or another person/entity.

- (b) The DPs shall not accept pre-signed DIS with blank columns from the BO(s).
- (c) The DPs shall issue only one DIS booklet containing not more than 20 slips for individual account holders and not more than 100 slips for non-individual account holders, at a time.
- (d) If the DIS booklet is lost/stolen/not traceable by the BO, the same must be intimated to the DP immediately by the BO in writing. On receipt of such intimation, the DP shall cancel the unused DIS of the said booklet.
- (e) The DPs can issue subsequent DIS booklet to BO only after the BO has used not less than 75 per cent of the slips contained in the previous DIS booklet. The DP shall also ensure that a new DIS booklet is issued only on the strength of the DIS instruction request slip (contained in the previous booklet) duly complete in all respects, unless the request for fresh booklet is due to loss, etc., as referred to in clause (d) above.
- (f) The DPs shall not issue more than 10 loose DIS to one account-holder in financial year (April to March). The loose DIS can be issued only if the BO(s) come in person and sign the loose DIS in the presence of an authorized DP official.
- (g) The DPs shall put in place appropriate checks and balances with regard to verification of signatures of the BOs while processing the DIS.
- (h) The DPs shall cross check with the BOs under exceptional circumstances before acting upon the DIS.
- (i) The DPs shall mandatorily verify with a BO before acting upon the DIS, in case of an account which remained inactive i.e., where no debit transaction had taken place for a continuous period of 6 months, whenever all the ISIN balances in that account (irrespective of the number of ISINs) are transferred at a time. However, in case of active accounts, such verification may be made mandatory only if the BO account has 5 or more ISINs and all such ISIN balances are transferred at a time. The authorized official of the DP verifying such transactions with the BO, shall record the details of the process, date, time, etc., of the verification on the instruction slip under his signature.

LESSON ROUND-UP

- As per Section 56(1) of the Companies Act, 2013, a company, whether public or private shall not register transfer of securities of the company unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and transferee has been delivered to the company along with the certificate relating to the securities or if no such certificate is in existence, along with the related letter of allotment of securities.
- Provisions of Section 56 not to apply to transfer of securities registered with the Depository.
- The transfer of shares attracts stamp duty under the Indian Stamp Act, 1899.
- The power of refusal to register a transfer of securities must be exercised judicially and not arbitrarily.
- The right of the holder of securities to transfer his securities in a company is absolute and he may appeal to the National Company Law Tribunal if there is any refusal to register transfer or transmission.
- When a shareholder sells only a part of the shares and not all of them, the procedure is different.
- In compulsory winding up, the transfer of shares made during winding up of a company is void unless it is made with the sanction of the Tribunal.

- Unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on shares of members.
- Every holder of securities of a company has right to nominate at any time in the prescribed manner a person to whom his securities shall vest in the event of his death.
- Depository system reduces the cost of issue and transfer of securities by eliminating stamp duty, it entitles the transferee to all the rights associated with the securities immediately on settlement of purchase transaction.

GLOSSARY

Fungibility	A good or asset's interchangeability with other individual goods/assets of the same type. Assets possessing this property simplify the exchange/trade process, as interchangeability assumes that everyone values all goods of that class as the same.
Dividend	Part of profit divisible among shareholders.
Stamp duty	The tax placed on legal documents usually in the transfer of assets or property. The transfer of documents in locations where this law exists, is only legally enforceable once they are stamped, which shows the amount of tax paid.
Transmission of Securities	It refers to those cases where a person acquires an interest in securities by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the holder of securities or by purchase in a Court-sale.
Lien on shares	A lien is the right to retain possession of a thing until a claim is satisfied. In the case of a company lien on a share means that the member would not be permitted to transfer his shares unless he pays his debt to the company.

SELF-TEST QUESTIONS

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

1. (a) Distinguish between transfer and transmission of securities.
 (b) "The directors have uncontrolled and unfettered powers to refuse registration of transfer of securities" — Comment.
2. What are the remedies available against refusal to register transfer of securities?
3. Explain the procedure for transfer of shares and debentures.
4. What are the consequences of a forged transfer?
5. Under what circumstances shares can be transferred during the winding up of a company?
6. A buys 200 shares in a company from B on the faith of a share certificate issued by the company. A tenders to company a transfer to himself from B duly executed together with B's share certificate. The company discovers that the certificate in the name of B has been fraudulently obtained and refuses to register the transfer. Is A entitled to get the registration of the transfer?
7. X and Y each held half the issued capital of the company. The Articles provided "the directors may, at any time, in their absolute and uncontrolled discretion refuse to register any transfer of shares".

X died and his executor applied to have his shares registered in his name. Y, who is director, refuse under the above mentioned provision of Articles. Can the Court come to the rescue of X's

executor?

8. An agreement for transfer of certain shares was entered into and the transferee was registered as a member without transfer deed being executed. Is the registration of the transfer valid?
 9. State the powers of the Board of directors to refuse registration?
 10. What are the benefits of depository system?
 11. How does an investor avail services of a depository?
 12. Are all eligible securities required to be in the depository mode?
 13. How are the shares allotted/allocated and transferred under the Depository System?
 14. Who is a depository participant? How is he appointed by the Issuer company? Also narrate his liabilities, duties and rights.

Lesson 14

Institution of Directors

LESSON OUTLINE

- Concept of Director
- Definition of Director
- Types of Directors i.e. executive director, non-executive director, nominee director and independent director etc.
- Legal position of Directors
- Minimum and Maximum number of Directors
- Maximum number of Directorships
- Appointment of Directors
- Obtaining Director Identification Number(DIN)
- Cancellation and surrender of DIN
- Removal of Directors
- Retirement of Directors
- Resignation of Directors
- Vacation of office of Directors

LEARNING OBJECTIVES

The company is an artificial person and is managed by the human beings. The humans who runs it are known as Board of Directors. Directors acting collectively are known as Board. The directors play a very important role in the day to day functioning of the company. It is the board, who is responsible of the company's overall performance.

To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors (collectively) and directors (individually). Directors of a Company are its eyes, ears, brain, hands and other essential limbs.

Chapter XI of Companies Act 2013 read with Companies (Appointment and Qualification of Directors) Rules 2014 specifies regulatory prescriptions relating to appointment of directors, directors identification number, disqualification, vacation etc.. The act has brought in many new provisions such as appointment of women director, resident director, independent director by certain class of companies act. After reading this lesson, you will be able to understand the legal concept of director, their qualifications, appointment, vacation , removal, etc.

INTRODUCTION

On incorporation, a company becomes a person in the eyes of law, it has a perpetual succession, its members may come and may go but the company lives till its death as aforementioned. It has a common seal, which is affixed on all the legal documents executed on behalf of the company in the presence of and signed by authorised signatory or signatories. It is empowered to hold all properties in its own name and in its own right. It can sue others and can be sued by others in its own name.

With all the strapping of a legal person, a company is unlike a living human being. It has no physical existence. It has no eyes to see, no ears to hear, no hands to sign and execute documents, no brain to think and no nerves to communicate among its various limbs. In order to enable a company to live and to achieve its objects as enshrined in the objects clause of its Memorandum of Association, it has necessarily to depend upon some agency, known as Board of directors.

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company.

The Companies Act, 2013 does not contain an exhaustive definition of the term "director". Section 2 (34) of the Act prescribed that "director" means a director appointed to the Board of a company.

Section 2 (10) of the Companies Act, 2013 defined that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company.

Minimum/Maximum Number of Directors in a Company- Section 149(1)

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required.

A period of one year has been provided to enable the companies existing on or before the commencement of Companies Act, 2013 to comply with this requirement.

LET US REMEMBER!!!!

Minimum number of directors- Public Company-3 Directors

Private Company - 2 directors

One Person Company(OPC) - 1 Directors

Maximum Number of Director is 15, which can be increased by passing a special Resolution.

Number of directorships- Section 165

Maximum number of directorships, including any alternate directorship a person can hold is 20. It has come with a rider that number of directorships in public companies/ private companies that are either holding or subsidiary company of a public company shall be limited to 10. Further the members of a company may restrict abovementioned limit by passing a special resolution.

Any person holding office as director in more than 20 or 10 companies as the case may be before the commencement of this Act shall, within a period of one year from such commencement, have to choose companies where he wishes to continue/resign as director. There after he shall intimate about his choice to concerned companies as well as concerned Registrar.

Such person shall not act as director in more than the specified number of companies after despatching the resignation or after the expiry of one year from the commencement of this Act, whichever is earlier.

If a person accepts an appointment as a director in contravention of above mentioned provisions, he shall be punishable with fine which shall not be less than ₹5,000 but which may extend to ₹25,000 for every day after the first day during which the contravention continues.

REMEMEBER THAT!!!

- Maximum limit on total number of directorship has been fixed at 20 companies and the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.
- The members of a company may, by special resolution , specify any lesser number of companies in which a director of the company may act as director.

Residence of a director in India

Section 149 (3) of the Act has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year.

Ministry of Corporate Affairs vide its circular dated June 26, 2014 has made the following clarification with respect to resident director

Section 149(3) of the Companies Act, 2013 (Act) requires every company to have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. Government has received requests from stakeholders for clarification with regard to applicability of these provisions in the current calendar/financial year.

2. The matter has been examined. It is clarified that the, residency requirement' would be reckoned from the date of commencement of section 14 of the Act i.e. 1st April, 2014, The first ,previous calendar year, for compliance with these provisions would, therefore, be Calendar year 2014. The period to be taken into account for compliance with these provisions will be the remaining period of calendar year 2014 i.e. 1st April to 31st December).

Therefore, on a proportionate basis, the number of days for which the director(s) would need to be resident in India. during Calendar year.2014, shall exceed 136 days.

3. Regarding newly incorporated companies it is clarified that companies incorporated between 1.4.2014 to 30.9.2014 should have a resident director either at the incorporation stage itself or within six months of their incorporation. Companies incorporated after 30.9.2014 need to have the resident director from the date of incorporation itself.

Woman Director

Second Proviso to section 149 provides that such class or classes of companies as may be prescribed in Companies (Appointment and Qualification of Directors) Rules, 2014, shall have at least one woman director.

Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes the following class of companies shall appoint at least one woman director-

- (i) every listed company;
- (ii) every other public company having :-
 - (a) paid-up share capital of one hundred crore rupees or more; or
 - (b) turnover of three hundred crore rupees or more .

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date of its incorporation:

However any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

Explanation.- For the purposes of this rule, it is hereby clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Independent Directors

The details of definition, declaration, qualification etc. are dealt in Lesson No. 15

Director elected by Small Shareholders- Section 151

According to section 151 of the Act every listed company may have one director elected by such small shareholders.

For the purpose of this section, "small shareholder" means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Terms & Conditions for Small Shareholders' Director

Rule 7, Companies (Appointment and Qualifications of Directors) Rules, 2014 laid down the following terms and conditions for appointment of small shareholder's director, which are as under:

- (i) A listed company, may upon notice of not less than 1000 or one-tenth of the total number of small shareholders, whichever is lower, have a small shareholders' director elected by the small shareholders. A listed company may suo moto opt to have a director representing small shareholders.
- (ii) The small shareholders intending to propose a person as a candidate for the post of small shareholder's director shall leave a signed notice of their intention with the company at least 14 days before the meeting specifying the their details and proposed director's details. The details include name, address, shares held and folio number etc. If the proposer does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.
- (iii) The notice shall be accompanied by a statement signed by the proposed director for the post of small shareholders' director stating

- (a) his Director Identification Number;
 - (b) that he is not disqualified to become a director under the Act; and
 - (c) his consent to act as a director of the company.
- (iv) If proposed director is qualified u/s 149 (6) for appointment as an independent director and has given declaration for his independence u/s 149 (7) then such director shall be considered as an independent director.
- (v) The director's tenure as small shareholders' director shall not exceed a period of 3 consecutive years and he shall not be liable to retire by rotation. Further he shall not be eligible for re-appointment after the expiry of his tenure.
- (vi) If the person is not eligible for appointment according to section 164, then he can't be appointed as small shareholder's director.
- (vii) Small shareholders' director shall vacate the office if -
- (a) he ceases to be a small shareholder, on and from the date of cessation;
 - (b) he incurs any of the disqualifications specified in section 164;
 - (c) the office of the director becomes vacant in pursuance of section 167;
 - (d) he ceases to meet the criteria of independence as provided section 149 (6).
- (viii) Simultaneously he shall not hold the office of small shareholders' director in more than two companies. If second company is in competitive business or is in conflict with business of the first company the he shall not be appointed in second company.
- (ix) He shall directly or indirectly not be appointed or associated in any other capacity with the company for a period of 3 years from the date of cessation as a small shareholder's director.

APPOINTMENT OF DIRECTORS – Section 152

First Director

The first directors of most of the companies are named in their articles. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152.

General provisions relating to appointment of directors

1. Except as provided in the Act, every director shall be appointed by the company in general meeting.
2. Director Identification Number is compulsory for appointment of director of a company.
3. Every person proposed to be appointed as a director shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under the Act.
4. A person appointed as a director shall on or before the appointment give his consent to hold the office of director in physical form DIR-2 i.e. Consent to act as a director of a company.

Company shall file Form DIR-12 (particulars of appointment of directors and KMP along with the form DIR-2 as an attachment within 30 days of the appointment of a director, necessary fee. {Rule8}

5. Articles of the Company may provide the provisions relating to retirement of all directors. If there is no provision in the article, then not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at annual general meeting. Further independent directors shall not be included for the computation of total number of directors. At the annual general meeting of a public company one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment.

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless—

- (i) a resolution for the re-appointment of such director has been put to the meeting and lost;
- (ii) the retiring director has expressed his unwillingness to be so re-appointed;
- (iii) he is not qualified or is disqualified for appointment;
- (iv) a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or
- (v) section 162 i.e. appointment of directors to be voted individually is applicable to the case.

Punishment - Section 159

If any individual or director of a company, contravenes any of the provisions of section 152, 155 and 156 such individual or director of the company shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs. 50,000 and where the contravention is a continuing one, with a further fine which may extend to Rs. 500 for every day after the first day during which the contravention continues.

Appointment of Additional Director- Section 161 (1)

The board of directors can appoint additional directors, if such power is conferred on them by the articles of association. Such additional directors hold office only upto the date of next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier. A person who fails to get appointed as a director in a general meeting cannot be appointed as Additional Director.

Appointment of Alternate Director- Section 161 (2)

Section 161(2) of the Act allowed the followings:

- (i) The Board of Directors of a company must be authorised by its articles or by a resolution passed by the company in general meeting for appointment of alternate director.
- (ii) The person in whose place the Alternate Director is being appointed should be absent for a period of not less than 3 months from India.

- (iii) The person to be appointed as the Alternate Director shall be the person other than the person holding any alternate directorship for any other Director in the Company.
- (iv) If it is proposed to appoint an Alternate Director to an Independent Director, it must be ensured that the proposed appointee also satisfies the criteria for Independent Directors.
- (v) An alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India.
- (vi) If the term of office of the original director is determined before he so returns to India, any provision for the automatic re- appointment of retiring directors in default of another appointment shall apply to the original, and not to the alternate director.

Appointment of Directors by Nomination Section 161(3)

This new sub-section now provides for appointment of Nominee Directors. It states that subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government Company.

Appointment of Directors in causal vacancy- Section 161 (4)

If any vacancy is caused by death or resignation of a director appointed by the shareholders in General meeting, before expiry of his term, the Board of directors can appoint a director to fill up such vacancy. The appointed director shall hold office only up to the term of the director in whose place he is appointed.

Appointment of directors to be voted individually- Section 162(1)

A single resolution shall not be moved for the appointment of two or more persons as directors of the company unless a proposal to move such a motion has first been agreed to at the meeting without any vote being cast against it.

A resolution moved in contravention of aforesaid provision shall be void, whether or not any objection was taken when it was moved. A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

Proportional representation for appointment of directors- Section 163

The articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise and such appointments may be made once in every three years and casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161.

Right of persons other than retiring directors to stand for directorship- Section 160

A person who is not a retiring director shall be eligible for appointment to the office of a director at any general meeting, if he, or some member intending to propose him as a director, has, not less than fourteen days before the meeting, left at the registered office of the company, a notice in writing under his hand signifying his candidature as a director or, as the case may be, the intention of such member to propose him as a candidate for that office, along with the deposit of one lakh rupees or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than 25% of total valid votes cast either on show of hands or on poll on such resolution.

Notice of candidature of a person for directorship- Section 160(2) and Rule 13

The company shall inform its members of the candidature of a person for the office of a director or the intention of a member to propose such person as a candidate for that office, at least seven days before the general meeting by serving individual notices to members through e-mail and where no e-mail address is available then in writing and by placing notice of such candidature or intention on the website of the company, if any.

If the company advertises such candidature/intention, not less than 7 days before the meeting at least once in a vernacular newspaper in the principal vernacular language of the registered office's district and at least once in English language in an English newspaper circulating in that district in which the registered office of the company is situated, then it shall not be required to serve individual notices upon the members as aforesaid.

DIRECTOR IDENTIFICATION NUMBER (DIN)

Procedure for application for allotment of DIN - Section 153 & Rule 9

- (1) Every individual, who is to be appointed as director of a company shall make an application electronically in Form DIR-3 (Application for allotment of Director Identification Number) to the Central Government for the allotment of a Director Identification Number (DIN).
- (2) The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.
- (3)
 - (a) The applicant shall download Form DIR-3 from the portal, fill in the required particulars and attaching photograph; proof of identity; proof of residence; and verification by the applicant in Form DIR-4, specimen signature duly verified and sign the form digitally.
 - (b) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by :-
 - (i) a chartered accountant in practice or a company secretary in practice or a cost accountant in practice; or
 - (ii) a company secretary in full time employment of the company or by the managing director or director of the company in which the applicant is to be appointed a director;

Procedure for Allotment of DIN- Section 154 and Rule 10

The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as mentioned below:

- (1) On the submission of the Form DIR-3 on the portal and payment of the requisite amount of fees through online mode the provisional DIN shall be generated by the system automatically which shall not be utilized till the DIN is confirmed by the Central Government.
- (2) After generation of the provisional DIN, the Central Government shall process the application. It may approve or reject the application and communicate the same to the applicant within a period of one month from the receipt of application. The such communication may be sent by post or electronically or in any other mode.
- (3) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of fifteen days of such

placing on the website and email:

Provided that Central Government shall-

- (a) reject the application and direct the applicant to file fresh application with complete and correct information, where the defect has been rectified partially or the information given is still found to be defective;
 - (b) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and
 - (c) Inform the applicant either by way of letter by post or electronically or in any other mode.
- (4) In case of rejection or invalidation of application, the provisional DIN so allotted by the system shall get lapsed automatically and the fee so paid with the application shall neither be refunded nor adjusted with any other application.
- (5) All Director Identification Numbers allotted to individual(s) by the Central Government before the commencement of these rules shall be deemed to have been allotted to them under these rules.
- (6) The Director Identification Number so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.

Cancellation/Surrender/Deactivation of DIN – Rule 11

The Competent Authority (Central Government/RD (North), Noida/ Authorised Officer by the RD) may, upon being satisfied on verification of particulars or documentary proof attached with the application received from any person, cancel or deactivate the DIN in case –

- (a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DIN shall be merged with the validly retained number;
- (b) the DIN was obtained in a wrongful manner or by fraudulent means;
- (c) of the death of the concerned individual;
- (d) the concerned individual has been declared as a lunatic or of unsound mind by a competent Court;
- (e) if the concerned individual has been adjudicated an insolvent.

Provided that before cancellation or deactivation of DIN pursuant to clause (b), an opportunity of being heard shall be given to the concerned individual;

- (f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN but after verification of e-records.

Intimation of changes in particulars of Director - Rule 12

- (1) Every director having DIN in the event of any change in his particulars as stated in Form DIR-3, intimate such change(s) to the Central Government within a period of 30 days of such change(s) in Form DIR-6 (Intimation of change in particulars of Director to be given to the Central Government). DIR-6 will be filed along copy of the proof of the changed particulars and verification in the Form DIR-7 (Verification of applicant for change in DIN particulars) all of which shall be scanned, signed digitally by applicant and submitted electronically. Form requires pre-certification by the professional CA/CS/CMA in practice.

- (2) The Central Government shall incorporate the said changes in the electronic database after due verification from the enclosed proofs and confirm the applicant by post/email/any other mode.
- (3) The DIN cell of the MCA shall also intimate the change(s) in the particulars of the director submitted to it in Form DIR-6 to the concerned Registrar(s) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated.
- (4) The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within fifteen days of such change.

General Provisions regarding DIN

According to Section 155, No individual shall apply for/obtain/ possess another Director Identification Number who has already been allotted a Director Identification Number under section 154.

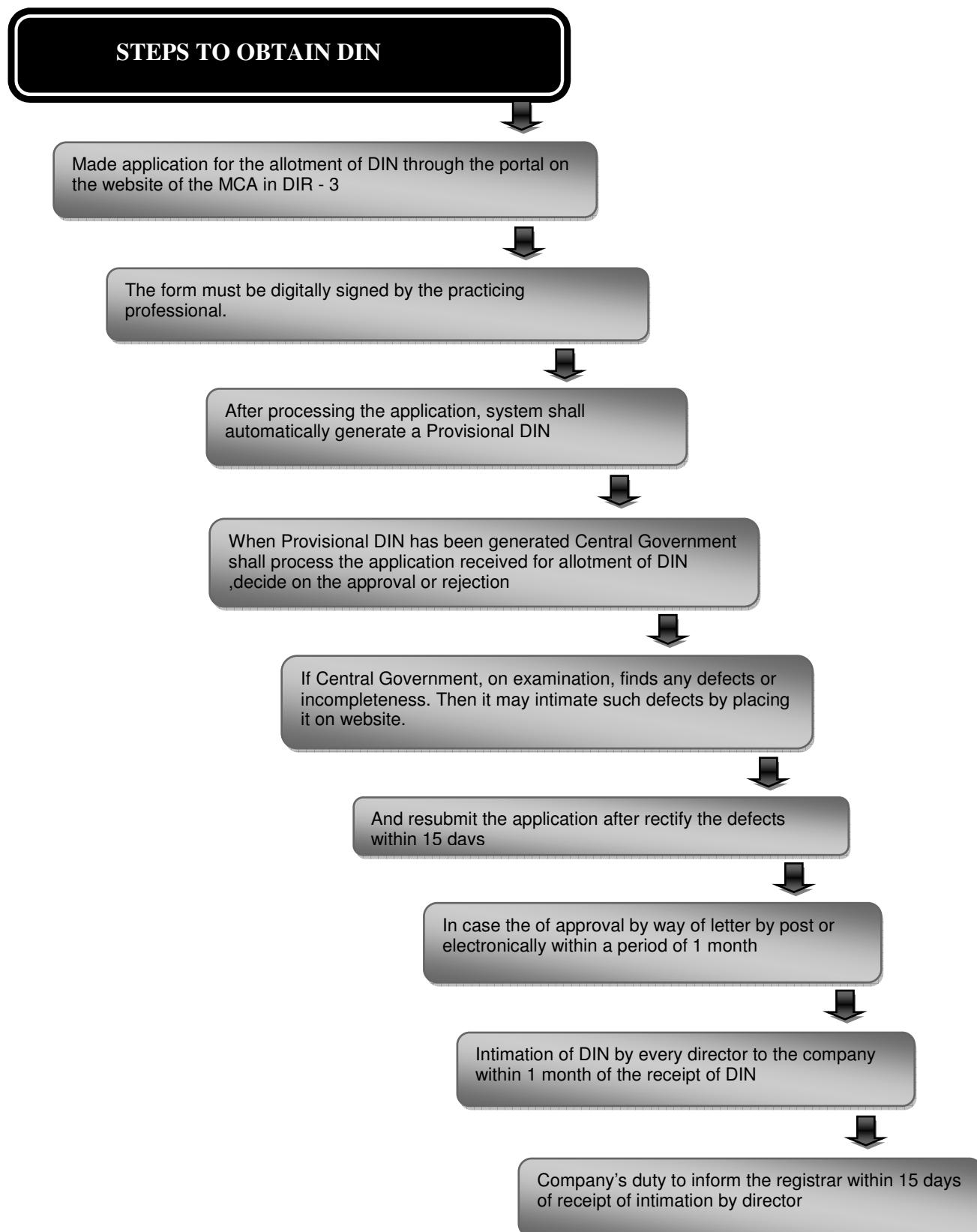
Section 156 stipulated that Every existing director shall intimate his DIN to the company or all companies wherein he is a director within 1 month of the receipt of DIN from the Central Government.

Section 157 (1) of the Act stipulated that every company shall, within fifteen days of the receipt of intimation under section 156, furnish the DIN of all its directors to the Registrar/authorised office by the Central Government. every such intimation shall be furnished in such form and manner as may be prescribed.

If a company fails to furnish Director Identification Number under section 157 (1), before the expiry of the 270 days period from the date by which it should have been furnished with additional fee, the company shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1,00,000 and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1,00,000.

Section 158 specified that every person or company shall mention the DIN in return, information or particulars as required to be furnished under this act, in case such return etc relate to the director or contain any reference of any director.

Steps to obtain DIN



11. Disqualifications for appointment of director -Section 164

- (1) A person shall not be eligible for appointment as a director of a company, if —
- (a) he is of unsound mind and stands so declared by a competent court;
 - (b) he is an undischarged insolvent;
 - (c) he has applied to be adjudicated as an insolvent and his application is pending;
 - (d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence.
- If a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;
- (e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;
 - (f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;
 - (g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or
 - (h) he has not got the DIN.

An additional disqualification is provided in sub section (2) of Section 164 relating to consequences of non filing of financial statements or annual returns. Any person who is or has been director of any company which has not filed any financial statements and Annual Return for 3 continuous financial year or has defaulted in payment of debentures/deposit/dividend etc, shall also not be eligible for appointment as director of any public company and for re- appointment in the same company for a period of five years from the date on which the said company fails to do so.

Rule 14 prescribed that every director who disqualified u/s 164 (2), shall inform to the company concerned in Form DIR-8 (Intimation by Director) before he is appointed or re-appointed. Whenever a company fails to file the financial statements/annual returns/fails to repay any deposit, interest, dividend/fails to redeem its debentures as specified u/s 164 (2), the company shall immediately file Form DIR-9 (Report by the company to Registrar), to the Registrar furnishing therein the names and addresses of all the directors of the company during the relevant financial years. But when a company fails to file the Form DIR-9 within a period of 30 days of the failure it would attract the disqualification u/s 164(2), officers of the company as specified u/s 2(60) shall be the officers in default. Upon receipt of the Form DIR-9 the Registrar shall immediately register the document and place it in the document file for public inspection. Any application for removal of disqualification of directors shall be made in Form DIR-10.

(3) A private company may by its articles provide for any disqualifications for appointment as a director in addition to aforesaid mentioned

Provided that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall not take effect—

- (i) for thirty days from the date of conviction or order of disqualification;
- (ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed off; or
- (iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed off.

Duties of directors- Section 166

For the first time, duties of directors have been defined in the Act. A director of a company shall :

- Act in accordance with the articles of the company.
- Act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
- Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- Not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- Not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
- Not assign his office and any assignment so made shall be void.

If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 5,00,000.

Vacation of office of director- Section 167

The office of a director shall become vacant in case—

- (a) He incurs any of the disqualifications specified in section 164;
 - (b) He absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;
 - (c) He acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;
 - (d) He fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested
 - (e) He becomes disqualified by an order of a court or the Tribunal;
 - (f) He is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than 6 months;
- Provided that the office shall be vacated by the director even if he has filed an appeal against the order of such court;
- (g) He is removed in pursuance of the provisions of this Act;

- (h) He, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified above, he shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 5,00,000 or with both.

Where all the directors of a company vacate their offices under any of the disqualifications specified above the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified above.

Resignation of director- Section 168 & Rule 15, 16

A director may resign from his office by giving notice in writing. The Board shall, on receipt of such notice within 30 days intimate the Registrar in Form DIR-12 and also place the fact of such resignation in the Directors' Report of subsequent general meeting of the company and post the information on its website. The director shall also forward a copy of resignation alongwith detailed reasons for the resignation to the Registrar in Form DIR-11 within 30 days from the date of resignation. The notice shall become effective from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later. Provided that the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

If all the directors of a company resign from their office or vacate their office, the promoter or in his absence the Central Government shall appoint the required number of directors to hold office till the directors are appointed by the company in General Meeting.

Removal of directors- Section 169

A company may, remove a director except the director appointed by National Company Law Tribunal u/s 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard after passing the ordinary resolution.

Provided that nothing contained in this sub-section shall apply where the company has availed itself of the option given to it under section 163 to appoint not less than two thirds of the total number of directors according to the principle of proportional representation.

A special notice shall be required of any resolution, to remove a director under this section, or to appoint somebody in place of a director so removed, at the meeting at which he is removed.

On receipt of notice of a resolution to remove a director under this section, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

Where notice has been given of a resolution to remove a director under this section and the director concerned makes with respect thereto representation in writing to the company and requests its notification to members of the company, the company shall, if the time permits it to do so,—

- (a) in any notice of the resolution given to members of the company, state the fact of the representation

having been made; and

- (b) send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company), and if a copy of the representation is not sent as aforesaid due to insufficient time or for the company's default, the director may without prejudice to his right to be heard orally require that the representation shall be read out at the meeting.

Provided that copy of the representation need not be sent out and the representation need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the Tribunal is satisfied that the rights conferred by this sub-section are being abused to secure needless publicity for defamatory matter; and the Tribunal may order the company's costs on the application to be paid in whole or in part by the director notwithstanding that he is not a party to it.

A vacancy created by the removal of a director under this section may, if he had been appointed by the company in general meeting or by the Board, be filled by the appointment of another director in his place at the meeting at which he is removed, provided special notice of the intended appointment has been given under sub-section (2).

A director so appointed shall hold office till the date up to which his predecessor would have held office if he had not been removed.

If the vacancy is not filled under sub-section (5), it may be filled as a casual vacancy in accordance with the provisions of this Act:

Provided that the director who was removed from office shall not be re-appointed as a director by the Board of Directors.

Nothing in this section shall be taken—

- (a) as depriving a person removed under this section of any compensation or damages payable to him in respect of the termination of his appointment as director as per the terms of contract or terms of his appointment as director, or of any other appointment terminating with that as director; or
- (b) as derogating from any power to remove a director under other provisions of this Act.

LESSON ROUND-UP

- To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors. Directors of a company are its eyes, ears, brain, hands and other essential limbs.
- Every public company shall have at least 3 directors and every private company shall have at least 2 directors and every one person company shall have atleast 1 director under section 149.
- Directors are trustees for the company i.e. the directors are persons selected to manage the affairs of the company for the benefit of the shareholders.
- Section 164 lays down disqualifications of directors. Also individually only can be a director under section 152 of the Act.
- Maximum Number of Director is 15, which can be increased by passing a special Resolution.
- Certain prescribed class or classes of companies is required to have at least one woman director. This is a mandatory provision.
- Every company including one person company shall have at least one director who stays in India for a period

of not less than 180 days in the previous calendar year.

- Maximum limit on total number of directorship has been fixed at 20 companies including sub limit of 10 for public companies.
- The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.
- A director may be removed from the office by giving a special notice.
- A director may resign his office in the manner provided by the articles.
- Any officer or employee of a company shall be punishable with the fine on the complaint of the company or any creditor or contributory thereof, if he wrongfully obtains, possession or withholds any property of the company.
- The overall limit on managerial remuneration shall not exceed 11% of the net profits.
- The remuneration payable to any one managing director or whole-time director or manager shall not exceed 5% of the net profits.
- If there is more than one such director, remuneration shall not exceed 10% of the net profits of the company.

SELF-TEST QUESTIONS

1. Explain the concept and the evolution of the institution of directors.
2. What are the qualifications of a director? When is a person disqualified for appointment as a director of the company? What are the rules as regards disqualification of Directors?
3. Explain the law relating to number of directors.
4. Who may be appointed as director of a company?
5. How can the directors be removed from the office before the expiry of their term?
6. Under what circumstances is a director deemed to have vacated the office of directorship?
7. How can the small shareholder's director be appointed?

Lesson 15

Independent Directors

LESSON OUTLINE

- Introduction
- Number of Independent Directors
- Manner of selection of Independent director
- Qualification of Independent Director
- Code for Independent Director
- Tenure of Independent Director
- Liability of Independent director
- Retirement of Independent directors
- Remuneration of Independent Directors
- Clause 49 relating Independent Directors
- Roles and functions of Independent Directors
- Duties of Independent Directors

LEARNING OBJECTIVES

The purpose of identifying and appointing independent directors is to effectively exercise their best judgment for the exclusive benefit of the stakeholders. Independent Directors are required because they perform the following important functions i.e

- (i) They balance the conflicting interest of stakeholders.
- (ii) They Fulfill a useful role in succession planning
- (iii) They act as a coach, mentor and sounding Board for their full time colleagues.
- (iv) They provide independent judgment and wider perspective.

In fact, Independent directors are meant to serve the company's shareholders. They are not a representative of any regulator watch dog. The Companies Act 2013 has introduced new provisions relating to independent directors, eligibility criteria, tenure, appointment, qualification , code etc., Clause 49 of the Listing agreement has also been amended in tune with the Companies Act 2013.

After reading this lesson you will be able to understand the legal provisions relating to appointment, remuneration, code, tenure and other prescriptions pertaining to independent directors.

1. INTRODUCTION

The Cadbury Committee in 1992, which itself was set up following the corporate scandals involving BCCI, Poly Peck and Maxwell, provided respectability to the concept of independent directors, by focusing on independent directors as a part of the new practices for better governance. Independent directors function as an oversight body in monitoring the performance and should raise red flags whenever suspicion occurs. They are expected to be more aware and question the company on relevant issues in their position as trustees of stakeholders.

The institution of independent directors is a critical instrument for ensuring good corporate governance and it is necessary that the functioning of the institution is critically analysed and proper safeguards are made to ensure efficacy.

Companies Act 2013 mandates appointment of independent directors by listed companies and other class of companies. It also prescribes other aspects such as maximum tenure of independent directors, separate meeting of independent directors, tenure, their qualifications, liability, appointment, remuneration and other aspect.

Definition of Independent Director

Section 149(6) gives the definition of Independent Director, in relation to a company, means a director other than a managing director or a whole time director or a nominee director,-

- (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
- (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
- (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year.

Classification for MCA on 'Pecuniary Interest'

(i) Section 149(6)(c): "pecuniary interest in certain transactions" :-

(a) This provision inter alia requires that an 'ID' should have no 'pecuniary relationship' with the company concerned or its holding/ subsidiary/ associate company and certain other categories specified therein during the current and last two preceding financial years. Clarifications have been sought whether a transaction entered into by an 'ID' with the company concerned at par with any member of the general public and at the same price as is payable/paid by such member of public would attract the bar of 'pecuniary relationship' under section 149(6)(c). The matter has been examined and it is hereby clarified that in view of the provisions of section 188 which take away transactions in the ordinary course of business at arm's length price from the purview of related party transactions, an 'ID' will not be said to have 'pecuniary relationship' , under section 149(6)(c) in such cases.

(b) Stakeholders have also sought clarification whether receipt of remuneration, (in accordance with the

provisions of the Act) by an 'ID' from a company would be considered as having pecuniary interest while considering his appointment in the holding company, subsidiary company or associate company of such company.

The matter has been examined in consultation with SEBI and it is clarified that 'pecuniary relationship' provided in section 149(6)(c) of the Act does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act.

- (d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) who, neither himself nor any of his relatives—
 - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
 - (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
 - (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
 - (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;
 - (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
 - (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or
- (f) who possesses such other qualifications as may be prescribed.

Explanation.—For the purposes of this section, "nominee director" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

2. Number of Independent Directors

Section 149(4) provides that every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies

Rule 4 Of Companies (Appointment and Qualification of Directors) rules 2014, provides that the following class or classes of companies shall have at least two directors as independent directors -

- (i) the Public Companies having paid up share capital of ten crore rupees or more; or
- (ii) the Public Companies having turnover of one hundred crore rupees or more; or
- (iii) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

LET US REMEMBER!

Nominee Directors are not Independent Directors

3. Qualification of independent Directors

Rule 5 of Companies(Appointment and Qualification of Directors) Rules,2014 made under Chapter XII provides that an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

4. Manner of selection of an Independent Director-

According to section 150 (1) of the Act, independent directors may be selected from a data bank of eligible and willing persons maintained by the agency (Any body, institute or association as may be authorised by Central Government). Such agency shall put data bank of independent directors on the website of Ministry of Corporate Affairs or any other notified website. Company must exercise due diligence before selecting a person from the data bank referred to above, as an independent director.

This section further stipulates that the appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Any person who desires to get his name included in the data bank of independent directors shall make an application to the agency in Form DIR-1 Application for inclusion of name in the databank of Independent Directors which includes the personal, educational, professional, work experience, other Board details of the applicant {Rule 6(4)}.

The agency may charge a reasonable fee from the applicant for inclusion of his name in the data bank of independent directors {Rule 6 (5)}

An existing or applicant of such data bank of independent directors shall intimate any changes in his particulars within fifteen days of such change to the agency {Rule 6 (6)}.

Rule 6 (7) prescribed that the databank posted on the website shall:

- a. be accessible at the specified website;
- b. be substantially identical to the physical version of the data bank;
- c. be searchable on the parameters specified in rule 6 (2);
- d. be presented in a format or formats convenient for both printing and viewing online; and
- e. contain a link to obtain the software required to view print the particulars free of charge.

➤ **Declaration by independent director**

Section 149(7) provides that every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence as provided in sub-section (6).

5. Code for Independent Directors

Section 149 (8) of the Act prescribes that the company and independent directors shall abide by the provisions specified in Schedule IV regarding code for independent directors. It is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

- Code of Conduct includes
- guidelines of professional conduct,
- role and functions, duties,
- manner of appointment, re-appointment,
- resignation or removal,
- separate meetings,
- evaluation mechanism.

Guidelines of professional conduct:

An independent director shall:

- (1) uphold ethical standards of integrity and probity;
- (2) act objectively and constructively while exercising his duties;
- (3) exercise his responsibilities in a bona fide manner in the interest of the company;
- (4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;
- (5) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;
- (6) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- (7) refrain from any action that would lead to loss of his independence;
- (8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- (9) assist the company in implementing the best corporate governance practices.

Role and functions:

The independent directors shall:

- (1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues

- of strategy, performance, risk management, resources, key appointments and standards of conduct;
- (2) bring an objective view in the evaluation of the performance of board and management;
 - (3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
 - (4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
 - (5) safeguard the interests of all stakeholders, particularly the minority shareholders;
 - (6) balance the conflicting interest of the stakeholders;
 - (7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
 - (8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

Duties:

The independent directors shall—

- (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- (2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
- (3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;
- (4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;
- (5) strive to attend the general meetings of the company;
- (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;
- (7) keep themselves well informed about the company and the external environment in which it operates;
- (8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;
- (9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;
- (10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
- (11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
- (12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders

and its employees;

- (13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

Manner of appointment:

- (1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.
- (2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.
- (3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.
- (4) The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :
 - (a) the term of appointment;
 - (b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;
 - (c) the fiduciary duties that come with such an appointment along with accompanying liabilities;
 - (d) provision for Directors and Officers (D and O) insurance, if any;
 - (e) the Code of Business Ethics that the company expects its directors and employees to follow;
 - (f) the list of actions that a director should not do while functioning as such in the company; and
 - (g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.
- (5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.
- (6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

Re-appointment:

The re-appointment of independent director shall be on the basis of report of performance evaluation.

Resignation or removal:

- (1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.
- (2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.

- (3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

Separate meetings:

- (1) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;
- (2) All the independent directors of the company shall strive to be present at such meeting;
- (3) The meeting shall:
 - (a) review the performance of non-independent directors and the Board as a whole;
 - (b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
 - (c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Evaluation mechanism:

- (1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
- (2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

NOTED THAT:-

Section 149(8) provides that the company and independent directors shall abide by the provisions specified in Schedule IV(Code of Conduct for Independent Director).

6. Tenure of Independent Director

Section 149(10) provides that subject to the provisions of section 152(Appointment of Directors), an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

Section 149(11) states that without contravening the section 149(10), no independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.

Proviso to Section 149(11) that an independent director shall not, during the said period of three years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Explanation to section 149(10) & (11) prescribes that, any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under those sub-sections.

Clarifications on Rules prescribed under the Companies Act, 2013 -Matters relating to appointment and qualifications of directors and Independent Directors

➤ **Section 149: Appointment of 'IDs' :**

Clarification has been sought if "IDs" appointed prior to April 1, 2014 may continue and complete their

remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company so decide) in accordance with the provisions of the new Act.

The matter has been examined in the light of the relevant provisions of the Act, particularly section 149(5) and 149(10) & (11). Explanation to section 149(11) clearly provides that any tenure of an "ID" on the date of commencement of the Act shall not be counted for his appointment/ holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), it is hereby clarified that it would be necessary that if it is intended to appoint existing 'IDs' under the new Act, such appointment shall be made expressly under section 149(10)/(11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

➤ **Section 149(10)/(11) - Appointment of 'IDs' for less than 5 years:-**

Clarification has been sought as to whether it would be possible to appoint an individual as an ID for a period less than five years.

It is clarified that section 149(10) of the Act provides a term of "upto five consecutive years" for an 'ID'. As such while appointment of an 'ID' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of 'ID' for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years

LET US REMEMBER:-

Independent Director shall hold office for a term upto 5 consecutive years, but shall be eligible for re-appointment on passing of a special resolution.

He shall not hold office for more than 2 consecutive terms, but such independent director shall be eligible for appointment after the expiration of 3 years of ceasing to become an independent director.

7 Liability of Independent Director

Section 149(12) provides that, notwithstanding anything contained in this Act,—

- (i) an independent director;
- (ii) a non-executive director not being promoter or key managerial personnel, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Retirement by rotation not applicable to independent directors

Section 149(13) states that the provisions of sections 152(6) & (7) in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

9. Remuneration of Independent Director

Section 149(9) provides that notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock

option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members .

A Comparative Study Of Provisions Made Under Clause 49 And The Companies Act, 2013 For Independent Directors

Particulars	Indian Regulatory Framework	
	Clause 49	Companies Act 2013
Prescription as to Board Independence	50% of the Board is to be independent if the Chairman is a promoter, otherwise 1/3rd of the board are to be independent.	Every listed company and prescribed class of companies to have at least 1/3rd of total number of directors as independent directors.(Section 149)
Separation of role of Chairman and CEO	Office of Chairman and CEO can be held by a same individual	Office of Chairman and CEO cannot be held by same individual subject to conditions(Section 203)
Lead Independent Director	Not required to be appointed	Not required to be appointed
Nominee Director	Nominee Directors are not considered as Independent Directors	An independent director in relation to a company, means a director other than a MD or a WTD or a nominee director. (Section 149(6))
Declaration as to independence	--	Section 149(7) mandates declaration from Independent Directors stating that they are meeting the criteria for independence.
Qualification of Independent Directors	Not specified.	Companies (Appointment and qualification of Directors) Rules, 2014 specifies certain criteria as to qualification.
Stock Options	Stock options prohibited to independent directors	Independent Directors are not entitled to any stock option.(section 197(7))
Separate Meeting of Independent Directors	The IDs of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. (Clause49(II)(B)(6))	Independent Directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. (Section 149 read with Schedule IV)
Audit Committee	The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.	Section 177. (1) The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee. (2) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:
Nomination Committee	The company shall set up a	The Nomination and Remuneration Committee

	<p>nomination and remuneration committee which shall comprise at least 3 directors, all of whom shall be NEDs and at least ½ shall be independent. Chairman of the committee shall be an independent director.</p>	<p>is applicable to the following classes of Companies Every listed Company Every other Public company- Having Paid up capital of Rs.10crores or more; or Having turnover of Rs.100 Crores Which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores. The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule. The above mentioned classes of companies shall constitute the Nomination and Remuneration Committee consisting of 3 or more NEDs out of which not less than one half shall be IDs. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.</p>
CSR Committee	--	135. (1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.
Stakeholders Grievance Committee	A committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as 'Stakeholders	The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. The SRC shall consider and resolve the grievances of security holders of the company(Section 178(5)

	Relationship Committee' and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends	
Performance Evaluation of Independent Directors	<p>Clause 49(II)(B)(5):</p> <ul style="list-style-type: none"> a. The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. b. The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report. c. The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated). d. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director. 	<p>Section 178(2) read with Schedule IV:</p> <p>The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director</p>
Tenure of Independent Directors	To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to Listing Agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only.	An independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.
Training of Independent Directors	The company shall provide suitable training to independent directors to familiarize them with the company, their roles,	No provision as to training.

	rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. The details of such training imparted shall be disclosed in the Annual Report	
Liability of Directors	An independent director shall be held liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable to Board process and with his consent or connivance or where he ad not acted diligently with respect to the provisions in the listing agreement.	An independent director a non executive director not being promoter or KMP, shall be held liable, only in respect of such acts or omission or commission by a company which had occurred with his knowledge, attributable through board processes and with his consent or connivance or where he had not acted diligently.(Section 149(12))

LESSON ROUND-UP

- An independent director in relation to a company means a director other than a managing director or a whole-time director or a nominee director.
- An independent director can be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent director.
- Every listed company shall have one-third independent directors.
- Section 149(8) provides that the company and independent directors shall abide by the provisions specified in Schedule IV.
- Different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed by the rules.
- An independent director shall hold office for a term up to 5 consecutive years on the Board of a company.
- The re- appointment of an independent director shall be on the basis of report of performance evaluation.[Clause VIII of Schedule IV]
- The resignation or removal of an independent director will be in the manner as is provided in sections 168 & 169 of the act.
- 50% of the Board is to be independent if the Chairman is a promoter, otherwise 1/3rd of the board are to be independent prescribed under Clause 49 of Listing Agreement.
- The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.
- The company shall provide suitable training to independent directors to familiarize them with the company.

SELF-TEST QUESTIONS

1. Write short notes on the followings:
 - Independent director under Clause 49
 - Code for Independent Directors
 - Tenure of Independent Directors
 - Maximum and Minimum Number of Independent Directors
 2. Explain the manner of appointment of Independent directors.
 3. Write the liabilities of a Independent Directors.
 4. Briefly explain the role & function of a Independent Directors.

Lesson 16

Board and its Powers

LESSON OUTLINE

- Distribution of powers of a Company
- Exercise of Powers
- Board Committees
- Restriction on powers of Board
- Loans to Directors
- Board's sanction for contracts in which Directors are interested.
- Related Party Transaction
- Register of Contracts or Arrangements in which Directors are interested
- Contract of Employment with Managing Director or Whole-Time Directors

LEARNING OBJECTIVES

In the previous chapter, we had learnt about the concept of directors, their appointment, removal, remuneration etc. Now let us learn about the powers and duties of directors. Directors acting collectively i.e. Board of Directors are authorized to do what the company is authorized to do unless barred by restrictions on their powers by the provisions of the Companies Act, 2013, the Memorandum or Articles of the company. Except where express provisions are made that the powers of a company in respect of any matter are to be exercised by the company in general meeting, in all other cases the Board is entitled to exercise all its powers. The directors acting together are the authority for conducting the affairs of the company. They are authorised to do what the company is authorised to do, unless barred by restrictions on their powers by the provisions of the Companies Act, 2013 (the Act), the Memorandum or Articles of the company.

DISTRIBUTION OF POWERS OF A COMPANY

The directors shall exercise their powers bona fide and in interest of the company. The directors while exercising their powers do not act as agents for the majority or even all the members and so the members cannot by resolution passed by a majority or even unanimously supercede the director's powers, or instruct them how they shall exercise their powers. This sovereignty of the directors within the limits of the powers conferred on them by the articles, and within limit laid down by the Act was clearly expressed by *Greer L.J. in John Shaw & Sons (Salford) Ltd v. Shaw*(1935) 2 K.B. 113 in the following words:

"A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. The powers of management are vested in the directors. They and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in the directors, is by altering the articles, or if opportunity arises under the articles, by refusing to re-elect the directors whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders".

In *Milan Senv. Guardian Plasticate Ltd.*(1998) 2 Comp L J 320, the directors passed a resolution for rights issue which was questioned by certain shareholders. The Calcutta High Court held that the question whether the company needed additional capital was a question which should primarily be decided by the directors of the company and if they were of the view that further capital in the form of rights issue was required the Court would be slow to disturb the same unless there were extreme circumstances of malafides or breach of trust.

Thus, from the provisions of Section 179 and the exposition of the law stated above, it is clear that subject to the restrictions contained in the Act, Memorandum and articles, the powers of directors are co-extensive with those of the company itself.

The relationship of the Board of directors with the shareholders is more of federation than one of subordinates and superior. Some powers are specially reserved for the Board e.g. appointing directors in casual vacancies, the power to issue debentures, etc. On the other hand, some powers are exclusively reserved for the members in general meeting e.g. borrowing in excess of the paid-up capital and free reserves, selling or disposing off the whole or substantially the whole of the undertaking etc.

However, in the following exceptional cases, the general body of shareholders is competent to act even in matters delegated to the Board:

- (a) Directors Acting Mala Fide: The general body of shareholders can intervene when it is proved that the directors have acted for improper motive or arbitrarily or capriciously. In *Satya Charan Lalv. Romeshwar Prasad Bajoria*(1950) SCR 394, it was stated that ordinarily the directors of a company are the only persons who can conduct litigation in the name of company, but when they are themselves the wrong doers, and have acted malafide and their personal interest is in conflict with their duty in such a way that they cannot or will not take steps to seek redress for the wrong done to the company, the majority of the shareholders may take steps for redressal of the wrong.

In Marshal's Valve Gear Co. Ltd v. Manning Wardle & Co. Ltd.(1909) 1 Ch. 267, A and three other persons were four directors of M. Co. and they held almost the whole of the subscribed capital of the company. A was the majority shareholder, but held less than three-fourth of the share capital.

Another company, known as N. Co. was committing infringement of M. Co.'s trademark and other three directors were interested in that company. The result was that at a meeting of the Board they declined to sanction any proceeding against N. Co. A, at a general meeting of the shareholders, resolved and commenced an action to restrain the alleged infringement.

- (b) Incompetent Board: The general body of shareholders may exercise the powers vested in the Board when the Board is incompetent to act, for instance, where all the directors are interested in the transaction or the Board is unwilling to act, or when there are no validly appointed directors functioning.

In *Vishwanathanv.Tiffins B.A. and P. Ltd.*, AIR 1953 Mad. 520, a clause in the articles of the company authorised the directors to fill casual vacancies and also to increase the number of directors within the maximum number fixed in the articles. Some casual vacancies occurred, and they were promptly filled at a general meeting of the shareholders. This was challenged on the ground that once the power to appoint was delegated to the Board, it could not have been exercised at a general meeting. The Court upheld the appointments by the company in the general meeting, as it found that at the time of the general meeting there was no director in office and, therefore, the members had the right to elect. Venkatarama Iyer, J. observed: "A company has inherent power to take all steps to ensure its proper working and that, of course, included the power to appoint directors. It can delegate these powers to the Board and such delegation will be binding upon it, but if there is no legally constituted Board which could function or if there is a Board that is unable or unwilling to function then the authority delegated to the Board lapses and the members can exercise the right inherent in them of appointing directors."

- (c) Deadlock in the Board: If the directors are unable or unwilling to act, on account of deadlock, the shareholders have the inherent power to act.

For instance, in the *Barronv.Potter*(1914) 1 Ch. 895, there were only two directors on the Board of the Company and one refused to act with the other. There was no provision in the articles enabling the general meeting of the shareholders to increase or reduce the number of directors. Held, that as there was a deadlock in the administration resulting from the fact that the power to take necessary steps to ensure the working of the company and to appoint additional director for the purpose.

From the above, it is clear that the residuary powers can be pressed into service by the shareholders in general meeting.

State whether the following statement is "True" or "False"

The powers of directors are co-extensive with those of the company itself.

- True
- False

Correct answer:True

The way we run board meetings says much about how we run the company. Successful companies use board meetings to create and improve key business strategies.

The board of directors of a company is primarily an oversight board. It oversees the management of the company to ensure that the interest of non-controlling shareholders is protected. It also functions as advisory board. Independent directors bring diverse knowledge and expertise in the board room and the CEO uses

the knowledge pool in addressing issues being faced by the company. The most important function of a monitoring board is to provide direction to the company.

Another very important function of a monitoring board is to set the ‘tone at the top’. It is expected to create the right culture within the company.

Meetings of the Board : Section 173

Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum.

1. The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.
2. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.
3. In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.

Notice of Board Meetings

1. The Act requires that not less than seven days' notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.
2. In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

Requirements and Procedures for Convening and Conducting Board's Meetings

Directors may participate in the meeting either in person or through video conferencing or other audio visual means.

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedures, in addition to the procedures required for Board meetings in person, for convening and conducting Board meetings through video conferencing or other audio visual means:

- (1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.
- (2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
 - (a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
 - (b) to ensure the availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;
 - (c) to record the proceedings and prepare the minutes of the meeting;

- (d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year;
 - (e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
 - (f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting, but the differently abled persons, may make request to the Board to allow a person to accompany him.
3. (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.
- (b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.
- (c) A director intending to participate through video conferencing mode or audio visual means shall communicate his intention to the Chairman or the company secretary of the company.
- (d) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangement in this behalf.
- (e) The director, who desire, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year.
- (f) In the absence of any such intimation from the director, it shall be assumed that the director will attend the meeting in person.
- (4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely :
- (a) name;
 - (b) the location from where he is participating;
 - (c) that he can completely and clearly see, hear and communicate with the other participants;
 - (d) that he has received the agenda and all the relevant material for the meeting; and
 - (e) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.
5. (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairman and confirm that the required quorum is complete.
- Explanation:* It is clarified that a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the Rules.
- (b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement

- of the meeting after every break to confirm the presence of a quorum throughout the meeting.
- (6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, which shall be in India, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.
 - (7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.
 - (8) (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.
 (b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or company secretary shall request for a repeat or reiteration by the director.
 - (9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.
 - (10) From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, directors, Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.
 - (11) (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority.
 (b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.
 - (12) (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.
 (b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
 (c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation - For the purposes of this rule, 'video conferencing or other audio visual means' means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Matters not to be dealt with in a Meeting through Video Conferencing or other Audio Visual Means

Rule 4 prescribe restriction on following matters which shall not be dealt with in any meeting held through

video conferencing or other audio visual means:

- (i) the approval of the annual financial statements;
- (ii) the approval of the Board's report;
- (iii) the approval of the prospectus;
- (iv) the Audit Committee Meetings for consideration of accounts; and
- (v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Penalty

Every officer of the company who is duty bound to give notice under this section if fails to do so shall be liable to a penalty of twenty five thousand rupees.

Compliance with Secretarial Standards relating to Board Meetings

For the first time in the history of Company Law in India, the Companies Act, 2013 has given statutory recognition to the Secretarial Standards issued by the Institute of Company Secretaries of India.

Section 118(10) of the Act reads as under:

Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In the context of this provision, observance of Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI) assumes special relevance and companies will have to ensure that there is compliance with these standards on their part. The ICSI is in process to bring out the Secretarial Standards in line with Companies Act, 2013 and has already issued the exposure draft of Secretarial Standard related to Board and General Meeting.

Quorum for Board Meetings : Section 174

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting.

If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company. It shall not act for any other purpose.

For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

It can thus be observed that the provisions of the Companies Act, 2013 relating to board meetings have been made more realistic and in line with the current expectations of the corporate sector.

Passing of Resolution by Circulation : Section 175

A company may pass the resolutions through circulation. The resolution in draft form together with the necessary papers may be circulated to the directors or members of committee at their address registered with the company in India or through electronic means which may include e-mail or fax.

The said resolution must be passed by majority of directors or members entitled to vote.

If more than one third of directors require that the resolution must be decided at the meeting, the chairperson shall put the resolution to be decided at the meeting.

The resolution passed through circulation be noted at a subsequent meeting and made part of the minutes of such meeting.

Defects in Appointment of Directors not to Invalidate Actions Taken: Section 176

All acts done by directors shall be valid notwithstanding that it is subsequently noticed that his appointment was invalid by reason of any defect or disqualifications or had terminated by virtue of the provisions of Companies Act or the articles of the company.

But this section doesn't give validity to any act done by directors whose appointment has been notices to be invalid or to have terminated.

BOARD COMMITTEES

Corporate boards usually consist of the following minimal standing committees: (1) audit, (2) compensation, (3) executive, and (4) governance and nominating. Sometimes, committee names might differ slightly (i.e., the compensation committee may be known as the compensation and benefits committee or the governance and nominating committee may be referred to as the nominating committee).

Businesses with unique governance issues may have additional committees to address specific concerns. The duties and responsibilities of each of these core committees are specified in the charters drafted and adopted for each standing committee.

In relation to structure we need to remember that conduct is also important. In practice, the value added by a board can largely depend upon the behaviours of directors and the quality of their decisions. The 'right' structure may not prevent board members from making the 'wrong' calls and adopting mistaken or inappropriate policies.

Committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allow in-depth scrutiny and focused attention.

The structure of a board and the planning of the board's work are key elements to effective governance. Establishing committees is one way of managing the work of the board, thereby strengthening the board's governance role. Any board should regularly review its own structure and performance and whether it has the right committee structure and an appropriate scheme of delegation from the board.

Audit Committee

In the wake of various corporate scandals, both in India and elsewhere, audit committee members are subject to enhanced responsibilities and liabilities. Regulators are conducting more investigations of the actions of directors and officers. Nevertheless, serving as an audit committee member can be a rewarding

experience and provides an opportunity to make a difference for a public company, its shareholders, and the investing public.

At the core of the financial reporting process is the audit committee of the company's board of directors. Audit Committee is now the gatekeeper of financial information that shareholders and the investing public rely upon in order to make informed investment decisions.

Section 177: Audit Committee

The Act has enlarged the responsibilities of auditors to include monitoring of auditors' independence, evaluation of their performance, approval of modification of related-party transactions, scrutiny of loans and investments, valuation of assets and evaluation of internal controls and risk management. They have to establish a vigil mechanism and protection for any whistle-blower. The members must be able to understand financial statements and have a majority of Independent Directors. Large companies must mandatorily have professional internal auditors.

1. The requirement of constitution of Audit Committee has been limited to :
 - (a) Every listed Companies; or
 - (b) The following class of companies –
 - (i) all public companies with a paid up capital of ten crore rupees or more;
 - (ii) all public companies having turnover of one hundred crore rupees or more;
 - (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation - The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

2. The Committee shall comprise of minimum 3 directors with majority of the directors being Independent Directors. The majority of members of audit committee including its chairperson shall be person with ability to read and understand the financial statement.
3. A transition period of one year from the date on which the new Act comes into effect has been provided to enable companies to reconstitute the Audit Committee.
4. The terms of reference of the Audit Committee have now been specified and inter alia includes, -
 - (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
 - (ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
 - (iii) examination of the financial statement and the auditors' report thereon;
 - (iv) approval or any subsequent modification of transactions of the company with related parties;
 - (v) scrutiny of inter-corporate loans and investments;
 - (vi) valuation of undertakings or assets of the company, wherever it is necessary;
 - (vii) evaluation of internal financial controls and risk management systems;
 - (viii) monitoring the end use of funds raised through public offers and related matters.
5. The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before

their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

6. The audit committee hold the authority to investigate into matters or referred by the Board and have the powers to obtain professional advice from external sources and have full access to records of the company.
7. In addition to the auditor, the KMP shall also have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report, though they shall not have voting rights.
8. Every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report genuine concerns or grievances (Rule 7):-
 - (1) The companies which accept deposits from the public;
 - (2) The companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.
9. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflicted of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.
10. In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.
11. This vigil mechanism shall provide for adequate safeguards against victimization of employees and directors who avail of the vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases.
12. In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.
13. The Vigil Mechanism shall operate for directors and employees to enable them to bring to report genuine concerns. Further the said mechanism shall provide safeguards against victimization and provide for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.
14. The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any and in the Board's report.

Audit Committee under Listing Agreement

In case of Listed Companies, their compliance shall be in accordance with the Corporate Governance provisions enshrined in Clause 49 of the Listing Agreement.

The provisions relating to Audit Committee as contained in the recently amended Clause 49 of the Listing Agreement which will take October 1, 2014 reads as under:

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

- (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;
- (ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

Explanation 1: The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2 : A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- (iii) The Chairman of the Audit Committee shall be an independent director;
 - (iv) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
 - (v) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company;
- The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;

- (vi) The Company Secretary shall act as the secretary to the committee.

Meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

Powers of Audit Committee

The audit committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary

Role of Audit Committee

The role of the audit committee shall include the following:

1. Oversight of the company ’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board

for approval, with particular reference to:

- a. Matters to be included in the Director's Responsibility Statement to be included in the Board's report;
 - b. Changes, if any, in accounting policies and practices and reasons for the same;
 - c. Major accounting entries involving estimates based on the exercise of judgment by management;
 - d. Significant adjustments made in the financial statements arising out of audit findings;
 - e. Compliance with listing and other legal requirements relating to financial statements;
 - f. Disclosure of any related party transactions;
 - g. Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
 6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
 7. Review and monitor the auditor's independence and performance, and effectiveness of audit process.
 8. Approval or any subsequent modification of transactions of the company with related parties.
 9. Scrutiny of inter-corporate loans and investments.
 10. Valuation of undertakings or assets of the company, wherever it is necessary.
 11. Evaluation of internal financial controls and risk management systems.
 12. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
 13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
 14. Discussion with internal auditors of any significant findings and follow up there on.
 15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
 16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
 17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors.
 18. To review the functioning of the Whistle Blower mechanism
 19. Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and

background, etc. of the candidate.

20. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

Explanation (i): The term “related party transactions” shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

Review of information by Audit Committee

The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters/letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Thus, it can be observed that the role of Audit Committee in listed companies will be governed both by the provisions of the Listing Agreement and the revised Section 177 of the Companies Act, 2013.

SECTION 178 : Nomination and Remuneration Committee and Stakeholders Relationship Committee

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management's and personnel's remuneration and incentive schemes. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document.

Except for certain large listed companies, the importance of constitution of the Nomination and Remuneration Committee has not been realised fully in India.

The Board of directors of following companies shall constitute Nomination and Remuneration Committee of the Board :

- (a) Every listed Companies; or
- (b) The following class of companies –
 - (i) all public companies with a paid up capital of ten crore rupees or more;
 - (ii) all public companies having turnover of one hundred crore rupees or more;
 - (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors.

The chairperson of the company may be appointed as member, but shall not chair such committee.

The Committee shall identify the person qualified to become directors and may be appointed in senior management and recommend their appointment and removal and also carry out evaluation of every director.

The Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a director and recommend to the Board the policy relating to remuneration for directors, KMPs and other employees.

While formulating its policy, the Nomination and Remuneration Committee shall ensure that(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks and (c) remuneration to Directors, KMP and senior management involves a balance between fixed and incentive pay reflecting short and long term performance objectives which are suited to the working of the company and its objectives.

The Nomination and Remuneration Committee shall, while formulating the policy under sub-section (3) ensure that—

- (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
- (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
- (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

Provided that such policy shall be disclosed in the Board's report.

Be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Duties of the Nomination and Remuneration Committee

The duties of the Nomination and Remuneration Committee have now been specified. They include

- (a) identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down;
- (b) recommend to the Board their appointment and removal;
- (c) carry out evaluation of every Director's performance;
- (d) formulate the criteria for determining qualifications, positive attributes and independence of a Director and
- (e) recommend to the Board a policy, relating to the remuneration for the Directors, KMP and other employees.

Nomination and Remuneration Committee under the Listing Agreement

In terms of the recently amended Clause 49 of the Listing Agreement which will take effect from October 1, 2014, companies are required to constitute Nomination and Remuneration Committee.

The provisions with regard Nomination and Remuneration Committee is as under:

- A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
 2. Formulation of criteria for evaluation of Independent Directors and the Board;
 3. Devising a policy on Board diversity;
 4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.
- C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders' queries. However, it would be up to the Chairman to decide who should answer the queries.

The Stakeholders Relationship Committee

Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee.

The Board of a company that has more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.

The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

Who can attend the general meeting of the company on behalf of committee constituted under this section?

The chairperson of each of the committees constituted under this section or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

Penalty for Contravention

The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine not less than rupees twenty five thousand but which may extend to one lakh rupees or with both.

The non-consideration of resolution of any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

Schedule IV under Section 149(7) of the Act contains the Code for Independent Directors. Under Sl. No. II (5) of the Code, Independent Directors are mandated to safeguard the interest of all stakeholders, especially the Minority Shareholders and balance the conflicting interests of the stakeholders.

It may be noted that listed companies are presently governed by the provisions of the Listing agreement executed with the various stock exchange(s). The provisions of Section 49 of the Listing Agreement mandate a mechanism for redressal of shareholder grievances.

Section 49 (IV) (G) (iii) of the Listing Agreement provides as under:

A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

Further, Listed Companies are also required to include the following information in the report on Corporate Governance forming part of their Annual Report:

- (i) Name of non-executive director heading the committee;
- (ii) Name and designation of compliance officer;
- (iii) Number of shareholders' complaints received so far;
- (iv) Number not solved to the satisfaction of shareholders;
- (v) Number of pending complaints.

With regard to investor redressal relating to Listed Companies, SEBI has also launched SCORES (SEBI Complaints Redress System) enabling investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This also enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

The requirement for a Stakeholders Relationship Committee is an interesting one. Relationships with stakeholders can be critical, and balancing the contending interests of different stakeholder groups and building mutually beneficial relationships with stakeholders are hallmarks of the effective board.

Again minimum compliance would be to establish a committee and hope it does not get in the way or prove a distraction. More benefit might be derived from using such a provision as a catalyst to identify and/or reassess the nature, interests and priorities of different stakeholder groups, the current state of relationships with them and how these might be improved.

Direction should be seen as a separate but complementary activity to management, rather than as a route to elevated status and higher earnings. Directors need to look beyond functional considerations and work for the best interests of the company and its stakeholders. Their perspective should be strategic rather than departmental.

Directors must reconcile the concerns of various stakeholder groups, and respect views of colleagues who may have a different perspective. Non-financial considerations need to be taken into account.

Corporate Social Responsibility Committee

The evolution of corporate social responsibility in India refers to changes over time in India of the cultural norms of companies engagement of Corporate Social Responsibility (CSR), with CSR referring to way that businesses are managed to bring about an overall positive impact on the communities, cultures, societies and environments in which they operate.

The fundamentals of CSR rest on the fact that not only public policy but even corporates should be responsible enough to address social issues. Thus companies should deal with the challenges and issues looked after to a certain extent by the states.

Among other countries, India has one of the richest traditions of CSR. Much has been done in recent years to make Indian entrepreneurs aware of social responsibility as an important segment of their business activity but CSR in India has yet to receive widespread recognition. If this goal has to be realised then the CSR approach of corporates has to be in line with their attitudes towards mainstream business- companies setting clear objectives, undertaking potential investments, measuring and reporting performance publicly.

As discussed above, CSR is not a new concept in India. Ever since their inception, large corporate houses in India have been involved in serving the community. Through donations and charity events, many other organizations have been doing their part for the society. The basic objective of CSR in these days is to maximize the company's overall impact on the society and stakeholders. CSR policies, practices and programs are being comprehensively integrated by an increasing number of companies throughout their business operations and processes.

A growing number of corporates feel that CSR is not just another form of indirect expense but is important for protecting the goodwill and reputation, defending attacks and increasing business competitiveness.

Companies have specialised CSR teams that formulate policies, strategies and goals for their CSR programs and set aside budgets to fund them. These programs are often determined by social philosophy which have clear objectives and are well defined and are aligned with the mainstream business.

The programs are put into practice by the employees who are crucial to this process. CSR programs ranges from community development to development in education, environment and healthcare etc.

Provision of improved medical and sanitation facilities, building schools and houses, and empowering the villagers and in process making them more self-reliant by providing vocational training and

a knowledge of business operations are the facilities that many companies focus on.

Also corporates increasingly join hands with NGOs and use their expertise in devising programs which address wider social problems.

One of the key changes in the Companies Act, 2013 is the introduction of a Corporate Social Responsibility section making India the first country to mandate CSR through a statutory provision. While CSR is not mandatory for companies, the rules are in line with the 'Comply or Explain' principle with penalties applicable only if an explanation is not offered.

The provisions of the Section may be summarized as under:

1. The Section applies to the following classes of companies during any financial year:
 - (i) Companies having Net Worth of rupees five hundred crore or more;
 - (ii) Companies having turnover of rupees one thousand crore or more;
 - (iii) Companies having Net Profit of rupees five crore or more
2. The companies specified above shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board.
3. The CSR Committee shall consist of three or more Directors, out of which at least one Director shall be an Independent Director.

4. After taking into account the recommendations of the CSR Committee, the Board shall approve the CSR Policy for the company.
5. The contents of the Policy shall be disclosed in the Board's report.
6. It shall also be placed on the Company 's website, if any, in a manner to be prescribed by the Central Government.
7. The Board shall ensure that the activities as are included in the CSR Policy (from the activities as specified in Schedule VII) are undertaken by the Company.

The following additional features of the Section are relevant:

1. While spending the amount earmarked for CSR activities, the company shall give preference to the local area and areas around it where it operates;
2. If the Company fails to spend the amount, the Board shall specify the reasons for not spending the amount in the Board's Report.
3. The eligible companies are required to spend in every financial year, at least two per cent of the Average Net Profits of the Company made during the three immediately preceding financial years in pursuance of its CSR Policy. For this purpose, "Average Net Profit" shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

Other Board Committees

In addition to the Committees of the Board mandated by the Companies Act, 2013 viz, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company.

A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

1. Corporate Governance Committee

The Corporate Governance Committee is responsible for considering and making recommendations to the Board concerning the appropriate size, functions and needs of the Board. The Corporate Governance Committee may, at its sole discretion, engage director search firms and has the sole authority to approve the fees and other retention terms with respect to any such firms. The Corporate Governance Committee also has the authority, as necessary and appropriate, to consult with other outside advisors to assist in its duties to the Company.

2. Science, Technology & Sustainability Committee

It is composed of non-employee Directors, determined to be "independent" under the listing standards of the New York Stock Exchange. It

- Monitors and reviews the overall strategy, direction and effectiveness of the Company's research and development.
- Serves as a resource and provides input, as needed, regarding the scientific and technological aspects of product safety matters.
- Reviews the Company 's policies, programs and practices on environment, health, safety and sustainability.

- Assists the Board in identifying and comprehending significant emerging science and technology policy and public health issues and trends that may impact the Company's overall business strategy.
- Assists the Board in its oversight of the Company's major acquisitions and business development activities as they relate to the acquisition or development of new science or technology.

3. *Regulatory, Compliance & Government Affairs Committee*

It consists of non-employee directors, determined to be "independent" under the listing standards of the New York Stock Exchange:

- Oversees the Company's non-financial compliance programs and systems with respect to legal and regulatory requirements.
- Oversees compliance with any ongoing Corporate Integrity Agreements or any similar undertakings by the Company with a government agency.
- Reviews the organization, implementation and effectiveness of the Company's health care compliance & ethics and quality & compliance programs.
- Oversees the Company's Policy on Business Conduct and Code of Business Conduct & Ethics for Members of the Board of Directors and Executive Officers.
- Reviews the Company's governmental affairs policies and priorities and other public policy issues facing the Company.
- Reviews the policies, practices and priorities for the Company's political expenditure and lobbying activities.

4. *Risk Committee*

(1) The recently amended Clause 49 of the Listing Agreement requires as under:

- A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.
- B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

The provisions of (C) above shall be applicable to top 100 listed companies by market capitalisation as at the end of the immediate previous financial year

Power of Board: Section 179

Section 179 of the Act deals with the powers of the board; all powers to do such acts and things for which the company is authorised is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting.

The following (section 179(3) and Rule 8) powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

- (1) to make calls on shareholders in respect of money unpaid on their shares;

- (2) to authorise buy-back of securities under section 68;
- (3) to issue securities, including debentures, whether in or outside India;
- (4) to borrow monies;
- (5) to invest the funds of the company;
- (6) to grant loans or give guarantee or provide security in respect of loans;
- (7) to approve financial statement and the Board's report;
- (8) to diversify the business of the company;
- (9) to approve amalgamation, merger or reconstruction;
- (10) to take over a company or acquire a controlling or substantial stake in another company;
- (11) to make political contributions;
- (12) to appoint or remove key managerial personnel (KMP);
- (13) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;
- (14) to appoint internal auditors and secretarial auditor;
- (15) to take note of the disclosure of director's interest and shareholding;
- (16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid-up share capital and free reserves of the investee company;
- (17) to invite or accept or renew public deposits and related matters;
- (18) to review or change the terms and conditions of public deposit;
- (19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.

The banking company is not covered under the purview of this section. The company may impose restriction and conditions on the powers of the Board.

SECTION 180 : Restriction on Powers of Board

The board can exercise the following powers only with the consent of the company by special resolution, namely –

- (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.
- (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
- (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from

- temporary loans obtained from the company's bankers in the ordinary course of business;
- (d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital and free reserves specify the total amount up to which the money may be borrowed by Board.

The title of buyer or the person who takes on lease any property, investment or undertaking on good faith cannot be affected and also in case if such sale or lease covered in the ordinary business of such company.

The resolution may also stipulate the conditions of such sale and lease, but this doesn't authorise the company to reduce its capital except the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital and free reserves is not valid and effectual, unless the lender proves that the loan was advanced on good faith and also having no knowledge of limit imposed had been exceeded.

SECTION 181 : Contributions to Charitable Funds and Political Parties

The power of making contribution to 'bona fide' charitable and other funds is available to the board subject to certain limits.

Further, the permission of company in general meeting is required if such contribution exceeds five percent of its average net profits for the three immediately preceding previous years.

SECTION 182 : Prohibitions and Restrictions Regarding Political Contributions

The non-government company or the company which has been in existence less than three financial years may contribute any amount directly or indirectly to any political party.

Further, the limit of contribution to political parties is 7.5% of the average net profits during the three immediately preceding financial years.

The contribution must be authorised by board in its meeting by resolution and such resolution deemed to be the justification in law for such contribution.

The donation may be directly or indirectly. The contribution so made if or likely to affect the public support for a political party deemed to be the contribution for political purpose.

If the expenditure incurred on advertisement in any publication souvenir, brochure, tract, pamphlet or the like is deemed as political contribution if such publication is by or on behalf of political party or if not, then for the advantage to such political party for a political purpose.

The company is required to disclose in its profit and loss account any amount or amounts contributed by it to any political party during the financial year and the particular of total amount contributed and the name of political party to whom the contribution so made.

Penalty for Contravention

The contribution in contravention of the provisions of this section, the company shall be punishable for an amount of which may extend to five times of the amount so contributed and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times of the amount so contributed.

Section 183 : Power of Board and other Persons to make Contributions to National Defence Fund, etc.

The Board is authorised to contribute such amount as it thinks fit to the National Defence Fund or any other fund approved by the Government for the purpose of national defence.

The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year.

Section 184 : Disclosure of Interest by Director

The Act provides for the disclosure by directors relating his concern or interest in any company or companies or body corporate (including shareholding interest), firms or other association of individuals by giving a notice in writing in form MBP 1 (Rule 9(1)) at the first meeting of board after being appointed as director and at first meeting of board of every financial year, in addition to this, any change required to be disclosed in next board meeting.

Every director is required to disclose the nature of his concern or interest at the meeting of board in which the contract or arrangement is discussed and he has not to participate in such meeting.

The abovementioned interest may be direct or indirect and relating to some contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director or such director in association with other director holds more than two percent shareholding or is a promoter, manager, Chief Executive Officer of that body corporate or with a firm or other entity in which such director is a partner, owner or member as the case maybe.

It shall be the duty of the director giving notice of interest to cause it to be disclosed at the meeting held immediately after the date of the notice. (Rule 9(2))

If a director is not concerned or interested at the time of contract but, subsequently becomes concerned or interested is required to disclose his interest or concern at the first meeting of the board.

All notices shall be kept at the registered office and such notices shall be preserved for a period of eight years from the end of the financial year to which it relates and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 9(3))

If a contract or arrangement entered into by the company without disclosure of interest by director or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

The contravention of the provisions leads to punishment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees or both.

Any contract or arrangement entered into or to be entered into between two companies, where any director of any company holds more than two percent of the paid up capital in other company, the provisions of this section shall not apply.

Section 185: Loans to Directors, etc.

No company shall directly or indirectly advance any loan to any of its directors or to any person in whom director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

But a company may advance loan to managing or whole-time director as part of the conditions of service

extended by the company to all its employees or pursuant to any scheme approved by the members by a special resolution or the company provides loans or gives guarantee or securities for the due repayment of any loan in due course of its business.

Rule 10 provides that any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company is exempted from the requirements under this section and any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company is exempted from the requirements under this section; provided that such loans are utilised by the subsidiary company for its principle business activities.

Penalty

The contravention of provisions of this section leads to punishment with fine which shall not be less than five lakh rupees but which may extend to twenty five lakh rupees. The director or to whom loan or advance is given or guarantee or security is given or provided shall be imprisonment which may extend to six months or with fine mentioned above or with both.

Section 186 : Loan and Investment by a Company

Companies can make investments only through two layers of investment companies subject to exceptions which includes company incorporated outside India.

A company can't directly or indirectly give any loan to any person or other body corporate; give any guarantee or provide security in connection with a loan to any other body corporate or person; and acquire by way of subscription, purchase or otherwise, the securities of any other body corporate, exceeding sixty percent of its paid-up share capital, free reserves and securities premium account or one hundred percent of its free reserves and securities premium account, whichever is more.

If the loan exceeding the limits, prior approval of the company in general meeting is necessary and it shall be through special resolution. The prior approval of company is not necessary in case the company is disclosing the details of such loans or guarantee or security or acquisition in the financial statement. (Rule 11(1))

The company is required to disclose in its financial statement the full particular of loans given, investment made or guarantee given or security provided with its purpose.

The decision of board should be unanimous and the prior approval of public financial institution is to be obtained if exceeds the limit and company is not in default in repayment of loan installment or interest thereon.

No company registered under section 12 of the Securities and Exchange Board of India Act, 1992 and also covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and Exchange Board, shall take any inter-corporate loan or deposits, in excess of the limits specified under the regulations applicable to such company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India. (Rule 11.3)

No loan shall be given under this section at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

A company who is in default in the repayment of any deposits accepted can't give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

Maintenance of Register (Rule 12)

Every company giving loan or giving guarantee or providing security or making an acquisition of securities

shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.

The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose. A register can be maintained either manually or in electronic mode.

The extract from the register may be furnished to any member of the company on payment of fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

The Ministry of Corporate Affairs vide Notification dated June 09, 2014 has clarified that the registers maintained by Companies pursuance to sub-section (5) of Section 372A of Companies Act, 1956 may be continued and new Form MBP 2 shall be effective on and from 1.4.2014.

Special Resolution (Rule 13)

Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or

security proposed to be made or given by the Board, exceed the limits specified under section 186 no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

A resolution passed at a general meeting in terms of sub- section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition:

Provided, that the company shall disclose to the members in the financial statement the full particulars in accordance with the provision of sub-section (4) of section 186.

Penalty

The contravention of the provisions of this section imposes punishment for the company with fine which shall not be less than twenty five thousand rupees but may extend to five lakh rupees.

Every officer of company in default shall be punishable with imprisonment for term which may extend to two years and with fine not less than twenty five thousand rupees but which may extend to five lakh rupees.

Section 187: Investments of Company to be held in its Own Name

All investment made or held by a company in a property, security or other asset must be made and held by it in its own name.

The company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

Exceptions

A company may deposit with a bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or

A company may deposit with, or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof, but required to again hold the shares or securities in its own name within a period of six months;

A company may deposit with, or transferring to, any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it;

A company may hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Maintenance of Register (Rule 14)

Every company shall, from the date of its registration, maintain a register in Form MBP 3 and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

Further, the company shall also record whether such investments are held in a third party's name for the time being or otherwise.

The register shall be maintained at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

Entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

The said register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Penalty

In case of contravention of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

Section 188: Related Party Transactions Related Party

With reference to company, the term 'related party' means and includes the following:

- a director or his relative,
- KMP or their relative,
- a firm in which a director, manager or his relative is a partner,
- a private company in which a director or manger is a director or members,

- a public company in which a director or Manager is a director or holds along with his relatives more than 2% of its paid up share capital.
- a person on whose advice, directions or instruction (except given in professional capacity) a director or manager is accustomed to act,
- a holding/ subsidiary or associate company, subsidiary's subsidiary, and such person as would be prescribed.

Nature of Transactions (Section 188 (1))

The scope of dealing with Related Party Transactions has been widened in Companies Act, 2013. The contracts or arrangements with related party which comes with respect to the following shall be covered under the scope of this provision:

- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;
- (f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (g) underwriting the subscription of any securities or derivatives thereof, of the company.

The expression "**office or place of profit**" means any office or place—

- (i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
- (ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

The expression "**arm's length transaction**" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

However, nature of transactions covered are comprehensive as they include routine to rare supply of goods or material either by way of direct sale, purchase or supply of any goods or services (technical support, maintenance, consultancy, advisory, leasing of property or sharing professional knowledge etc.) or by appointing agent for the same and underwriting financial instruments of the Company. While entering into such type of transactions, Company will be required to take prior approval of Board of Directors, by way of a resolution passed in the board meeting.

The transactions done in ordinary course of business on arm length's basis shall be outside the scope of this provision.

Entering into Contract or Arrangement with Related Party [Rule 15 of The Companies (Meeting of Board and its Powers) Rules 2014]

A company shall enter into any contract or arrangement with a related party subject to the following (Rule 15) conditions –

1. The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-
 - (a) the name of the related party and nature of relationship;
 - (b) the nature, duration of the contract and particulars of the contract or arrangement;
 - (c) the material terms of the contract or arrangement including the value, if any;
 - (d) any advance paid or received for the contract or arrangement, if any;
 - (e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
 - (f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
 - (g) any other information relevant or important for the Board to take a decision on the proposed transaction.
- (2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.
- (3) ***For the purposes of first proviso to sub-section (1) of section 188, except with the prior approval of the company by a special resolution –***
 - (i) a company having a paid-up share capital of ten crore rupees or more shall not enter into a contract or arrangement with any related party; or
 - (ii) a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into –
 - (a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188 with criteria, as mentioned below –
 - (i) sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding twenty five percent. of the annual turnover as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;
 - (ii) selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding ten percent. of net worth as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;
 - (iii) leasing of property of any kind exceeding ten percent. of the net worth or exceeding ten percent. of turnover as mentioned in clause (c) of sub-section (1) of section 188;
 - (iv) availing or rendering of any services directly or through appointment of agents exceeding ten percent. of the net worth as mentioned in clause (d) and clause (e) of

- sub-section (1) of section 188;
- (b) appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188; or
 - (c) remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding one percent. of the net worth as mentioned in clause (g) of sub-section (1) of section 188.
- (2) In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.
- (3) The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars namely:
- (a) name of the related party ;
 - (b) name of the director or key managerial personnel who is related, if any;
 - (c) nature of relationship;
 - (d) nature, material terms, monetary value and particulars of the contract or arrangement;
 - (e) any other information relevant or important for the members to take a decision on the proposed resolution.

Where the transactions mentioned above are carried out or done in the ordinary course of business and on the arm's length transaction basis, then there is no requirement of obtaining approval from Board of Directors.

Arms Length Transaction

Arm's length transaction would mean transaction between two related or affiliated parties that is conducted as if they were unrelated, so that there is no question of a conflict of interest. The concept of an arm's length transaction is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other part.

Disclosure in Board's Report

Every related party contracts or arrangements shall have to be disclosed in the Board's report and referred to shareholders along with the justification for entering into such type of transactions.

Consequences of Contravention of Provisions

In case, where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a special resolution in the general meeting under sub-section (1) and,

- (i) if it is not ratified by the Board or
- (ii) by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into,

such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

Recovery of Loss in Related Party Transaction

Besides subsequent approval, it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

Penal Provisions

Any director or any other employee of a company, who authorised to enter into the contracts or arrangement, in violation of the provisions of this section, shall be punishable as under -

- (i) In case of listed company – Any director or other employee of the listed company be punishable with,
 - (a) imprisonment for a term which may extend to 1 year; or
 - (b) fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees; or
 - (c) with both.
- (ii) In case of other than listed company – Any director or other employee of the unlisted company be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees.

Other Disclosures/Provisions

Following disclosures are also required in relation to the transaction between the company and related parties:

- Any arrangement between a company and its director in respect of acquisition of assets for consideration other than cash shall require prior approval by a resolution in general meeting and if the director or connected person is a director of its holding company, approval is required to be obtained by passing a resolution in general meeting of the holding company. [Section 192].
- Where a one person company limited by shares or by guarantee enters into a contract with the sole member of the company who is also its director, the company shall unless the contract is in writing, ensure that the terms of the contract or offer are contained in the memorandum or are recorded in the minutes of the first Board meeting held after entering into the contract. The company shall inform the Registrar about every contract entered in to by the company are recorded in the minutes. [Section 193]
- The Companies Act requires the Audit Committee to approve or modify transaction with related parties, scrutinise inter- corporate loans and investments and value undertaking or assets of the company, wherever it is necessary. Further, the Companies Act gives Audit Committee the authority to investigate into any matter falling under its domain and the power to obtain professional advice from external sources and have full access to information contained in the records of the company.

Let us Recapitulate

RELATED PARTY IN RELATION TO COMPANY INCLUDES

OUTSIDERS



INSIDERS

SUBSIDIARIES

FELLOW
SUBSIDIARIES

DIRECTORS
OR HIS
RELATIVES

CEO/ MD

COMPANIES
UNDER
COMMON
CONTROL

ASSOCIATE

CFO

COMPANY
SECRETARY

INVESTING
PARTIES

JOINT
VENTURES

WHOLE TIME
DIRECTOR

RELATED PARTY TRANSACTIONS REQUIRING SPECIAL RESOLUTION



Company having paid-up capital of ₹10 crore or more

Sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 25% of the annual turnover

Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding 10% of net worth

Leasing of property of any kind exceeding 10% of the net worth or exceeding 10% of turnover

Availing or rendering of any services directly or through appointment of agents exceeding 10% of the net worth

Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding 2,50,000 rupees

Remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth

Related Party Transactions under the Listing Agreement

The provisions with regard to related party transactions under the recently amended Clause 49 of the Listing Agreement is as under:

- A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.
- B. A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:
 - 1. A person or a close member of that person's family is related to a company if that person:
 - (a) is a related party under Section 2(76) of the Companies Act, 2013; or
 - (b) has control or joint control or significant influence over the company; or
 - (c) is a key management personnel of the company or of a parent of the company; or
 - 2. An entity is related to a company if any of the following conditions applies:
 - (a) The entity is a related party under Section 2(76) of the Companies Act, 2013; or
 - (b) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or
 - (c) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or
 - (d) Both entities are joint ventures of the same third party; or
 - (e) One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or
 - (f) The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or
 - (g) The entity is controlled or jointly controlled by a person identified in (1).
 - (h) A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or

Explanation : For the purpose of Clause 49(V) and Clause VII(B), the term "control" shall have the same meaning as defined in SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

- C. The company shall formulate a policy on materiality of related party transactions and also on dealing with Related Party Transactions.

Provided that a transaction with a related party shall be considered material if the transaction / transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

- D. All Related Party Transactions shall require prior approval of the Audit Committee.
- E. All material Related Party Transactions shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

In terms of the Listing agreement, the following disclosures are envisaged:

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.
2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

Meaning and Disclosure requirement for Related Party Transactions under Accounting Standard on Related Party Transactions (AS-18)

- I. The objective of AS-18 is to establish requirements for disclosure of:
 - related party relationships; and
 - transactions between a reporting enterprise and its related parties.
- II. AS-18 is mandatory for accounting periods beginning on or after 1st April, 2001 and is to be complied with, for the preparation of financial statements of each reporting enterprise and consolidated financial statements of holding companies.
- III. Some of the important definitions under the AS are as follows:
 - (i) Related Party: Parties are considered to be related, if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.
 - (ii) Control means
 - a. ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or
 - b. control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in the case of any other enterprise, or
 - c. a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.
 - (iii) Significant Influence implies participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.
- IV. AS-18 deals with following related party transactions:
 - (a) Enterprises that directly or indirectly by one or more intermediaries, control or are being controlled by reporting enterprise OR under common control with the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries). For eg : X Ltd has 60% shares of Y Ltd. Y Ltd has 52% share of Z Ltd. Then X Ltd and Z Ltd are related because X Ltd controls Z Ltd through Y Ltd.
 - (b) Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture. For eg : A Ltd. has two associates, B Ltd. and C Ltd. In this case B Ltd. and C Ltd. are not related because B Ltd. is associated with A Ltd. and not with C Ltd. So if B Ltd. is a reporting enterprise, then only A Ltd. is related. If C Ltd. is reporting enterprise, then only A Ltd. is related. But if A Ltd. is reporting enterprise, then B Ltd. and C Ltd. are related.
 - (c) Individuals owning, directly or indirectly an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise. The relatives of any such individual are also considered as related party. AS-18 defines relative as under:

In relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise. For eg: Mr. M and Mrs. M have 45% shares in XYZ Ltd., then Mr. M and Mrs. M are related with enterprises. Father of Mr. M is also related with the enterprise.

- (d) Key management personnel and relatives of such personnel. i.e. Managing Director or any director who has influence in policy making.
- (e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

V. Following are not deemed to be related parties:

Two companies simply because they have a director in common, notwithstanding paragraph (d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);

- (a) A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and
- (b) The following parties in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):
 - providers of finance;
 - trade unions;
 - public utilities;
 - Government departments and government agencies including government sponsored bodies.

Following Disclosures are required to be made:

1. Name and nature of the related party relationship where control exists, the following should be disclosed by the reporting enterprise:
 - (a) the name of the transacting related party,
 - (b) a description of the nature of transactions and relationship between the parties,
 - (c) volume of the transactions either as an amount or as an appropriate proportion,
 - (d) any other elements of the related party transactions necessary for an understanding of the financial statements,
 - (e) outstanding items and provisions pertaining to related parties at the balance sheet date,
 - (f) amounts written off in respect of debts due from or to related parties.
2. Items of a similar nature may be consolidated and disclosed by type of related party.

Section 189: Register of Contracts or Arrangements in which Directors are interested

Every company is required to keep one or more registers in Form MBP 4 giving separately the particulars of all contracts or arrangements and shall enter therein the particulars of (Rule 16(1))-

- (a) company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest as mentioned in sub-section (1) of section 184. But the particulars of the company or companies or bodies corporate in which a director himself together with any other director holds two percent or less of the paid-up share capital would not be required to be entered in the register.
- (b) contracts or arrangements with a body corporate or firm or other entity as mentioned under sub-section (2) of section 184, in which any director is, directly or indirectly, concerned or interested; and
- (c) contracts or arrangements with a related party with respect to transactions to which section 188 applies;

The entries in the register shall be made at once, whenever there is a cause to make entry, in chronological order and shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose. (Rule 16(2))

Such register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 16(3))

Such register or registers are required to be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Every director within thirty days of his appointment or relinquishment is required to disclose his concern or interest in other associations, which are required to be included in the register.

The register be kept at the registered office of the company and also open for inspection during business hours. The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding ten rupees per page. (Rule 16(4))

Penalty

Every director who fails to comply is liable to a penalty of twenty- five thousand rupees.

Section 190 : Contract of Employment with Managing Director or Whole-Time Directors

Every company which is not a private company is required to keep the copy of contract if in writing with a managing director or whole-time director for contract of service or a written memorandum setting its terms if not in writing.

The abovementioned copies required to be kept open to inspection for any member of the company free of cost.

Penalty

The default in complying with the provisions of this section, the company is liable to a penalty of twenty five thousand rupees and every officer of the company who is in default liable to a penalty of five thousand rupees for each default.

Section 191: Payment to Director for Loss of Office, etc., in Connection with Transfer of Undertaking, Property or Shares

No director of a company shall receive any payment by way of compensation in case of transfer of the whole

or any part of any undertaking or property of the company or the transfer to any person of all or any of the shares in a company; the following particulars mentioned in Rules 17 are required to be disclosed to the members of the company and they pass a resolution at a general meeting approving the payment of such amount:-

- (a) name of the director
- (b) amount proposed to be paid;
- (c) event due to which compensation becomes payable;
- (d) date of Board meeting recommending such payment;
- (e) basis for the amount determined;
- (f) reason/justification for the payment;
- (g) manner of payment - whether payable in cash or otherwise and how;
- (h) sources of payment; and
- (i) any other relevant particulars as the Board may think fit.

Any payment made by the company to a managing director or whole-time director or manager of the company by way of compensation for loss of office or as a consideration for retirement from office or in connection with such loss or retirement subject to the limit as set out under section 202. (Rule 17(2))

No payment shall be made to the managing director or whole time director or manager of the company by way of compensation for the loss of office or as consideration for retirement from office (Rule 17(3)) (other than notice pay and statutory payments in accordance with the terms of appointment of such director or manager, as applicable) or in connection with such loss or retirement if:

- (a) the company is in default in repayment of public deposits or payment of interest thereon;
- (b) the company is in default in redemption of debentures or payment of interest thereon;
- (c) the company is in default in repayment of any liability, secured or unsecured, payable to any bank, public financial institution or any other financial institution;
- (d) the company is in default in payment of any dues towards income tax, VAT, excise duty, service tax or any other tax or duty, by whatever name called, payable to the Central Government or any State Government, statutory authority or local authority (other than in cases where the company has disputed the liability to pay such dues);
- (e) there are outstanding statutory dues to the employees or workmen of the company which have not been paid by the company (other than in cases where the company has disputed the liability to pay such dues); and
- (f) the company has not paid dividend on preference shares or not redeemed preference shares on due date.

If the payment is not approved for want of quorum either in a meeting or an adjourned meeting, the proposal shall not be deemed to have been approved.

If a director of a company receives payment of any amount in contravention of sub-section (1) or the proposed payment is made before it is approved in the meeting, the amount so received by the director shall be deemed to have been received by him in trust for the company.

Penalty upon Contravention

The director who contravenes shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Section 192: Restriction on Non- Cash Transactions Involving Directors

A company can't enter into an agreement by which –

- (a) a director of the company or its holding, subsidiary or associate company or a person connected with him acquires or is to acquire assets for consideration other than cash, from the company; or
- (b) the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

A company can enter into an arrangement only with the prior approval for such arrangement is accorded by a resolution of the company in general meeting and if the director or connected person is a director of its holding company, approval shall also be required to be obtained by passing a resolution in general meeting of the holding company.

The notice for approval of the resolution by the company or holding company in general meeting shall include the particulars of the arrangement along with the value of the assets involved in such arrangement duly calculated by a registered valuer.

Any arrangement entered into by a company or its holding company in contravention of the provisions of this section shall be voidable at the instance of the company.

The arrangement will be valid if the restitution of any money or other consideration which is the subject matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or any rights are acquired bona fide for value and without notice of the contravention of the provisions of this section by any other person.

Section 193: Contract by One Person Company

Where One Person Company limited by shares or by guarantee enters into a contract except in its ordinary course of business with the sole member of the company who is also the director of the company, the company shall ensure that the contract is in writing.

If the contract is not in writing, it ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract.

The company is required to inform the Registrar about every contract entered into by the company and recorded in the minutes of the meeting of its Board within a period of fifteen days of the date of approval by the Board.

Section 194: Prohibition on Forward Dealings in Securities of Company by Director or Key Managerial Personnel

Directors and key managerial personnel are prohibited from buying in the company, or in its holding, subsidiary or associate company –

- (a) a right to call for delivery or a right to make delivery at a specified price and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures; or

- (b) a right, as he may elect, to call for delivery or to make delivery at a specified price and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures.

Contravention and Penalty

Such director or key managerial personnel shall be punishable with imprisonment for a term which may extend to two years or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

Such director or key managerial personnel is liable to surrender the same to the company and the company shall not register the securities so acquired in his name in the register, and if they are in dematerialised form, it shall inform the depository not to record such acquisition and such securities, in both the cases, shall continue to remain in the names of the transferors.

SECTION 195: Prohibition on Insider Trading of Securities

Insider trading is totally prohibited in the Act, including any trading by director or key managerial personnel. Any communication required in the ordinary course of business or profession or employment or under any law is not amounting to insider trading.

Meaning of Insider Trading

An act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

An act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

Contravention and Penalty

If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

LESSON ROUND-UP

- Director can participate in the Board meeting through video conferencing or other audio visual mode as may be prescribed
- Notice of not less than seven days in writing is required to call a board meeting and notice of meeting to all directors shall be given, whether he is in India or outside India by hand delivery or by post or by electronic means.
- The participation of director at Board meeting through video conferencing or by other electronic means shall be counted for the purpose of Quorum
- Every Listed Company and such other company as may be prescribed shall form Audit Committee comprised of minimum 3 directors with majority of the Independent Directors and majority of members of committee shall be person with ability to read and understand financial statement
- Vigil mechanism to be established in the prescribed manner by every listed company or such class or

classes of companies, as may be prescribed.

- Every listed company and prescribed class or classes of companies, shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors
- Inter corporate investments not to be made through more than 2 layers of investment companies.
- Forward dealing in securities of company by director and key managerial personnel is prohibited.
- Insider trading of the securities in the company is prohibited.

SELF-TEST QUESTIONS

1. Explain the term Key Managerial Personnel under the Companies Act, 2013. Is it necessary for every company to appoint a Key Managerial Personnel?
2. state the provisions of appointing a Key Managerial Personnel According to Companies Act 2013.
3. what are the provisions on punishment for the contravention of section 203 of the companies Act 2013?
4. discuss the role of Company Secretary .
5. Enumerate the duties and liabilities of a Secretary.
6. Discuss the role of company secretary as a statutory officer, as co-ordinator and as an administrative officer.
7. State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980.
8. Define Secretary in whole-time practice.

Lesson 17

Appointment and Remuneration of Key Management Personnel

LESSON OUTLINE

- Key managerial personnel(KMP)- introduction
- Compulsory Appointment of KMP
- Appointment of KMP by Board
- Vacancy of KMP office
- Penal provisions
- Period of appointment of KMP
- Disqualification of appointment
- Conditions for appointment
- Company secretary defined as KMP
- Powers & duties of CS
- Role of company secretary
- Functions of a company secretary

LEARNING OBJECTIVES

The Companies Act 2013 has introduced a new concept for appointment of the Key Managerial Personnel on top level of the organizational structure. In the new Act the position of company secretary has been enhanced multifold, from record keeper to key managerial personnel. A present day company secretary is expected to do statutory, administrative, managerial and strategic functions.

After reading this lesson, you will be able to understand the legal and procedural aspects as regards appointment, conditions for appointment, how to fill the vacancies in office of KMP, CS as a Key Managerial personnel, powers and duties of KMP, Penal Provisions for the Contravention of provisions applicable ,etc, from the Act.

"Effective leadership is putting first things first. Effective management is discipline, carrying it out." – Stephen Covey

1. INTRODUCTION

The executive management of a company is responsible for the day to day management of a company. The Companies Act, 2013 has used the term key management personnel to define the executive management. The key management personnel are the point of first contact between the company and its stakeholders. While the Board of Directors are responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation.

Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of Key Managerial Personnel including Managing Director, Whole-time Director or Manager, managerial remuneration, secretarial audit etc.

Let us understand certain definitions.

Key Managerial Personnel

The Companies Act, 2013 has for the first time recognized the concept of Key Managerial Personnel. As per section 2(51) "key managerial personnel", in relation to a company, means—

- (i) the Chief Executive Officer or the managing director or the manager;
- (ii) the company secretary;
- (iii) the whole-time director;
- (iv) the Chief Financial Officer; and
- (v) such other officer as may be prescribed.

Managing Director

Section 2(54) of the Companies Act, 2013, defines 'managing director'. It stipulates that a "managing director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

Whole Time Director

Section 2 (94) of the Companies Act, 2013 defines "whole-time director" as a director in the whole-time employment of the company.

Manager

Section 2(53) of the Companies Act, 2013 defines "manager" as an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or

substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

Chief Executive Officer and Chief Financial Officer

Section 2(18)/(19) of the Companies Act, 2013 defined “Chief Executive Officer”/ “Chief Financial Officer” as an officer of a company, who has been designated as such by it;

Company Secretary

Section 2(24) of the Companies Act, 2013 defines “company secretary ” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

Appointment of Managing Director, Whole-Time Director or Manager

Section 196 of the Companies Act, 2013 provides that no company shall appoint or employ at the same time a Managing Director and a Manager. Further, a company shall not appoint or reappoint any person as its Managing Director, Whole Time Director or manager for a term exceeding five years at a time and no reappointment shall be made earlier than one year before the expiry of his term.

No company shall appoint or employ at the same time a Managing Director or a Manager.

Section 196(4) of the Companies Act, 2013 provides that subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in Schedule V. Approval of the Central Government is not necessary if the appointment is made in accordance with the conditions specified in Schedule V to the Act.

Appointment of Managing/whole time Director require Board/general meeting approval.

Therefore, the appointment of a managing director or whole-time director or manager and the terms and conditions of such appointment and remuneration payable thereon must be first approved by the Board of directors at a meeting and then by an ordinary resolution passed at a general meeting of the company.

Notice convening Board and General Meting to contain particulars of appointment

A notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

Rule 3 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

A company shall file a return of appointment of a Managing Director, Whole Time Director or Manager, Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer (CFO) within sixty days of the appointment, with the Registrar in Form No. MR.1 along with such fee as may be specified for this purpose.

Section 196(5) provides that subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid.

No company shall appoint or employ at the same time a Managing Director or a Manager

Appointment with the Approval of Central Government

In case the provisions of Schedule V of the Companies Act, 2013 are not fulfilled by company, an application seeking approval to the appointment of a managing director (Whole-time director or manager) shall be made to the Central Government, in e-Form No. MR.2.

As per section 200, the Central Government or a company may, while according its approval under section 196, to any appointment of a managing director, whole-time director or manager, the Central Government or the company shall have regard to—

- (a) the financial position of the company;
- (b) the remuneration or commission drawn by the individual concerned in any other capacity;
- (c) the remuneration or commission drawn by him from any other company;
- (d) professional qualifications and experience of the individual concerned;
- (e) such other matters as may be prescribed.

As per Rule 6 for the purposes of item (e) of section 200, the Central Government or the company shall have regard to the following matters while granting approval to the appointment of managing director under section 196:

- (1) Financial and operating performance of the company during the three preceding financial years.
- (2) Relationship between remuneration and performance.
- (3) The principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other executive directors on the board and employees or executives of the company.
- (4) Whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.
- (5) The securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

Disqualifications

Section 196(3) of the Act makes a specific prohibitory provision with regard to the appointment of managing director, whole time director or manager. The section lays down that no company shall appoint or continue the employment of any person as its managing director, whole time director or manager who—

- (a) is below the age of twenty-one years or has attained the age of seventy years:

Provided that appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person;

- (b) is an undischarged insolvent or has at anytime been adjudged as an insolvent;
- (c) has at any time suspended payment to his creditors, or makes, or has at any time made, a composition with them; or
- (d) has at any time been, convicted by a court of an offence and sentenced for a period of more than

six months.

Apart from this, Part I of Schedule V contains five conditions which must be satisfied by a person to be eligible for appointment as managing director, whole-time director or manager without the approval of the Central Government. These conditions are as below:

- (a) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the following Acts, namely:-
 - (i) the Indian Stamp Act, 1899,
 - (ii) the Central Excise Act, 1944,
 - (iii) the Industries (Development and Regulation) Act, 1951,
 - (iv) the Prevention of Food Adulteration Act, 1954 ,
 - (v) the Essential Commodities Act, 1955,
 - (vi) the Companies Act, 2013,
 - (vii) the Securities Contracts (Regulation) Act, 1956,
 - (viii) the Wealth-tax Act, 1957,
 - (ix) the Income-tax Act, 1961,
 - (x) the Customs Act, 1962,
 - (xi) the Competition Act, 2002,
 - (xii) the Foreign Exchange Management Act, 1999,
 - (xiii) the Sick Industrial Companies (Special Provisions) Act, 1985,
 - (xiv) the Securities and Exchange Board of India Act, 1992,
 - (xv) the Foreign Trade (Development and Regulation) Act, 1992;
 - (xvi) the Prevention of Money Laundering Act, 2002;
- (b) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974;

Provided that where the Central Government has given its approval to the appointment of a person convicted or detained under sub-paragraph (a) or sub-paragraph (b), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval;

- (c) he has completed the age of 21 years and has not attained the age of 70 years:

Provided that where he has attained the age of 70 years; and where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the Central Government shall be necessary for such appointment;

- (d) where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling provided in section V of Part II;
- (e) he is resident in India.

Explanation : For the purpose of above, resident in India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India:

- (i) for taking up employment in India, or
- (ii) for carrying on a business or vocation in India.

But this condition shall not be applicable to the companies in Special Economic Zones, as may be notified by Department of Commerce from time to time.

However, a person, being a non-resident in India, shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, alongwith the visa application form, profile of the company, the principal employer and the terms and conditions of such person's appointment.

Reappointment of Managing Director

Under sections 196 and 203 of the Companies Act, 2013, appointment includes reappointment. Reappointment of a managing director of a company must be taken for consideration before the expiry of his term of office. If the reappointment of the managing director is approved and if it is not in accordance with the conditions specified in Schedule V then the approval of the Central Government must be obtained for such reappointment. Rest of the provisions for reappointment of a managing director are same as in the case of appointment of a managing director.

CASE LAW

The managing director of a company filed a suit on behalf of the company against the tenants and the trial court granted decree directing the tenants to vacate and deliver possession of the tenanted premises. The court also directed payment of damages and, in default, to pay interest. The tenants filed an application and contended that in the instant case, the managing director, who had filed suit, had no proper authorization from the board of directors. The Court dismissed the application of the tenants and held that the words 'substantial powers of management' specifically excludes certain acts from its purview. Therefore, except the excluded acts, the managing director has power and privilege of conducting the business of the company in accordance with the memorandum and articles of association of the company. The institution of the suit on behalf of the company by the managing director is deemed to be within the meaning of 'substantial powers of management', since such a power is necessary and incidental to manage the day-to day affairs and business of the company. Therefore, by virtue of provisions of section 2(26) [Corresponds to section 2(54) of the Companies Act, 2013], the suit instituted by the managing director is deemed to be within his power and authority. The suit was obviously filed for the benefit of the company. In that view of the matter, the contention that the managing director had no authority to file a suit is untenable and the same is rejected. [*Wasava Tyres v. Printers (Mysore) Ltd.* (2008) 86 SCL 171 (Kar)].

In *G. Subba Rao v. Rasmi Die-Casting Ltd.* [1998] 93 Com. Cases. 797, the Andhra Pradesh High Court held that from the definition of 'managing director' as per Section 2(26) [Corresponds to section 2(54) of the Companies Act, 2013] , it is clear that the managing director has to act under the superintendence, control and direction of the Board of directors. Moreover, powers of routine administrative nature like the power to affix the common seal, to draw and endorse any negotiable instrument do not fall within the substantial powers conferred upon the managing director. What is to be seen is whether the managing director making any representation for and on behalf of a company had in fact, 'actual authority' either in terms of the provisions of the constitution of that company or by virtue of the delegation by the Board of directors.

A managing director must hold and continue to hold the office of director. A managing director is first a director and then a managing director with certain additional powers [*Shanta Shamsher Jung Bahadur v. Kamani Brothers P. Ltd.* (1959) 29 Com Cases 501 (Bom)]. A managing director is an ordinary director entrusted with special powers. If a company wants to appoint a person as managing director, who is not a director of the company, he has first to be appointed as an additional director in accordance with the provisions of Section 260 [Corresponds to section 161 of the Companies Act, 2013] of the Act.

Appointment of Key Managerial Personnel

Section 203 of the Companies Act, 2013 read with Rule 8 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid-up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

- (i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
- (ii) company secretary; **and**
- (iii) Chief Financial Officer:

Rule 8 and 8A of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

Rule 8. Appointment of Key Managerial Personnel.-

Every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial personnel

Rule 8A Appointment of Company Secretaries in companies not covered under rule 8.—A company other than a company covered under rule 8 which has a paid up share capital of five crore rupees or more shall have a whole-time company secretary.

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless the articles of such a company provide otherwise; or the company does not carry multiple businesses. However, such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government are exempted from the above.

A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. However, he can hold such other directorship with the permission of the Board.

A whole-time key managerial personnel holding office in more than one company at the same time, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Functions of Company Secretary

According to Section 205 the functions of the company secretary shall include,—

- (a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
- (b) to ensure that the company complies with the applicable secretarial standards;
- (c) to discharge such other duties as may be prescribed.

Explanation.—For the purpose of this section, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government.

For the purposes of clause (c) of sub-section (1) of section 205, the Central Government has prescribed that the duties of Company Secretary shall also include—

- (1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
- (2) to facilitate the convening of meetings and attend Board, committee and general meetings, and maintain the minutes of these meetings;
- (3) to obtain approvals from the Board, general meetings, the Government and such other authorities as required under the provisions of the Act;
- (4) to represent before various regulators, Tribunal and other authorities under the Act in connection with discharge of various functions under the Act;
- (5) to assist the Board in the conduct of the affairs of the company;
- (6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
- (7) to discharge such other duties as may be assigned by the Board from time to time;
- (8) such other duties as have been prescribed under the Act and Rules.

Section 205(2) provides that provisions contained in section 204 and section 205 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or whole-time director under this Act, or any other law for the time being in force.

MANAGERIAL REMUNERATION

Just as profits drive business, incentives drive the managers of business. Not surprisingly then, in a fiercely competitive corporate environment, managerial remuneration is an important piece in the management puzzle. While it is important to incentivize the workforce performing the challenging role of managing companies, it is equally important not to go overboard with the perks and the pay. In India, to keep a check on unnecessary profit squandering by companies and, at the same time, to ensure adequate and reasonable compensation to managerial personnel, the law intervenes to do the balancing act.

Remuneration to Managerial Personnel

Overall managerial remuneration

Section 197 of the Companies Act, 2013 prescribed the maximum ceiling for payment of managerial remuneration by a public company to its managing director whole-time director and manager which shall not exceed 11% of the net profit of the company in that financial year computed in accordance with section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

Further, the company in general meeting may, with the approval of the Central Government, authorise the

payment of remuneration exceeding 11% of the net profits of the company, subject to the provisions of Schedule V.

The net profits for the purposes of this section shall be computed in the manner referred to in section 198.

Remuneration to Managing Director/whole time Director/Manager

The remuneration payable to any one managing director or whole-time director or manager shall not exceed 5% of the net profits of the company and if there are more than one such director remuneration shall not exceed 10% of the net profits to all such directors and manager taken together.

Remuneration to other directors

Except with the approval of the company in general meeting, the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed,—

- 1% of the net profits of the company, if there is a managing or whole-time director or manager;
- 3% of the net profits in any other case.

Remuneration payable to exclusive of sitting fees

The percentages aforesaid shall be exclusive of any fees payable to directors for attending the meeting of the board/committees or for such other purposes as decided by the board.

Remuneration by a Company having no Profit or Inadequate Profit

If, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including managing or whole time director or manager, any remuneration exclusive of any fees payable to directors except in accordance with the provisions of Schedule V and if it is not able to comply with Schedule V, with the previous approval of the Central Government.

In cases, where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

Remuneration to Directors in other Capacity [Section 197(4)]

The remuneration payable to the directors including managing or whole-time director or manager shall be inclusive of the remuneration payable for the services rendered by him in any other capacity except the following:

- (a) the services rendered are of a professional nature; and
- (b) in the opinion of the Nomination and Remuneration Committee (if applicable) or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Sitting Fees to Directors for Attending the Meetings [Section 197(5)]

A director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board. Provided that the amount of such fees shall not exceed the amount as may be prescribed.

The Central Government through rules prescribed that the amount of sitting fees payable to a director for attending meetings of the Board or committees thereof may be such as may be decided by the Board of

directors or the Remuneration Committee thereof which shall not exceed the sum of rupees 1 lakh per meeting of the Board or committee thereof.

The Board may decide different sitting fee payable to independent and non-independent directors other than whole-time directors.

Monthly Remuneration to Director or Manager

Permissible forms of Remuneration

A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. [Section 197 (6)]

Independent directors are not entitled to stock options

An independent director shall not be entitled to any stock option and may receive remuneration by way of fees, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. [Section 197 (7)]

Commission or remuneration from holding or subsidiary company

Any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report. [Section 197 (14)]

Remuneration Drawn in Excess of Prescribed Limit

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company. [Section 197(9)]

The company shall not waive the recovery of any sum refundable to it under sub-section 9 mentioned above, unless permitted by the Central Government. [Section 197 (10)]

Insurance Premium not part of Remuneration

Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration. [Section 197(13)]

Disclosure of Remuneration in Board Report [(Section 197 (14)] read with Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014

Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

The central government through rules prescribed the following disclosure by a listed company in its Board's

report:

- (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
- (ii) percentage increase in remuneration of each director and CEO in the financial year;
- (iii) percentage increase in the median remuneration of employees in the financial year;
- (iv) number of permanent employees on the rolls of company;
- (v) explanation on the relationship between average increase in remuneration and company performance;
- (vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;
- (vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;
- (viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;
- (ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;
- (x) the key parameters for any variable component of remuneration availed by the directors;
- (xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year;
- (xii) affirmation that the remuneration is as per the remuneration policy of the company.

The board's report shall include a statement showing the name of every employee of the company who-

- (i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees;
- (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than five lakh rupees per month;
- (iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

The above statement shall also indicate -

- (i) Designation of the employee;

- (ii) Remuneration received;
- (iii) Nature of employment, whether contractual or otherwise;
- (iv) Qualifications and experience of the employee;
- (v) Date of commencement of employment;
- (vi) The age of such employee;
- (vii) The last employment held by such employee before joining the company;
- (viii) The percentage of equity shares held by the employee in the company within the meaning of sub-clause (iii) of sub-rule (2) above; and
- (ix) Whether any such employee is a relative of any director or manager of the company and if so, name of such director.

The particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than 60 lakh rupees per financial year or 5 lakh rupees per month, as the case may be, shall not be included in the above statement of the Board's report but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports and such particulars shall be made available to any shareholder on a specific request made by him during the course of annual general meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders.

(These disclosures were also discussed under the chapter Board's Report and Disclosures)

Managerial Remuneration under Schedule V (Part II)

Section I : Remuneration by Companies having Profits

A company having profits in a financial year may pay remuneration to its managerial persons in accordance with Section 197.

Section II: Remuneration by Companies having no profits or inadequate profits without Central Government approval

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it, may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under (A) and (B) below:

(A):

Where the effective capital is	Limit of yearly remuneration payable shall not exceed (Rs)
Negative or less than 5 Crore	30 Lakhs
5 Crore and above but less than 100 Crore	42 Lakhs
100 Crore and above but less than 250 Crore	60 Lakhs
250 Crore and above	60 Lakhs plus 0.01% of the effective capital in excess of Rs. 250 Crore

If a special resolution is passed by the shareholders, the above limits shall be doubled.

Explanation:- It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

- (B) In the case of managerial person who was not a shareholder, employee or a Director of the company at any time during the two years prior to his appointment as managerial person- 2.5% of the current relevant profit.

If a special resolution is passed by the shareholders, this limit shall be doubled.

The Schedule V (Part II) also prescribes certain conditions and additional disclosures to be made in the explanatory statement to the notice of the general meeting, where remuneration is required to be paid in accordance with Schedule V.

Remuneration in Special Circumstances (Section III)

Section III of Schedule V provides special circumstances under which companies having no profit or inadequate profit can pay remuneration to its managerial personnel in excess of amount provided in Section II of Schedule V above, without Central Government's approval.

Calculation of Net Profit for the purpose of Managerial Remuneration (Section 198)

Section 198 of the Companies Act, 2013 lays down the manner of calculations of net profits of a company any financial year for purposes of Section 197. Sub- Section (2) specifies the sums for which credit shall be given and sub-section (3) specifies the sums for which credit shall not be given while calculating the net profit.

Similarly, sub-section (4)/(5) specifies the sums which shall be deducted/not deducted while calculating the net profit.

Recovery of Managerial Remuneration in certain cases (Section 199)

This is a new provision introduced in the new Act. It provides for recovery of remuneration including stock options received by the specified Managerial Personnel, where the benefits given to them are found to be in excess of what is reflected in the restated financial statements.

It states that without prejudice to any liability incurred under the provisions of this Act or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement under this Act and the rules made there under, the company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per restatement of financial statements.

Central Government or Company to Fix Remuneration Limit (Section 200)

In respect of cases where the company has inadequate or no profits, the Central Government or a company may fix the remuneration within the limits specified in the Act. While doing so, the Central Government or the company shall have regard to—

- (a) the financial position of the company;
- (b) the remuneration or commission drawn by the individual concerned in any other capacity;
- (c) the remuneration or commission drawn by him from any other company;

- (d) professional qualifications and experience of the individual concerned;
- (d) such other matters as may be prescribed.

As per Rule 13.4 for the purpose of item (e) of section 200, the Central Government or the company shall have regard to the following matters while granting approval:

- (1) Financial and operating performance of the company during the three preceding financial years.
- (2) Relationship between remuneration and performance.
- (3) The principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other executive directors on the board and employees or executives of the company.
- (4) Whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.
- (5) The securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

Compensation for Loss of Office of Managing or Whole- time Director or Manager (Section 202)

Section 202 provides that a company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

However, No payment shall be made in the following cases:—

- (a) where the director resigns from his office as a result of the reconstruction/amalgamation of the company and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company/of resulting company from the amalgamation;
- (b) where the director resigns from his office otherwise than on the reconstruction/ amalgamation of the company;
- (c) where the office of the director is vacated due to disqualification;
- (d) where the company is being wound up due to the negligence or default of the director;
- (e) where the director has been guilty of fraud or breach of trust or gross negligence or mismanagement of the conduct of the affairs of the company or any subsidiary company or holding company; and
- (f) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

Any payment made to a managing or whole-time director or manager shall not exceed the remuneration which he would have earned if he had been in office for the remainder of his term or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which he ceased to hold office, or where he held the office for a lesser period than three years, during such period. (Sub-section 3)

Provided that no such payment shall be made to the director in the event of the commencement of the

winding up of the company, whether before or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

However, Section 202 not prohibit the payment to a managing or whole-time director, or manager, of any remuneration for services rendered by him to the company in any other capacity. (Sub-section 4)

Issue of General Notice before making Application to Central Government

Section 201 of the Companies Act, 2013 provides that before any application is made by a company to the Central Government under any of the sections aforesaid, there shall be issued a general notice to the members indicating the nature of the application proposed to be made and such notice shall be published at least once in a newspaper in the principal language of the district in which the registered office of the company is situate and at least once in English in an English newspaper circulating in that district.

The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

The Central Government prescribed that every application made to the Central Government under the provisions of Chapter XIII shall be made in Form MR 2.

Remuneration by unlisted companies in case of Inadequacy of profits

It further prescribed that the companies other than listed companies and subsidiary of a listed company may without Central Government approval pay remuneration to its managerial person in the event of no profit or inadequate profit beyond ceiling prescribed in section II, part II of Schedule V subject to complying with the following conditions:-

- (i) Payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub- section (1) of section 178 also by the Nomination and Remuneration Committee, if any and while doing so record in writing clear reason and justification for payment of remuneration beyond the said limit;
- (ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;
- (iii) Prior approval of shareholders by way of a special resolution at a general meeting of the company for payment of remuneration for a period not exceeding three years;
- (iv) A statement along-with a notice calling the general meeting referred to clause (iii) of sub-rule (2) above, shall contain the information as per sub clause (iv) of second proviso to clause (B) of section II of part-II of Schedule V of the Act including reasons and justification for payment of remuneration beyond the said limit.

Let us Remember:

1. No approval of the Central Government is required for making payment of salary to Non Executive Directors by way of monthly payment provided it is within the limits provided.
2. The re-appointment of a managerial person cannot be made earlier than one year before the expiry of their term instead of two years as per the existing provision of section 317 of the 1956 Act.

4. Independent Directors may be paid different Sitting Fees compared to other directors. Independent Directors cannot receive stock options. They may receive remuneration only by way of sitting fees, or reimbursement of expenses for participation in the Board and other meetings or profit related commission as approved by the members of the company.
5. Every Listed Company will have to disclose in the Board's report the ratio of the remuneration of each Director to the median employee's remuneration and such other details as prescribed by the Central Government through the Rules. In view of the widespread debate in the country and abroad on the subject of excessive managerial pay, the purpose of bringing this provision appears to disclose to the shareholders the extent of pay comparison among employees and directors.
6. Premium paid on any insurance policy taken by a Company on behalf of its Managing Director, Whole-Time Director, Manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the Company, shall not be treated as part of the remuneration payable to them unless such personnel is proved to be guilty.
7. For remuneration payable to any Director in any other capacity, if such services are of professional nature, no approval of the Central Government is required, when the Nomination and Remuneration Committee or Board of Directors is of the opinion, that the person possesses the necessary qualification for practice of profession.

SECRETARIAL AUDIT

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Considering the increasing importance of Corporate Governance, Section 204 of the Companies Act, 2013 mandates every listed company and such other class of prescribed companies to annex a Secretarial Audit Report, given by a company secretary in practice with its Board's report.

The Central Government through rules has prescribed such other class of companies as under-

- (a) every public company having a paid-up share capital of fifty crore rupees or more; or
- (b) every public company having a turnover of two hundred fifty crore rupees or more.

It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

The Board of Directors, in their report, shall explain in full any qualification or observation or other remarks made in the Secretarial Audit Report.

Secretarial Audit is an independent, objective assurance intended to add value and improve an organisation's operations. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

LESSON ROUND-UP

- Under Section 2(51) a Key Managerial Personnel is defined as the Chief executive officer or managing director or the manager or, a company secretary or the whole time director and the chief financial officer in relation to a company
- Every listed Company having a paid up share capital of ₹ 10 crore or more is compulsorily required to have a key managerial personnel .
- The whole time key managerial personnel is to be appointed by the Board and shall not hold office in more than one company however he is permitted to hold such other office with the permission of Board of the company.
- Every director or the key managerial personnel who is in default shall be punishable with a fine which may extend to 50,000 rupees and a further fine which may be extended to 1,000 rupees for every day during which the default continues.
- The Company secretary has been covered under the same section of KMP i.e. section 203
- Every company secretary is expected to adhere not only to the letter of the law but also ensure that the spirit of the law is followed.
- A Company Secretary exercises supervisory and checking role so as to prevent any chance of negligence in implementing various laws applicable to a particular company.
- Companies Act, through its various sections cast upon company secretary various duties and liabilities called statutory duties and statutory liabilities.
- Role of company secretary is three-fold, namely, as a statutory officer, as a coordinator, and as an administrative officer.
- Practising company secretaries provide plethora of corporate services to the corporate world beginning from the incorporation of a new company to filing of various documents with the authorities concerned, representing the company in front of various government authorities etc. One of the most important roles of practising company secretaries is to provide advisory services to various companies.
- Practising members are allowed to advertise the services provided and particulars of his firm subject to the Guidelines for Advertisement by Company Secretary in practice.

SELF-TEST QUESTIONS

1. Explain the term Key Managerial Personnel under the Companies Act, 2013. Is it necessary for every company to appoint a Key Managerial Personnel?
2. state the provisions of appointing a Key Managerial Personnel According to Companies Act 2013.
3. what are the provisions on punishment for the contravention of section 203 of the companies Act 2013?
4. discuss the role of Company Secretary .
5. Enumerate the duties and liabilities of a Secretary.
6. Discuss the role of company secretary as a statutory officer, as co-ordinator and as an administrative officer.
7. State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980.
8. Define Secretary in whole-time practice.

Lesson 18

General Meetings

LESSON OUTLINE

- Introduction
- Meaning of a Meeting
- Kinds of Company Meetings
- Requisites of Valid Meeting (General Meeting)
- Quorum
- Proxy
- Voting at General Meeting
- Chairman
- Motion
- Methods of ascertaining sense of the Meeting
- Resolutions
- Registration of Resolutions and Agreements
- Passing of resolutions by Postal Ballot/e-Voting
- Adjournment
- Minutes of proceedings of Meetings
- Report on Annual General Meeting

LEARNING OBJECTIVES

Members of a company or the directors of a company can exercise their powers and can bind the company only when they act as a body at a validly convened and held meeting. An individual member or shareholder, irrespective of his shareholding cannot bind a company by his individual act. In Companies Act 2013 a new concept of e-voting is introduced. This is a method of voting via electronic means. The Central Government has been empowered to prescribe the class or classes of companies and the manner in which a member may exercise his rights to vote by the electronic means given under Rule 20 Companies (Management and Administration) Rules, 2014 in chapter VII. It is to be noted that every gathering or assembly does not constitute a meeting. These must be convened and held in perfect compliance with the various provisions of the Companies Act, 2013 and rules framed under Chapter VII on Companies (Management and Administration) Rules, 2014.

INTRODUCTION

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business. There must be atleast two persons to constitute a meeting. Therefore, one shareholder usually cannot constitute a company meeting even if he holds proxies for other shareholders. However, in certain exceptional circumstances, even one person may constitute a meeting.

It is to be noted that every gathering or assembly does not constitute a meeting. Company meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 2013 and the rules framed thereunder.

A company is composed of members, though it has its own entity distinct from members. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held Meetings. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures.

The decision making powers of a company are vested in the Members and the Directors and they exercise their respective powers through Resolutions passed by them. General Meetings of the Members provide a platform to express their will in regard to the management of the affairs of the company.

Convening of one such meeting every year is compulsory. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. Shareholder Democracy, Class Action Suits and Protection of interest of investors are the essence and attributes of the Companies Act, 2013.

Members' Meetings

A company is required to hold meetings of the members to take approval of certain business items, as prescribed in the Act.

The meetings to be held for seeking approval to ordinary business and special business are called annual general meeting and extraordinary general meeting. In certain cases, a company may have to hold a meeting of the members of a particular class of members.

MEMBER'S MEETINGS

**ANNUAL GENERAL
MEETING**

**EXTRA ORDINARY
GENERAL MEETING**

CLASS MEETING

Annual General Meeting (section 96)

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 provides that every company, other than a one person company is

required to hold an annual general meeting every year. Following are the key provisions regarding the holding of an annual general meeting:

Holding of annual general meeting

1. Annual general meeting should be held once every year.
2. First annual general meeting of the company should be held within 9 months from the closing of the first financial year. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3. Subsequent annual general meeting of the company should be held within 6 months from the closing of the financial year.
4. The gap between two annual general meetings should not exceed 15 months.

Extension of validity period of AGM

In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period not exceeding 3 months. No such extension of time can be granted by the Registrar for the holding of the first annual general meeting,

Time and place for holding an annual general meeting

An annual general meeting can be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. It should be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate. The Central Government is empowered to exempt any company from these provisions, subject to such conditions as it may impose.

“National Holiday ” for this purpose means and includes a day declared as National Holiday by the Central Government.

Default in holding the annual general meeting

Section 99 provides that if any default is made in complying or holding a meeting of the company, the company and every officer of the company who is in default shall be punishable with fine which may extend to 1 lakh and in case of continuing default, with a further fine which may extend to Rs. 5,000/- for each day during which such default continues.

If any default is made in holding the annual general meeting of a company, any member of the company may make an application to the Tribunal to call or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

Business to be transacted at annual general meeting:

Sub-section (2) of Section 102 provides that all other businesses transacted at an Annual General Meeting except the following are special business:

- (i) the consideration of financial statements and the reports of the Board of Directors and auditors;
- (ii) the declaration of any dividend;
- (iii) the appointment of directors in place of those retiring;
- (iv) the appointment of, and the fixing of the remuneration of, the auditors.

In case of any other Meeting all business shall be deemed to be special.

Extra Ordinary General Meeting (Section 10)

All general meetings other than annual general meetings are called extraordinary general meetings.

CALLING OF EGM

BY BOARD

**BY BOARD ON
REQUISITION OF
SHAREHOLDERS**

**BY
REQUISITIONISTS**

BY TRIBUNAL

All businesses items can be transacted at the extraordinary general meetings are special business. Following are the key provisions, provided in section 100, regarding calling and holding of an extraordinary general meeting:

(I) By Board [Section 100 (1)]

The Board may, whenever it deems fit, call an extraordinary general meeting of the company.

(II) By Board on requisition [Section 100 (2)]

The Board must call an extraordinary general meeting on receipt of the requisition from the following number of members:

- (a) in the case of a company having a share capital: members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;
- (b) in the case of a company not having a share capital: members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote

The requisition should set out the matters to be considered at the proposed meeting and the same should be signed by the requisitionists and sent to the registered office of the company.

The Board must, within 21 days from the date of receipt of a valid requisition, proceed to call a meeting on a day not later than 45 days from the date of receipt of such requisition.

(III) By requisitionists [Section 100(4)]

If the Board does not within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than 45 days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves. However in such case, the meeting should be held within a period of 3 months from the date of the requisition.

Reasonable expenses incurred by the requisitionists in calling such a meeting shall be reimbursed

by the company to the requisitionists. The company in turn recover such expenses from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting. [Section 100(6)]

In case, the quorum is not present within half-an-hour from the time appointed for holding a meeting called by requisitionists, the meeting shall stand cancelled. [Section 103(2)(b)]

Rules 17 provides as under with regard to calling of extraordinary general meeting by requisitionists:

- The members may requisition convening of an extraordinary general meeting in accordance with sub- section (4) of section 100, by providing such requisition in writing or through electronic mode at least clear twenty- one days prior to the proposed date of such extraordinary general meeting.
- The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting. The requisitionists should convene meeting at Registered office or in the same city or town where Registered office is situated and such meeting should be convened on working day.
- If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.
- The notice shall be signed by all the requisitionists or by a requisitionists duly authorised in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.
- No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requisitionists and the requisitionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.
- The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requisitionists deposit with the Company a valid requisition for calling an extraordinary general meeting.
- Where the meeting is not convened, the requisitionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty- five days from the date of receipt of a valid requisition.
- The notice of the meeting shall be given by speed post or registered post or through electronic mode . Any accidental omission to give notice to, or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

(IV) By Tribunal [Section 98 (not yet enforced)]

Section 98 provides that if for any reason it is impracticable to call a meeting of a company or to hold or conduct the meeting of the company, the Tribunal may, either suo motu or on the application of any director or member of the company who would be entitled to vote at the meeting:

order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company.

Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. Meeting held pursuant to such order shall be deemed to be a meeting of the company duly called, held and conducted.

Notice of Meeting (Section 101)

A general meeting of a company may be called by giving not less than 21 clear days' notice either in writing or through electronic mode. Notice through electronic mode shall be given in such manner as may be prescribed.

Short notice

A general meeting may be called after giving a shorter notice also if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting.

Contents of Notice

Place of meeting (Section 96)

The notice should state the place where the general meeting is scheduled to be held. In case of an annual general meeting, the place of the meeting has to be either the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated. Explanation to Rule 17(2) of Companies (Management and Administration) Rules 2014 states that for the purpose of this sub rule it is hereby clarified that requisitionists should convene meeting at Registered Office or in the same city or town where the Registered Office is situated and such meeting should be convened on working day.

Day of meeting (Section 96)

The day and date of the meeting should be clearly stated in the notice. In case of an annual general meeting, the day should be one that is not a National Holiday. An extraordinary general meeting can however be held on any day.

Time of meeting (Section 96)

Exact time of holding the meeting should be given in the notice. An annual general meeting can be called during business hours only, that is, between 9 a.m. and 6 p.m. There is no need to follow such timings in case of an extraordinary general meeting.

Agenda (Section 102)

A statement of the business to be transacted at the general meeting should be given in the notice. In case, the meeting is to transact a special business, a explanatory statement should be attached about such item.

Proxy clause with reasonable prominence [Section 105(2)]

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

Notice through Electronic Mode (Rule 18 of Companies (Management and Administration) Rules 2014)

A company may give notice through electronic mode. Electronic mode' means any communication sent by a company through its authorized and secured computer programme which is capable of producing

confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

Conditions for notice send through e-mail are as under:

A notice may be sent through e-mail as a text or as an attachment to e-mail or as a notification providing electronic link/ Uniform Resource Locator (URL) for accessing such notice.

- The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company. The company has to provide an advance opportunity atleast once in a financial year, to the member to register his e-mail address and changes therein and such request may be made by only those members who have not got their email id recorded or to update a fresh email id and not from the members whose e-mail ids are already registered.
- The subject line in e-mail shall state the name of the company, notice of the type of meeting and the date on which meeting is scheduled.
- If notice is sent in the form of an attachment to e-mail, such attachment shall be in the Portable Document Format (PDF) or electronic documentation format together with a facility for recipient for downloading relevant version of the software for accessing such notice along with instructions for downloading such software and alternative contact details in case of inability of the recipient to open or read the attachment.
- There shall be no difference in the text of the physical version of the notice and electronic version except in respect of mode of dispatch of notice.
- Sending of notice via e-mail shall be subject to such option being confirmed by the member and e-mail address being updated in writing at least 30 days prior to dispatch of notice. In such cases, the company shall not be under obligation to deliver physical copy of the notice unless specifically requested by the member in writing before the date of the meeting.
- When notice or notifications of availability of notice are sent by e-mail, the company should ensure that it uses a system which produces confirmation of the total number of recipients e-mailed and a record of each recipient to whom the notice has been sent. A copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as 'proof of sending'.
- The company's obligation shall be satisfied when it transmits the e-mail and the company will not be held responsible for a failure in transmission beyond its control. However the company shall, where it is aware of the failure in delivery of the e-mail (and subsequent attempts do not rectify the situation), revert to sending physical copy of the notice at the member's registered address within 72 hours of the original attempt.
- If a member entitled to receive notice fails to provide or update relevant e-mail address to the company, company shall not be in default for not delivering notice via e-mail.
- Company may send e-mail through in-house facility or authorize any third party agency providing bulk e-mail facility.
- Notice made available on the electronic link/ URL has to be readable, and the recipient should be able to obtain and retain copies. The company shall give the complete URL/address of the website and full details of how to access the document/ information.
- The notice is taken to be 'sent' on the date the notification is sent. The notice must be available on

the electronic link/ URL provided from the date of notification until the conclusion of the meeting. The failure to make notice available throughout the required period shall be disregarded if it is made available for part of that period and the failure is wholly attributable to circumstances that the company could not reasonably have prevented or avoided.

The notice of the general meeting of the company shall be simultaneously placed on the website of the company and on the website as may be notified by the Central Government.

Persons entitled to receive Notice

In terms of Section 101(3), notice of every meeting of the company must be given to:

- (a) every member of the company, legal representative of any deceased member or the assignee of an insolvent member;
- (b) the auditor or auditors of the company; and
- (c) every director of the company.

Any accidental omission to give notice to, or the non-receipt of such notice by, any member or other person who is entitled to such notice for any meeting shall not invalidate the proceedings of the meeting.

Statement to be Annexed to Notice (Section 102)

In case of special business items to be transacted at a general meeting, a statement setting out the following material facts, shall be annexed to the notice calling the meeting:

- (I) (a) the nature of concern or interest, financial or otherwise, if any, in respect of each item of:
 - every director and the manager, if any;
 - every other key managerial personnel; and
 - relatives of the persons mentioned above.
- (b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid- up share capital of that company, also be set out in the statement.

- (II) Where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected.

Where as a result of the non-disclosure or insufficient disclosure in any statement referred as above, being made by a promoter, director, manager, if any, or other key managerial personnel, any benefit which accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

Quorum for Meetings

Quorum refers to the minimum number of members required to constitute a valid meeting. Following are the

minimum numbers provided in section 103, for various categories of companies. However the Articles of Association of the company may provide for a higher number.

(a) *Public company:*

- 5 members personally present if the number of members as on the date of meeting is not more than 1000;
- 15 members personally present if the number of members as on the date of meeting is more than 1000 but up to 5000;
- 30 members personally present if the number of members as on the date of the meeting exceeds 5000.

(b) *Private company:*

- 2 members personally present, shall be the quorum for a meeting of the company.

Absence of quorum

If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company:

- (a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or
- (b) the meeting, if called by requisitionists, shall stand cancelled.

Adjourned meeting

In case of an adjourned meeting or of a change of day, time or place of meeting, the company shall give not less than 3 days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.

If at the adjourned meeting also, a quorum is not present within half-an-hour from the time appointed for holding meeting, the members present shall be the quorum.

Chairman of Meetings (Section 104)

Unless the articles of the company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act and the Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the meeting.

Proxies (Section 105)

Appointment of a proxy is an important right of a member of the company. The Act contains elaborate provisions regarding exercise of this right by a member.

Any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for

voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member. Hence a company not having a share capital can abstain from complying with this provision by incorporating necessary clause in its articles of association.

A proxy shall not have the right to speak at the meeting. A proxy shall be entitled to vote only on a poll.

A member of a company registered under section 8 shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

A person appointed as proxy shall not act as proxy on behalf of more than fifty members and members holding in the aggregate more than ten percent of the total share capital of the company carrying voting rights.

The instrument appointing the proxy must be deposited with the company, 48 hours before the meeting. Any provision contained in the articles, requiring a longer period than 48 hours shall have effect as if a period of 48 hours had been specified.

The instrument appointing a proxy must be in Form No. MGT. 11. It needs to be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument should be under its seal or be signed by an officer or an attorney duly authorised by the body corporate. For execution of proxy, the Articles of Association of a company can not specify any special requirement to be complied with.

Let us Remember:

The Instrument appointing a proxy must be in Form No. MGT 11

Every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, is entitled to inspect the proxies lodged with the company, if at least 3 days notice is given to the company. Such inspection can be taken during the period beginning 24 hours before the time fixed for the commencement of the meeting, during the business hours of the company, and ending with the conclusion of the meeting.

Restriction on Voting Rights (Section 106)

A member shall not exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid or on which company has exercised any right or lien. No member can be prohibited from exercising his voting right on any other ground.

Voting by Show of Hands (Section 107)

At any general meeting, a resolution put to the vote of the meeting shall in the first instance be decided on a show of hands. A declaration by the Chairman of the meeting of the passing of a resolution or otherwise, by show of hands shall be conclusive evidence of the fact of passing of such resolution or otherwise, unless a poll is demanded before or immediately on declaration by Chairman.

Voting through Electronic Means (Section 108)

Every listed company or a company having five hundred or more shareholders may provide to its members facility to exercise their right to vote at general meetings by electronic means. a member may exercise his right to vote at any general meeting by electronic means and company may pass any resolution by electronic voting system .

It may be noted that 'voting by electronic means' or 'electronic voting system' means a 'secured system' based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, such that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralized server with adequate 'cyber security'.

'Secured system' means computer hardware, software, and procedure that –

- (a) are reasonably secure from unauthorized access and misuse;
- (b) provide a reasonable level of reliability and correct operation;
- (c) are reasonably suited to performing the intended functions; and
- (d) adhere to generally accepted security procedures.

"Cyber security" means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorized access, use, disclosures, disruption, modification or destruction.

A company which opts to provide the facility to its members to exercise their votes at any general meeting by electronic voting system shall follow the following procedure:

- The notices of the meeting shall be sent to all the members, auditors of the company, or directors either - (a) by registered post or speed post ; or (b) through electronic means like registered e-mail id; (c) through courier service.
- The notice shall also be placed on the website of the company, if any and of the agency forthwith after it is sent to the members.
- The notice of the meeting shall clearly mention that the business
- may be transacted through electronic voting system and the company is providing facility for voting by electronic means.
- The notice shall clearly indicate the process and manner for voting by electronic means and time schedule including the time period during which the votes may be cast, address of places for casting votes duly sorted in order of name of states or union territories, where the members can cast their votes electronically.
- The company shall cause an advertisement to be published, not less than five days before the date of beginning of the voting period, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, about having sent the notice of the meeting and specifying therein, inter alia, the following matters:
 - statement that the business may be transacted by electronic voting;
 - the date of completion of sending of notices;
 - the date and time of commencement of voting through electronic means;
 - the date and time of end of voting through electronic means;
 - the statement that voting shall not be allowed beyond the said date and time;
 - website address of the company and agency, if any, where notice of the meeting is displayed; and

- contact details of the person responsible to address the grievances connected with the electronic voting;
- The e-voting shall remain open for not less than one day and not more than three days. Provided that in all such cases, such voting period shall be completed three days prior to the date of the general meeting;
- During the e-voting period, shareholders of the company, holding shares either in physical form or in dematerialized form, as on the record date, may cast their vote electronically. Once the vote on a resolution is cast by the shareholder, he shall not be allowed to change it subsequently
- At the end of the voting period, the portal where votes are cast shall forthwith be blocked.
- The Board of directors shall appoint one scrutinizer, who may be chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an advocate, but who is not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinize the e-voting process in a fair and transparent manner. It may be noted that the scrutinizer so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system.
- The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.
- The scrutinizer shall, within a period of not exceeding three working days from the date of conclusion of e-voting period, unblock the votes in the presence of at least two witnesses and make a scrutinizer's report of the votes cast in favour or against, if any, forthwith to the Chairman.
- The scrutinizer shall maintain a register either manually or electronically to record the consent or otherwise, received, mentioning the particulars of name, address, folio number or client ID of the shareholders, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights.
- The register and all other papers relating to electronic voting shall remain in the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes. Thereafter, the scrutinizer shall return the register and other related papers to the company.
- The results declared along with the scrutinizer's report shall be placed on the website of the company and on the website of the agency within two days of passing of the resolution at the relevant general meeting of members.
- Subject to receipt of sufficient votes, the resolution shall be deemed to be passed on the date of the relevant general meeting of members.

Clarifications on issues associated with e-voting procedure

Ministry of Corporate Affairs vide Circular dated 17th June, 2014 gives clarification regard to voting through electronic means – it provides that Section 108 of the Companies Act, 2013 read with rule 20 of the Companies (Management and Administration) Rules, 2014 deal with the exercise of right to vote by members by electronic means (e-means). The provisions seek to ensure wider shareholders participation in the decision making process in companies. Corporate and other stakeholders while appreciating the new approach have drawn attention to some practical difficulties in respect of general meetings to be held in the next few months.

"The suggestions received from the stakeholders have been examined. It is noticed that compliance with

procedural requirements, engagement of Depository Agencies and the need for clarity on matter like demand for poll/ postal ballot etc will take some more time. Accordingly, it has been decided not to treat the relevant provisions as mandatory till 31st December, 2014." The relevant notification in this regard is being issued separately.

To provide clarity and ensure uniformity in the e-voting procedure, clarifications on certain issues raised by the stakeholders are provided in the Annexure to this circular for guidance of all concerned.

This issue with the approval of the competent authority.

Annexure

Clarifications on issues associated with e-voting procedure

(i) *Show of hands not to be allowed in case of e-voting*:- In view of clear provisions of section 107, voting by show of hands would not be allowable in cases where rule 20 of Companies (Management and Administration) Rules, 2014 is applicable.

(ii) *Participation in the general meeting after voting by e-means*:- It is clarified that a person who has voted through e-voting mechanism in accordance with rule 20 shall not be debarred from participation in the general meeting physically. But he shall not be able to vote in the meeting again, and his earlier vote (cast through e-means) shall be treated as final.

(iii) *Applicability of rule 20 for matters specified under rule 22(16)*: Stakeholders have asked whether matters specified under rule 22(16) (transactions of certain items only through postal ballot) can be considered in a general meeting where e-voting facilities is available. It has been examined and it is stated that in view of clear provisions of section 110(1Xa) read with such rule 22(16) it would be necessary to transact items specified in rule 22(16) only through postal ballot and not at the general meeting.

(iv) *Relevance of provisions relating to demanding for poll*:- In case of companies having share capital, voting through e-means takes into account 'Proportion principle'[i.e. 'one share - one vote] unlike one person - one vote' principle under 'show of hands'. This along with provisions of section 107 make it clear that in case of companies which are covered under section 108 read with rule 20 of Companies (Management and Administration) Rules, the provisions relating to demand for poll would not be relevant.

(v) *Permissibility of voting by postal ballot under rule 20*:- Stakeholders have sought a clarification that in cases (covered under rule 20) where a shareholder who is not able to participate in the general meeting personally and who is also not exercising voting through e means whether such a person shall have the option to vote through postal ballot. The matter has been examined and it is felt that keeping in view the provisions of the Act such an option would not be available.

(vi) *Manner of noting in case of shareholders present in the meeting*:- Stakeholders have sought clarity about manner of voting for shareholders (of a company covered under rule 20) who are present in the general meeting. It is hereby clarified that since voting through e-means would be on the basis of proportion of share in the paid-up capital or 'one-share one-vote', the Chairperson of the meeting shall regulate the meeting accordingly.

(vii) *Applying rule 20 voluntarily*:- Stakeholders have referred to words A company which opts to' appearing in rule 20(3) and have raised a query whether rule 20 is applicable to companies not covered in rule 20(1). It is clarified that rule 20 (3) is being amended to align it with rule 20(1). Regarding voluntary application of rule 20, it is clarified that in case a company not mandated under rule 20(1) opts or decided to give its shareholders the e-voting facility, in such a case, the whole of procedure specified in rule 20 shall be

applicable to such a company. This is necessary so that any piece-meal application does not prejudice the interest of shareholders.

Demand for Poll (Section 109)

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the

Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the following person(s):

- (a) in the case a company having a share capital: by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than Rs.5,00,000/- or such higher amount as may be prescribed, has been paid-up; and
- (b) in the case of any other company: by any member or members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power.

The demand for a poll may be withdrawn at any time by the persons who made the demand.

Time for taking poll and declaring the result

A poll shall be taken forthwith, if it is demanded for adjournment of the meeting or appointment of Chairman of the meeting.

A poll shall be taken at such time, not being later than 48 hours from the time when the demand was made on any other question.

Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinise the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.

The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

Manner the Chairman of Meeting get the poll process scrutinised and Report thereon

Rule 21 provides that the chairman of a meeting shall ensure that –

- The Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies.
- The Scrutinizers are provided with all the documents received by the Company.
- The Scrutinizers initial the Polling papers and distribute them to the members and proxies present at the meeting. In case of joint shareholders, the polling paper shall be given to the first named holder or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio. The Polling paper shall be in Form No. MGT.12.
- The Scrutinizers keep a record of the polling papers issued.
- The Scrutinizers lock and seal an empty polling box in the presence of the members and proxies.
- The Scrutinizers open the Polling box in the presence of two persons as witnesses after the voting process is over.

- In case of ambiguity about the validity of a proxy, the Scrutinizers decide the validity in consultation with the Chairman.
- The Scrutinizers shall ensure that if a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.
- The Scrutinizers count the votes cast on poll and prepare a report thereon addressed to the Chairman.
- Where voting is conducted by electronic means, the company shall provide all the necessary support, technical and otherwise, to the Scrutinizers in orderly conduct of the voting and counting the result thereof.
- The Scrutinizers' report state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.
- The Scrutinizers submit the Report to the Chairman who shall counter-sign the same.
- The Chairman declare the result of Voting on poll. The result may either be announced by him or a person authorized by him in writing.

The scrutinizer/s appointed for the poll, shall submit a report to the Chairman of the meeting in Form No. MGT No. 13. The report shall be signed by the scrutinizer / all the scrutinizers, in case there is more than one scrutinizer, and be submitted by them to the Chairman of the meeting within 7 days from the date the poll is taken.

Postal Ballot (Section 110)

As per section 2(65) "postal ballot" means voting by post or through any electronic mode.

The Act provides that a company shall in respect of such items of business as the Central Government by notification declare shall be transacted only by postal ballot.

Rule 22 provides as under with regard to conducting business through postal ballot.

The rules provide that the following items of business shall be transacted only by means of voting through a postal ballot-

- (a) Alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;
- (b) Alteration of articles of association in relation to insertion or removal of provisions which, under sub-section (68) of section 2, are required to be included in the articles of a company in order to constitute it a private company;
- (c) Change in place of registered office outside the local limits of any city, town or village as specified in sub-section (5) of section 12;
- (d) Change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised under sub-section (8) of section 13;
- (e) Issue of shares with differential rights as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 43;
- (f) Variation in the rights attached to a class of shares or debentures or other securities as specified under section 48;

- (g) Buy-back of shares by a company under sub-section (1) of section 68;
- (h) Election of a director under section 151 of the Act;
- (i) Sale of the whole or substantially the whole of an undertaking of a company as specified
- (j) Giving loans or extending guarantee or providing security in excess of the limit prescribed under sub-section (3) of section 186;

Section 110(1)(b) further provides that a company may pass any item of business, other than ordinary business and any business in respect of which director or auditors have a right to be heard.

Procedure for conducting business through postal ballot

- (1) Where a company is required or decides to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot or by electronic means within a period of thirty days from the date of dispatch of the notice.
- (2) The notice shall be sent either (a) by Registered Post or speed post, or (b) through electronic means like registered e-mail id or (c)through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.
- (3) An advertisement shall be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, about having dispatched the ballot papers and specifying therein, inter alia, the following matters:
 - a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;
 - the date of completion of dispatch of notices;
 - the date of commencement of voting;
 - the date of end of voting;
 - the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;
 - a statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and
 - contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means.
- (4) The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.
- (5) The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner. (6) The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.

- (6) If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot including voting by electronic means, it shall be deemed to have been duly passed at a general meeting convened in that behalf.
- (7) Postal ballot received back from the shareholders shall be kept in the safe custody of the scrutinizer. After the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.
- (8) The scrutineer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof;
- (9) The scrutineer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid;
- (10) The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutineer till the chairman considers, approves and signs the minutes. Thereafter, the scrutineer shall return the ballot papers and other related papers/register to the company who shall preserve such ballot papers and other related papers/register safely;
- (11) The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received;
- (12) The results shall be declared by placing it, along with the scrutineer's report, on the website of the company;
- (13) The resolution shall be deemed to be passed on the date of declaration of its result;
- (14) The provisions regarding voting by electronic means shall apply, as far as applicable, mutatis mutandis in respect of the voting by electronic means.

If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf. In case of One Person Company and other companies having members upto fifty are not required to transact any business through postal ballot.

Circulation of Members' Resolution (Section 111)

As per Section 111, a company shall, on requisition in writing of certain number of members, give notice to members of any proposed resolution intended to be moved in the meeting or circulate any statement with respect to matters referred in proposed resolution. The company shall be bound to give notice of resolution only if the requisition is deposited not less than six weeks before the meeting. In case of other requisition not less than 2 weeks before the meeting. The statement need not be circulated if the Central Government declares that the right conferred is being abused to secure needless publicity for defamatory matters. If default is made the company and every officer of the company shall be punishable with fine.

Representation of President and Governors in Meetings

Section 112 of the Act provides that President of India or the Governor of a State, if he is a member of a company, may appoint such person as he thinks fit, to act as his representative at any meeting of the company. The person so appointed shall be deemed to be a members and have the same rights including the right vote by proxy or postal ballot, as the President or Governor could exercise as a member of the company.

Representation of Corporations at Meeting of Companies and of Creditors

In terms of Section 113, where a body corporate is a member or a creditor including a holder of debentures of the company and it authorises any person as its representative at any meeting of the company or any class of members of the company or at any meeting of creditors of the company, such representative shall be entitled to exercise the same rights and powers including right to vote by proxy and by postal ballot on behalf of the body corporate which he represents.

Ordinary and Special Resolutions

Section 114 provides with regard to Ordinary and Special Resolution

Ordinary Resolution

A resolution shall be an ordinary resolution if the notice has been duly given and it is required to be passed by the votes cast, in favour of the resolution, including the casting vote, if any, of the Chairman, exceed the votes, if any, cast against the resolution.

Special Resolution

A resolution shall be a special resolution when:

- (a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution;
- (b) the notice required under this Act has been duly given; and
- (c) the votes cast in favour of the resolution, are required to be not less than 3 times the number of the votes, if any, cast against the resolution.

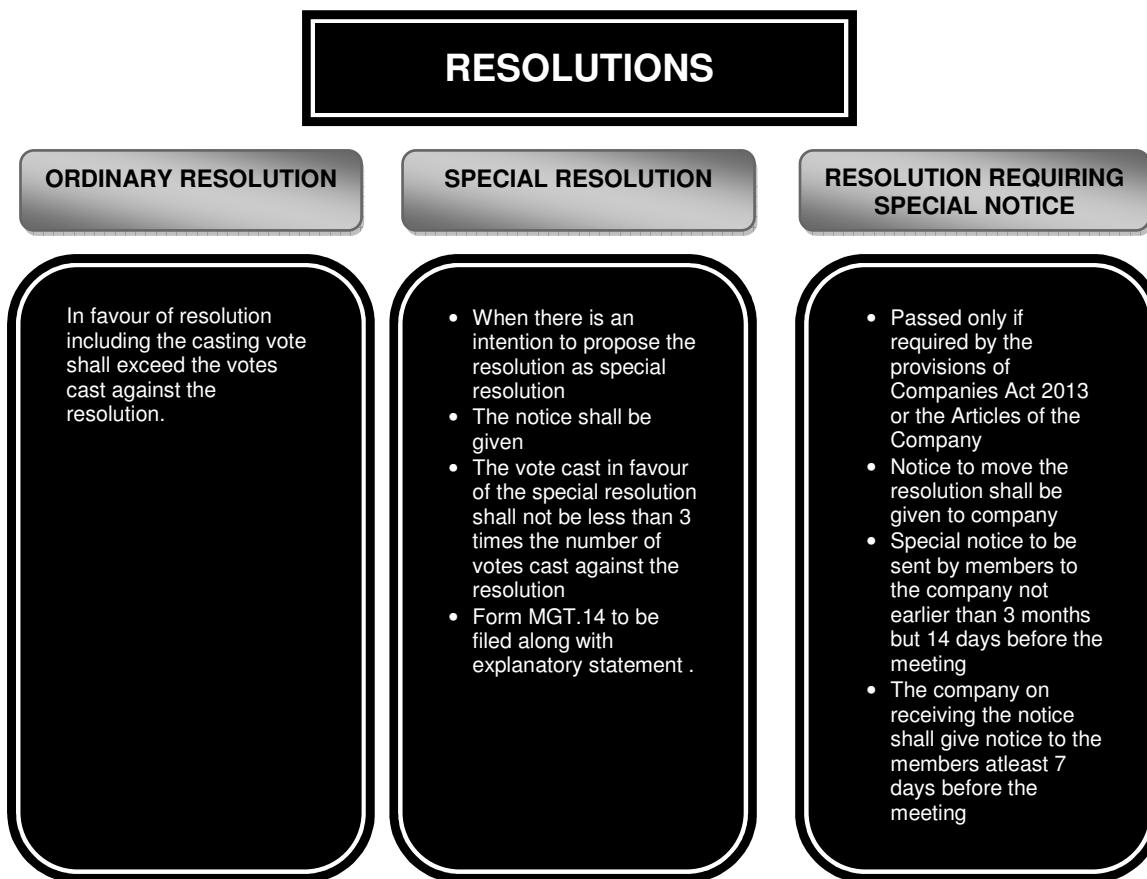
Resolutions requiring Special Notice

Section 115 provides that where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of total voting power or holding shares on which such aggregate sum not exceeding Rs.5,00,000/- as may be prescribed has been paid-up and the company shall give its members notice of the resolution in the following manner as prescribed in Rules.

Procedure for special notice:

- A special notice required to be given to the company shall be signed, either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice.
- Such notice shall be sent by members to the company not earlier than three months but at least 14 days before the date of the meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.
- The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven days before the meeting , exclusive of the day of dispatch of notice and day of the meeting , in the same manner as it gives notice of any general meetings.
- Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered

office of the Company is situated. Such notice shall also be posted on the website, if any, of the Company. Such notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.



Resolutions passed at Adjourned Meeting

As per Section 116 where a resolution is passed at an adjourned meeting of a company; or the holders of any class of shares in a company; or the Board of Directors, the resolution shall be treated as passed on the day it was actually passed and not on any earlier date.

Resolutions and Agreements to be filed with the Registrar

Section 117 provides that a copy of every resolution and an agreement in respect of matters specified therein together with a explanatory statement shall be filed in Form No. MGT.14 with the Registrar within thirty days of its passing. The Registrar shall register the same and in case of any default, a company and every officer who is in default including the liquidator shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Resolutions and agreements to be filed with the Registrar are as under:

- special resolutions;
- resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special

- resolutions;
- (c) any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
 - (d) resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;
 - (e) resolutions passed by a company according consent to the exercise by its Board of Directors of any of the powers under clause (a) and clause (c) of sub-section (1) of section 180;
 - (f) resolutions requiring a company to be wound up voluntarily passed in pursuance of section 304;
 - (g) resolutions passed in pursuance of sub-section (3) of section 179; and
 - (h) any other resolution or agreement as may be prescribed and placed in the public domain.

Maintenance of Minutes of Meetings

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting.

As per section 118(10) every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

Rule 25 contains provisions with regards to minutes of meetings.

A distinct minute book shall be maintained for each type of meeting namely:

- (i) general meetings of the members;
- (ii) meetings of the creditors;
- (iii) meetings of the Board; and
- (iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution

Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.

Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minute books of general meetings shall be kept at the registered office of the company. Minutes of the Board and committee meetings shall be kept at the registered Office or at such other place as may be approved by the Board.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act.

Inspection of Minute book of General Meeting

In terms of Section 119, the minute's book of general meetings shall be kept at the registered office of a company and shall be open for inspection to members during business hours without any charge subject to such restrictions as the company may impose. A member shall be entitled for a copy of any minutes subject to payment of fees as may be specified in the Articles of Association of the company, but not exceeding a sum of ten rupees for each page or part of any page. The copy should be made available to him within seven days of his making request.

Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, with a copy of any minutes of any general meeting, on payment of such sum as may be specified in the articles of the company but not exceeding a sum of ten rupees for each page or part of any page. A member who has made a request for provision of soft copy in respect of minutes of any previous general meetings held during a period of immediately preceding three financial years shall be entitled to be furnished, with the same free of cost.

Where the company refuses inspection or fails to furnish a copy of minutes within specified time, the Tribunal is empowered to direct immediate inspection or sending a copy of minutes in the matter and the company and every officer of the company shall be punishable with fine.

Maintenance and Inspection of Document in Electronic Form

According to section 120 the documents, records, registers, minutes may be kept and inspected in electronic form.

According to Rule 27, every listed company or a company having not less than one thousand share holders, debenture holders and other security holders, shall maintain its records, as required to be maintained under

the Act or rules made there under, in electronic form.

The records in electronic form shall be maintained in such manner as the Board of directors of the company may think fit, provided that-

- the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made there under;
- the information as required under the provisions of the Act or the rules made there under should be adequately recorded for future reference;
- the records must be capable of being readable, retrievable and reproducible in printed form;
- the records are capable of being dated and signed digitally wherever it is required under the provisions of the Act or the rules made there under;
- the records, once dated and signed digitally, shall not be capable of being edited or altered;
- the records shall be capable of being updated, according to the provisions of the Act or the rules made there under, and the date of updation shall be capable of being recorded on every updation;

It may be noted that the term “records” means any register, index, agreement, memorandum, minutes or any other document required by the Act or the rules made there under to be kept by a company.

Security of Records maintained in electronic form

The Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsible for the maintenance and security of electronic records.

The person who is responsible for the maintenance and security of electronic records shall-

- provide adequate protection against unauthorized access, alteration or tampering of records;
- ensure against loss of the records as a result of damage to, or failure of the media on which the records are maintained;
- ensure that the signatory of electronic records does not repudiate the signed record as not genuine;
- ensure that computer systems, software and hardware are
- adequately secured and validated to ensure their accuracy, reliability and consistent intended performance;
- ensure that the computer systems can discern invalid and altered records;
- ensure that records are accurate, accessible, and capable of being reproduced for reference later;
- ensure that the records are at all times capable of being retrieved to a readable and printable form;
- ensure that records are kept in a non-rewriteable and non-erasable format like pdf. version or some other version which cannot be altered or tampered;
- ensure that at least two backups, taken at a periodicity of not exceeding one day, are kept of the updated records kept in electronic form, every backup is authenticated and dated and such backups shall be securely kept at such places as may be decided by the Board;

- limit the access to the records to the managing director, company secretary or any other director or officer as may be authorized by the Board in this behalf;
- ensure that any reproduction of non-electronic original records in electronic form is complete, authentic, true and legible when retrieved;
- arrange and index the records in a way that permits easy location, access and retrieval of any particular record; and
- take necessary steps to ensure security, integrity and confidentiality of records.

Inspection and Copies of Records maintained in Electronic Form

Where a company maintains its records in electronic form, any duty imposed by the Act or rules made there under to make those records available for inspection or to provide copies of the whole or a part of those records, shall be construed as a duty to make the records available for inspection in electronic form or to provide copies of those records containing a clear reproduction of the whole or part thereof, as the case may be.

Penalty

If any default is made in compliance with any of the provisions of this rule, the company and every officers or such other person who is

in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which such contravention continues.

Report on Annual General Meeting

In terms of section 121(1) every listed public company required to prepare a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of the Act and the rules made thereunder. A copy of the report is to be filed with the Registrar in Form No. MGT. 15 within thirty days of the conclusion of annual general meeting along with the prescribed fee.

According to Rule 31, the report shall be prepared in the following manner:

- (a) A report under this section shall be prepared in addition to the minutes of the general meeting.
- (b) The report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing director, if there is one.
- (c) Such report shall contain the details in respect of the following:
 - The day, date, hour and venue of the annual general meeting.
 - Confirmation with respect to appointment of Chairman of the meeting.
 - Number of members attending the meeting.
 - Confirmation of quorum.
 - Confirmation with respect to compliance of the Act and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting.
 - Business transacted at the meeting and result thereof.

- Particulars with respect to any adjournment, postponement of meeting, change in venue.
 - Any other points relevant for inclusion in the Report.
- (d) Such Report shall contain fair and correct summary of the proceedings of the meeting.

LESSON ROUND-UP

- An annual general meeting is required to be held every year by every company whether public or private, limited by shares or by guarantee, with or without share capital or unlimited company.
- In case of default is made in holding the annual general meeting of a company under section 96 , the Tribunal may call or direct the calling of an annual general meeting.
- Class meetings are those meetings which are held by holders of a particular class of shares e.g. preference shares.
- It is mandatory for a company to pass resolution by postal ballot in respect of such items of business as the central government may by notification declare transacted only by the postal ballot.
- For a General Meeting to be valid, it must be duly convened, properly constituted and the business must be validly transacted.
- In case of public company the quorum shall depend on number of members as on the date of meeting:-
 - If members not more than 1000—quorum shall be 5
 - If members more than 1000 but less than 5000- quorum shall be 15
 - If members more than 5000- quorum shall be 30
- In case of private company 2 members personally present shall be the quorum of the meeting.
- The central government is vested with the power to prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.
- Chairman plays a very important role in a meeting as he is responsible for successful conduct of a meeting
- A motion becomes a resolution only after the requisite majority of members have adopted it.
- Various methods which may be adopted for taking votes on a motion properly placed before a meeting are by show of hands, by poll, by postal ballot and by electronic voting.
- There are three kinds of resolutions under the Act (a) Ordinary Resolution (S. 114), (b) Special Resolution (S. 114) (c) Resolution requiring special notice (S. 115)
- In accordance with Section 117 of the Act, certain resolutions are required to be filed with the Registrar for its recording within 30 days of its passing at the meeting.
- There are certain businesses, specified under Section 110 of the Act, which are required to be passed through postal ballot.
- Postponement is the act of the convening authority whereas the adjournment is the act of meeting itself.
- Every company is required to keep minutes of the proceedings of general meetings and of the meetings of Board of Directors and its Committees.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What are the items that constitute Ordinary Business in an Annual General Meeting of a company?

2. Who shall be chairman of a general meeting of a company? What are the provisions of the Companies Act, 2013 regarding his election?
 3. Every Annual General Meeting of a company shall be called on a day which is not a public holiday. Can an adjourned Annual General Meeting of a company be called on a public holiday?
 4. A shareholder having given proxy, personally attends and votes at the meeting. Comment, illustrating a case law.
 5. A valid demand of a poll was received at a general meeting. Thereafter, those who made it, can withdraw it. Examine the same in the light of the provisions of the Companies Act.
 6. At a general meeting, two joint holders voted on a resolution. Will the votes of both the joint holders be accepted?
 7. Discuss Postal Ballot.
 8. What are the provision of the Companies Act, in regard to the holding of a Extra Ordinary General Meeting?
 9. Write short notes on:
 - (i) Proxy; (ii) Special Business; (iii) Quorum; (vi) 'Material Facts'.
 10. Can any company pass some resolutions through postal ballot? If yes, what are the Rules in connection to it.

Lesson 19

Loans and Investments by Companies

LESSON OUTLINE

- Introduction to investment
- Loans and investments by companies
- Comparison of section 186 with section 185
- Applicability of section 186 to Section 8 company
- Applicability of section 186 to a guarantee company not having share capital
- Register of loans made, guarantees given, securities provided and investments made.
- Inspection of register.
- Punishment for contravention and exemptions.
- Investments to be held in company's own name and exemptions.
- Register of investments not held in company's own name.

LEARNING OBJECTIVES

As per Section 186 of the Companies Act 2013, a company cannot, unless otherwise prescribed, make investment through more than 2 layers of investment companies except to comply with law and in case of acquisition of a foreign company. Compliance with this requirement may involve significant restructuring in many cases. Besides the section prescribes the limits beyond which special resolution is to be obtained for loans or investments etc.,

After reading this lesson you will be able to understand the provisions of the Companies Act, 2013(the Act) in relation to loans and investments by companies, the conditions wherein such loans and investments can/cannot be made. It also gives provisions for register of loans made, guarantees given, securities provided and investments made as also register of investments not held in company's own name. The lesson further lists the circumstances wherein companies are not required to keep the investments in its own name.

1. INTRODUCTION

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, for the purpose of this study, the term 'Investments' is used in a limited sense to mean the investment of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount. Thus apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.

Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013 by inserting Section 186. As of now, an overall limit of 60% of paid-up share capital plus free reserves and securities premium account or 100% of free reserves and securities premium account, whichever is more has been fixed.

Let us understand some terminologies used in Section 186 of the Companies Act 2013

Free reserves

As per section 2(43) "free reserves" means such reserves which, as per the latest audited balance Sheet of a company, are available for distribution as dividend:

Provided that—

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves;

"body corporate" or "corporation"

As per Section 2(11) "body corporate" or "corporation" includes a company incorporated outside India, but does not include—

- (i) a co-operative society registered under any law relating to co-operative societies; and
- (ii) any other body corporate (not being a company as defined in this Act),

which the Central Government may, by notification, specify in this behalf;

Investment Company & Infrastructure facilities

As per explanation to Section 186

- (a) the expression "investment company" means a company whose principal business is the acquisition of shares, debentures or other securities;

(b) the expression "infrastructure facilities" means the facilities specified in Schedule VI.

As per Schedule VI, the term "infrastructural projects" or "infrastructural facilities" includes the following projects or activities:—

(1) Transportation (including inter modal transportation), includes the following:—

- (a) roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services;
- (b) rail system, rail transport providers, metro rail roads and other railway related services;
- (c) ports (including minor ports and harbours), inland waterways, coastal shipping including shipping lines and other port related services;
- (d) aviation, including airports, heliports, airlines and other airport related services;
- (e) logistics services.

(2) Agriculture, including the following, namely:—

- (a) infrastructure related to storage facilities;
- (b) construction relating to projects involving agro-processing and supply of inputs to agriculture;
- (c) construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality.

(3) Water management, including the following, namely:—

- (a) water supply or distribution;
- (b) irrigation;
- (c) water treatment.

(4) Telecommunication, including the following, namely:—

- (a) basic or cellular, including radio paging;
- (b) domestic satellite service (i.e., satellite owned and operated by an Indian company for providing telecommunication service);
- (c) network of trunking, broadband network and internet services.

(5) Industrial, commercial and social development and maintenance, including the following, namely:—

- (a) real estate development, including an industrial park or special economic zone;
- (b) tourism, including hotels, convention centres and entertainment centres;
- (c) public markets and buildings, trade fair, convention, exhibition, cultural centres, sports and recreation infrastructure, public gardens and parks;
- (d) construction of educational institutions and hospitals;
- (e) other urban development, including solid waste management systems, sanitation and sewerage systems.

(6) Power, including the following:—

- (a) generation of power through thermal, hydro, nuclear, fossil fuel, wind and other renewable sources;

- (b) transmission, distribution or trading of power by laying a network of new transmission or distribution lines.
- (7) Petroleum and natural gas, including the following:—
- (a) exploration and production;
 - (b) import terminals;
 - (c) liquefaction and re-gasification;
 - (d) storage terminals;
 - (e) transmission networks and distribution networks including city gas infrastructure.
- (8) Housing, including the following:—
- (a) urban and rural housing including public / mass housing, slum rehabilitation, etc;
 - (b) other allied activities such as drainage, lighting, laying of roads, sanitation and facilities.
- (9) Other miscellaneous facilities/services, including the following:—
- (a) mining and related activities;
 - (b) technology related infrastructure;
 - (c) manufacturing of components and materials or any other utilities or facilities required by the infrastructure sector like energy saving devices and metering devices;
 - (d) environment related infrastructure;
 - (e) disaster management services;
 - (f) preservation of monuments and icons;
 - (g) emergency services (including medical, police, fire and rescue).
- (10) such other facility service as may be prescribed.

Securities

As per Section 2(81) “securities” means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;

2. LOANS AND INVESTMENTS BY COMPANIES(Section 186)

Not more than two layers of investment companies(Section 186(1))

1. A company shall unless otherwise prescribed, make investment through not more than two layers of investment companies. [Sub-section (1) of section 186]

However, the aforesaid provisions shall not affect,—

- (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
- (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force. [Proviso to sub-section (1) of section 186]

Restriction on providing loans, guarantees and investment (Section 186(2))

No Company shall, directly or indirectly:

- (a) give any loan to any person or other body corporate;

(b) give any guarantee, or provide security, in connection with a loan to any other person body corporate or person; and

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more unless the same is previously authorised by a special resolution passed in a general meeting.

Loan/investment to be made with the approval of all the directors at the Board Meeting(Section 186(5))

No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all directors present at the meeting.



State whether the following statement is “True” or “False”

Section 186 except sub-section (1) therein does not apply to a Banking Company.

- True
- False

Correct answer: True

Note: Every proposal for making loan to any other body corporate, exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more, shall be approved at the general meeting by way of special resolution. [Section 186(3)]

Disclosure in financial statements (Section 186(5))

The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

Prior Approval of Financial Institution (Section 186(5))

The company has to obtain prior approval of the public financial institution concerned where any term loan is subsisting. Section 185(5) provides that no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it, is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, alongwith the investments, loans, security or guarantee proposed to be made or given does not exceed the limit of 60% specified above and there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution. [Proviso Section 186(5)]

Prior approval by Special Resolution

Section 186(3) read with Rule 13 states that

- (1) Where the aggregate of the loans and investment so far made, the amount for which guarantee or

security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under section 186 no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

Explanation.- For the purpose of this sub-rule, it is clarified that it would sufficient compliance if such special resolution is passed within one year from the date of notification of this section.

(2) A resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition:

Provided, that the company shall disclose to the members in the financial statement the full particulars in accordance with the provision of sub-section (4) of section 186.

Rule 11 of Companies (Meetings of Board and its Powers) Rules, 2014 states that

(1) when a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of sub-section (3) of section 186 shall not apply.

Loans and investments by intermediaries etc(Section 186(6))

No company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

Pursuant to the above provisions no stock broker, sub-broker, share transfer agent, banker to issue, Registrar to an issue, Merchant Baker, underwriter, portfolio manager, investment advisor or any intermediary associated with capital market and which is registered under section 12 of the SEBI Act, shall make loans or investments or give guarantees or provide security in excess of the limits specified above. [Rule 11(3)]

Rate of interest(Section 186(7))

Loan given under this section shall carry the rate of interest not lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

Default subsists with respect to repayment of deposits(Section 186(8))

No company, which is in default in repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall give any loan or give any guarantee, or provide any security or make an acquisition till such default is subsisting.

This prohibition will operate in respect of any default made under Section 73 to 76 and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.

5. REGISTER OF LOANS MADE, GUARANTEES GIVEN, SECURITIES PROVIDED AND INVESTMENTS MADE

Sub-section (9) of section 186 provides that every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars

and shall be maintained in such manner as may be prescribed.

Rule 12 states that

- (1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.
- (2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.
- (3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.
- (4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.
- (5) For the purpose of sub-rule (4), the register can be maintained either manually or in electronic mode.
- (6) The extracts from the register maintained under sub-section (9) of section 186 may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

Inspection of Register

Sub-section (10) of section 186 provides that the register referred to in sub-section (9) shall be kept at the registered office of the company and —

- (a) shall be open to inspection at such office; and
- (b) extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

Offence and Penalty

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees. [Section 186(3)]

Exemptions

Sub-section (11) of section 186 provides that Nothing contained in section 186, except sub-section (1), shall apply—

- (a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;
- (b) to any acquisition—
 - (i) made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities:

Provided that exemption to non-banking financial company shall be in respect of its investment and lending activities;

- (ii) made by a company whose principal business is the acquisition of securities;
- (iii) of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.

(2) For the purposes of clause (a) of sub-section (11) of section 186, the expression "business of financing of companies" shall include, with regard to a Non-Banking Financial Company registered with Reserve Bank of India, "business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business".

Section 186 compared with Section 185

It should be noted that the provisions of Section 185 of the Companies Act will be applicable in case a loan is given by a company to another private company in which a director of the first company is a director or member. As a result, such a loan would be void unless it is given to a managing director or whole-time director pursuant to a scheme approved by the members by way of a special resolution. Also in cases where one or more directors of the a company exercise 25% or more of the total voting power in any other body corporate, no loan can be given by such company to that body corporate as it is prohibited under section 185.

Applicability of Section 186 to Section 8 Company or a guarantee Company not having share capital

The provisions of Section 186 shall also apply to these Companies. In such cases where there is no share capital, computation shall be based upon the free reserves of the company if any.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Every proposal for making loan to any other body corporate, in excess of the limits exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more, is not liable for approval at the general meeting.

- True
- False

Correct answer: False

INVESTMENTS TO BE HELD IN COMPANY'S OWN NAME

According to Sub-section (1) of Section 187, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name.

The requirement that the investment made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. In a case where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. Therefore, the investments by the company as a trustee and held in the name of the beneficiaries is allowed.

As per proviso to section 187(1), the company may hold any shares in its subsidiary company in the name of

any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

CASE LAW

Where the shares of a company were registered in the joint names of the company and one of its directors, it was held that the director was a nominee of the company for that purpose and could only act jointly as he had no rights of his own. [*Exchange Travel (Holdings) Ltd. Re*, (1991) BCLC 728 (Ch D)].

If company holds shares in dematerialised form, the name of depository is entered in the register of members as member of the company and the name of the investing company as the beneficial owner of the said shares.

Exemptions from applicability of Section 187(1)

1. In terms of the provisions of Section 187(2), Section 187(1) does not prevent a company:
 - (a) from depositing with the bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or
 - (b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof. However, if within a period of 6 months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or
 - (c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.
 - (d) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME

According to sub-section (3) of section 187 where in pursuance of clause (d) of sub-section (2), any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Therefore, a company is only required to maintain a register for securities not held in the name of the company, when the investments are held in the name of a depository.

Accordingly when any shares or securities in which investments have been made by a company are not held by it in its own name as a beneficial owner when such investments are held in the name of a depository pursuant to Section 187(2)(d), the company shall forthwith enter in a register maintained by it for the purpose, the prescribed particulars.

Companies (Meetings of Board and its Powers) Rules, 2014

Rule 14 of Companies (Meetings of Board and its Powers) Rules, 2014 states that

(1) Every company shall, from the date of its registration, maintain a register in Form MBP 3 and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(2) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(3) The register shall be maintained at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

(4) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

PUNISHMENT

According to section 187(4), if a company contravenes the provisions of section 187, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

Let us Remember

The company has to maintain register of loans, investments in Form MBP 2 and register of Investment beneficially held by the company but not held in the name of the company in MBP 3.

LESSON ROUND-UP

- 'Investments' has been used in a limited sense in the lesson to mean the investing of money in shares, stock, debentures or other securities.
- The power to invest the funds of the company is the prerogative of the Board of Directors. However, the Board must not misuse its powers. The Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Restrictions are also placed on the guarantees which the company can give or security it can provide for a loan.
- The provisions for restrictions on investments and loans by companies would also apply to Section 8 companies and guarantee companies not having a share capital.

- Approvals for making investments and loans would have to be taken in accordance with the specific provisions of the Companies Act. A blanket approval of the shareholders for the purpose would not suffice.
- The Companies Act provides for the particulars to be provided in the register of loans made, guarantees given, securities provided and investments made and the manner in which it is to be kept.
- Provisions have also been given in relation to inspection of such register and penalties imposable in case of defaults in maintaining the required registers.
- However, there are certain exemptions wherein these provisions would not be applicable.
- As per the Act, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name. This requirement is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. However, in certain circumstances, the Act exempts the companies from complying with the above provisions.
- When any shares or securities in which investments have been made by a company are not held by it in its own name as a beneficial owner when such investments are held in the name of a depository pursuant to permissible conditions given in the Act, the company shall forthwith enter in a register maintained by it for the purpose, particulars as specified in the Act.
- In case of default, the company is punishable with fine and every officer of the company who is in default shall be punishable with imprisonment or with fine or with both.

GLOSSARY

Dematerialization	The move from physical certificates to electronic book keeping. The share certificates are being removed and retired from circulation in exchange for electronic recording.
Rematerialization	This is the reverse of dematerialization, in rematerialization the share certificates are being moved from electronic book keeping to physical certificate.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. Discuss the law relating to loans and investments by companies.
2. Which companies are exempt from the provisions with regard to loans and investments by companies?
3. What particulars are required to be entered in the Register of Loans and Investments?
4. Your company, which is a public limited company wishes to make investments in shares of a company. The total investment exceeds the statutory limit stipulated by the Act. What are the formalities to be complied with in this regard?

Lesson 20

Deposits

LESSON OUTLINE

- Introduction
- Definition of certain terms used
- Prohibition of acceptance of deposit from public
- Conditions for acceptance of deposit from members
- Deposit repayment reserve
- Deposits accepted before the commencement of the Companies Act 2013
- Damages for fraud
- Acceptance of deposits from public by certain companies
- Other remedies provided under Companies Act 2013
- Companies (Acceptance of Deposits) Rules 2014

LEARNING OBJECTIVES

Acceptance of deposits by Non Banking Financial Companies are regulated by Reserve Bank of India, whereas the acceptance of deposits by non banking non-financial companies are regulated by the provisions of Companies Act and Companies (Acceptance of Deposits) Rules, 2014. It regulates aspects as to ceiling of total deposits, circular/advertisement, exemptions etc.

After reading this chapter you will be able to understand the meaning of deposits, procedural and regulatory aspects involved in accepting, renewal and repayment of deposits and consequences of failures in this regard.

"Bank failures are caused by depositors who don't deposit enough money to cover losses due to mismanagement".

– Dan Quayle

Introduction

Section 73 to 76 of the Companies Act (herein after called the Act) read with Rules made under Chapter V of the Companies Act, 2013(herein after called ‘the Rules’) regulate the invitation and acceptance of deposits. It prohibits acceptance of deposits except from the members through ordinary resolution or acceptance deposits by “eligible company” being a public company, subject to conditions specified in the rules. (Eligible company is defined under the rules based on net worth and turnover).

The Act read with the Rules also deals with various aspects including prohibition of acceptance of deposits except from the members, subject to conditions, inclusive definition of deposit, eligible company, depositor etc., conditions for acceptance of deposits such as approval of shareholders in a general meeting, credit rating, provision of deposit insurance, trustees of deposit holders etc., In addition the act protect the interest of depositor through Section 37 and 245(class action suit by requisite number of depositors)of the Act. In addition the act provides for stringent penalty for any violations in complying with the provisions of this Act, in this regard.

Proviso to Section 73(1) read with rule 1(3) of Companies (Acceptance of Deposits) Rules 2014 excludes banking Companies, non-banking financial companies as defined in the Reserve Bank of India Act, 1934 and registered with Reserve Bank of India, a housing finance company registered with National Housing Bank established under the National Housing Bank Act 1987 and any other company as may be specified by the government in this regard.

Definition of certain terms used

What is a deposit?

Section 2(31) of the Companies Act (herein after called the act) defines deposit as under “deposit” includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India;

What is not a deposit?

Inclusive Definition of the word “Deposit” under Rule 2(1)(c) of Rules made under Chapter V is as under

“Deposit” includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include-

- (i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of parliament or a state legislature;
- (ii) any amount received from foreign Governments, foreign/international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign government owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 and rules and regulations made there under;
- (iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking institution notified by the Central Government under

section 51 of the Banking Regulation Act, 1949 (10 of 1949), or a corresponding new bank as defined in clause (d) or clause (b) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934) ;

- (iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India, regional financial institutions, Insurance Companies, Scheduled Banks as defined in the Reserve Bank of India Act, 1934;
- (v) any amount received against issue of commercial paper or any other instrument issued in accordance with the guidelines or notification issued by the Reserve Bank of India;
- (vi) any amount received by a company from any other company;
- (vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for. If the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules. For the purpose of this rule any adjustment of the amount for any other purpose will not be treated as refund;
- (viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company. The director from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others;
- (ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds/ debentures compulsorily convertible into shares of the company within five years. If such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;
- (x) any amount received from an employee not exceeding his annual salary, under a contract of employment with the company in the nature of non-interest bearing security deposit;
- (xi) any non-interest bearing amount received or held in trust;
- (xii) any amount received in the course of or for the purposes of the business of the company:
 - (a) as an advance for the supply of goods or provision of services provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from acceptance of such advance. In case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply.
 - (b) as advance, accounted for in any manner whatsoever, received in connection with consideration for property under an agreement or arrangement, provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement.

- (c) as security deposit for the performance of the contract for supply of goods or provision of services.
- (d) As advance received under long term projects or for supply of capital goods except those covered under item (b) above.

If the amount received under (a) (b) and (d) above becomes refundable (with or without interest) because the company accepting the money does not have necessary permission or approval to deal in the goods or properties or services for which the money is taken, the amount received shall be deemed to be a Deposit under these rules.

Explanation: For the purpose of sub-clause the amount referred to in the first proviso shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

- (xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions:-

 - (a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance; and
 - (b) the loan is provided by the promoters themselves or by their relatives or by both and
 - (c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter.

- (xiv) any amount accepted by a Nidhi Company in accordance with the rules made under Section 406 of the Act.

For the purposes of this clause, any amount.-

- (a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or
- (b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be treated as a deposit.

Who is depositor?

Rule 2(1)(d) under Chapter V defines depositor as under

'Depositor' means-

- (i) any member of the company who has made a deposit with the company in accordance with sub-section (2) of section 73 of the Act, or
- (ii) any person who has made a deposit with a public company in accordance with section 76 of the Act.

Who is an Eligible Company?

Rule 2(1)(e) of Rules made under Chapter V defines eligible company as under

"Eligible company" means a public company as referred to in sub- section (1) of section 76, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits;

Provided that an eligible company, which is accepting deposits within the limits specified under clause (c) of sub-section (1) of section 180, may accept deposits by means of an ordinary resolution;

"Trustee" means the Trustee as defined in section 3 of the Indian Trusts Act, 1882.

Prohibition on acceptance of deposits from public

Section 73(1) states that, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under Chapter V.

Exceptions

Proviso to Section 73(1) prohibition, does not apply to

- a banking company and
- non-banking financial company as defined in the Reserve Bank of India Act, 1934 and
- to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

Conditions for acceptance of deposits from Members

Section 73(2) states that a company may, subject to

- (i) the passing of a resolution in general meeting and
- (ii) subject to such rules as may be prescribed in consultation with the Reserve Bank of India,

accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:—

- (a) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;
- (b) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;
- (c) depositing such sum which shall not be less than fifteen per cent. of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;
- (d) providing such deposit insurance in such manner and to such extent as may be prescribed;
- (e) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and
- (f) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company. In case when a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as "unsecured deposits" and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

Section 73(3) states that every deposit accepted by a company under sub-section (2) shall be repaid with

interest in accordance with the terms and conditions of the agreement referred to in that sub-section.

Section 73(4) states that when a company fails to repay the deposit or part thereof or any interest thereon under sub-section (3), the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

Deposit Repayment reserve

Section 73(5) states that the deposit repayment reserve account referred to in clause (c) of sub-section (2) shall not be used by the company for any purpose other than repayment of deposits.

Rules under Chapter V

Rule 3- Terms and conditions as to acceptance of deposits

Rule 3 under Chapter V states that on and from the commencement of these rules,—

- No company under sub-section (2) of section 73 and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice, within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit:

Exceptions to the Rule (3)

A company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to the condition that-

- (a) such deposits shall not exceed ten per cent of the aggregate of the paid up share capital and free reserves of the company, and
- (b) such deposits are repayable not earlier than three months from the date of such deposit or renewal thereof.

Joint names

Deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor", if the depositors desires so. [Rule 3(2)]

Rule 3(3) states that no company referred to in sub-section (2) of section 73 shall accept or renew any deposits if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds 25 per cent of the aggregate of the paid-up share capital and free reserves of the company.

Rule 3(4) states that no Eligible company shall accept or renew

- (a) Any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent of the aggregate of the paid-up share capital and free reserves of the company;
- (b) Any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in (a), outstanding on the date of acceptance or renewal exceeds 25% aggregate of the paid-up share capital and free reserve of the company.

Rule 3(5) - deposits by Government Companies

No Government company eligible to accept deposits under section 76 shall accept or renew any deposit, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent. of the aggregate of its paid up share capital and free reserves of the company.

Rule 3(6) -Rate of interest of deposits/payment of brokerage.

Rule 3(6) states that no company under sub-section (2) of section 73 or any Eligible company shall invite or accept or renew any deposits in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies.

Who is eligible to receive brokerage?

Only the person who is authorized, in writing, by a company to solicit deposits on its behalf and through whom deposits are actually procured will be entitled to the brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of these Rules. [Explanation to Rule 3(6)]

Rule 3(7) states that the company shall not reserve to itself either directly or indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted.

Rule 4- Form and particulars of advertisements/circulars.

- (1) Every company referred to in sub-section (2) of section 73 intending to invite deposit from its members shall issue a circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1. In addition to issue of such circular to all members in the manner specified above, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.
- (2) Every eligible company intending to invite deposits shall issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper and in vernacular language in one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.
- (3) Every company inviting deposits from the public shall upload a copy of the circular on its website, if any.
- (4) No company shall issue or allow any other person to issue or cause to be issued on its behalf, any circular or a circular in the form of advertisement inviting deposits, unless such circular or circular in the form of advertisement is issued on the authority and in the name of the Board of directors of the company.
- (5) No circular or a circular in the form of advertisement shall be issued by or on behalf of a company unless, not less than thirty days before the date of such issue, there has been delivered to the Registrar for registration a copy thereof signed by a majority of the directors of the company as constituted at the time the Board approved the circular or circular in the form of advertisement, or their agents, duly authorised by them in writing.
- (6) A circular or circular in the form of advertisement issued shall be valid until the expiry of six months

from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier, and a fresh circular or circular in the form of advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

For the purpose of this rule, the date of the issue of the newspaper in which the advertisement appears shall be taken as the date of issue of the advertisement and the effective date of issue of circular shall be the date of dispatch of the circular. [Explanation to the Rule 4(6)]

Rule 5 –Deposit Insurance

(1) Every company referred to in sub-section (2) of section 73 and every other eligible company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be. For the purposes of this sub-rule, the amount as specified in the deposit insurance contract shall be deemed to be the amount in respect of both principal amount and interest due thereon.

(2) The deposit insurance contract shall specifically provide that in case the company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits and the interest thereon by the insurer up to the aggregate monetary ceiling as specified in the contract. In the case of any deposit and interest not exceeding twenty thousand rupees, the deposit insurance contract shall provide for payment of the full amount of the deposit and interest and in the case of any deposit and the interest thereon in excess of twenty thousand rupees, the deposit insurance contract shall provide for payment of an amount not less than twenty thousand rupees for each depositor.

(3) The amount of insurance premium paid on the insurance of such deposits shall be borne by the company itself and shall not be recovered from the depositors by deducting the same from the principal amount or interest payable thereon.

(4) If any default is made by the company in complying with the terms and conditions of the deposit insurance contract which makes the insurance cover ineffective, the company shall either rectify the default immediately or enter into a fresh contract within thirty days and in case of non-compliance, the amount of deposits covered under the deposit insurance contract and interest payable thereon shall be repaid within the next fifteen days and if such a company does not repay the amount of deposits within said fifteen days it shall pay fifteen per cent. interest per annum for the period of delay and shall be treated as having defaulted and shall be liable to be punished in accordance with the provisions of the Act.

Rule 6 – Creation of Security

(1) For the purposes of providing security, every company referred to in sub-section (2) of section 73 and every eligible company inviting secured deposits shall provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance. In the case of deposits which are secured by the charge on the assets referred to in Schedule III of the Act excluding intangible assets, the amount of such deposits and the interest payable thereon shall not exceed the market value of such assets as assessed by a registered valuer. For the purposes of this sub-rule it is clarified that the company shall ensure that the total value of the security either by way of deposit insurance or by way of charge or by both on company's assets shall not be less than the amount of deposits accepted and the interest payable thereon.

For the purposes of proviso to sub-clause (ix) of clause (c) of sub-rule (1) of rule 2 and this sub-rule, it is hereby clarified that pending notification of sub-section (1) of section 247 of the Act and finalisation of qualifications and experience of valuers, valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.

(2) The security (not being in the nature of a pledge) for deposits as specified in sub-rule (1) shall be created in favour of a trustee for the depositors on:

- (a) specific movable property of the company, or
- (b) specific immovable property of the company wherever situated, or any interest therein.

Rule 7 Appointment of deposit trustees.

Consent of deposit trustees with respect to their appointment

No company under sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more deposit trustees for depositors for creating security for the deposits. A written consent shall be obtained from the deposit trustee(s) before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the deposit trustee(s) have given their consent to the company to be so appointed.

Execution of deposit trust deed before issuing advertisement

(2) The company shall execute a deposit trust deed in Form No. DPT-2 at least 7 days before issuing the circular or circular in the form of advertisement.

Certain persons not to be appointed as deposit trustees

- (3) No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the deposit holders, if the proposed trustee -
 - (a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;
 - (b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
 - (c) has any material pecuniary relationship with the company;
 - (d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;
 - (e) is related to any person specified in clause (a) above.

Removal of deposit trustees

(4) No deposit trustee may be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board. In case the company is required to appoint independent directors, at least one independent director shall be present in such meeting of the Board

Rule 8 Duties of deposit trustees.

It shall be the duty of every deposit trustee to-

- (1) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon;
- (2) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act;
- (3) ensure that the company does not commit any breach of covenants and provisions of the trust deed;
- (4) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits;
- (5) take steps to call a meeting of the holders of depositors as and when such meeting is required to be held;
- (6) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance;
- (7) do such acts as are necessary in the event the security becomes enforceable;
- (8) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances.

Rule 9- Meeting of depositors through deposit trustee

The meeting of all the depositors shall be called by the deposit trustee on- (1) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding; (2) the happening of any event, which constitutes a default or which in the opinion of the deposit trustee affects the interest of the depositors.

Rule 10 - Form of application for deposits.

- (i) On and from the commencement of these rules, no company shall accept, or renew any deposit, whether secured or unsecured, unless an application, in the form prescribed by the company, is submitted by the intending depositor for the acceptance of such deposit.
- (ii) The application referred to in rule 10(i) shall contain a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

Rule 11 - Nomination

A depositor may, at any time, make a nomination and the provisions of section 72 shall, as far as may be, apply to the nomination made under this Rule.

Rule 12 -Furnishing of deposit receipts to depositors.

Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a deposit receipt for the amount received by the company, within a period of two weeks from the date of receipt of money or realization of cheques.

Deposit receipt referred to above shall be signed by an officer of the company duly authorized by the Board in this behalf and shall state the date of deposit, the name and address of the depositor, the amount received by the company as deposit, the rate and periodicity of interest payable thereon and the date on which the deposit is repayable.

Rule 13- Maintenance of liquid assets and creation of Deposit Repayment Reserve Account.

Every company referred to in sub-section (2) of section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said sub-section with any scheduled bank and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits. The amount remaining deposited shall not at any time fall below fifteen per cent. of the amount of deposits maturing, until the end of the current financial year and the next financial year.

Rule 14 -Registers of deposits.

(1) Every company accepting deposits shall, from the date of such acceptance, keep at its registered office one or more separate registers for deposits accepted/renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

- (a) Name, address and PAN of the depositor/s;
- (b) Particulars of guardian, in case of a minor;
- (c) Particulars of the nominee;
- (d) Deposit receipt number;
- (e) Date and amount of each deposit;
- (f) Duration of the deposit and the date on which each deposit is repayable;
- (g) Rate of interest;
- (h) Due date(s) for payment of interest;
- (i) Mandate and instructions for payment of interest and for non-deduction of tax at source, if any;
- (j) Date or dates on which payment of interest will be made;
- (k) Details of deposit insurance including extent of deposit insurance;
- (l) Particulars of other security/ charge created;
- (m) Any other particulars relating to the deposit;

(2) Entries in the register shall be made within seven days from the date of issuance of the deposit receipt and such entries shall be authenticated by a director or secretary of the company or by any other officer authorized by the Board for this purpose.

(3) The register or registers referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

Rule 15 - General provisions regarding premature repayment of deposits.

When a company makes a repayment of deposits, on the request of the depositor, after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted, the rate of interest payable on such deposit shall be reduced by one per cent. from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run and the company shall not pay interest at any rate higher than the rate so reduced. Nothing contained in this rule shall apply to the repayment of any deposit before the expiry of the period for which such deposit was accepted by the company, if such repayment is made solely for the purpose of—

- (a) complying with the provisions of rule 3; or
- (b) providing war risk or other related benefits to the personnel of the naval, military or air forces or to

their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under article 352 of the Constitution :

When a company referred to in under sub-section (2) of section 73 or any eligible company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of a higher rate of interest, the company shall pay interest to such depositor at the higher rate if such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit. For the purposes of this rule, where the period for which the deposit had run contains any part of a year, then, if such part is less than six months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year.

Rule 16 - Return of deposits to be filed with the Registrar.

Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.

Rule 17- Penal rate of interest.

Every company shall pay a penal rate of interest of eighteen per cent. per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid..

Rule 18 - Power of Central Government to decide certain questions.

If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

Rule 19 - Applicability of sections 73, 74 and 75 to eligible companies

Pursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73, 74 and 75 shall, mutatis mutandis, apply to acceptance of deposits from public by eligible companies.

It may be noted that

For the purposes of this rule, it is hereby clarified that in case of a company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and rules made under that Act (hereinafter known as "Earlier Deposits") and has been repaying such deposits and interest thereon in accordance with such provisions, the provisions of clause (b) of sub-section (1) of section 74 of the Act shall be deemed to have been complied with if the company complies with requirements under the Act and these rules and continues to repay such deposits and interest due thereon on due dates for the remaining period of such deposit in accordance with the terms and conditions and period of such Earlier Deposits and in compliance with the requirements under the Act and these rules. The fresh deposits by every eligible company shall have to be in accordance with the provisions of Chapter V of the Act and these rules; Without prejudice to above, in case of deposits accepted by an eligible company under section 76 of the Act, the provisions of sub- section (3) and (4) of section 73, provisions of sub-sections (2) and (3) of section 74 and provisions of section 75 shall be applicable irrespective of the fact that such deposits were not accepted by the company before the commencement of this Act.

Deposit accepted before the commencement of the Act

Section 74(1) states that when, in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

- (a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and
- (b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Rule 20 of the Companies (Acceptance of deposits) Rules, 2014 provides that for the purpose of clause (a) of Section 74(1), the statement shall be in Form DPT-4.

Section 74(2) states that the tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

Section 74(3) states that if a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

Damages for fraud

Section 75(1) states that when a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

Section 75(2) states that any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

Acceptance of deposit from public by certain companies

Section 76(1) states that notwithstanding anything contained in section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (2) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe.

Such a company shall be required to obtain the rating (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits. [First Proviso to Section 76(1)]

Every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the

deposit holders in accordance with such rules as may be prescribed. [Second Proviso to Section 76(2)]

Section 76(2) states that the provisions of this Chapter shall, mutatis mutandis, apply to the acceptance of deposits from public under this section.

Other remedies provided under Companies Act 2013

As per Section 245(1)(g) requisite number of depositor or depositors may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the depositors for seeking orders including claiming damages or compensation or demand any other suitable action from or against—

- the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
- the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
- any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
- to seek any other remedy as the Tribunal may deem fit.

Section 245 (2) states that when the depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

Section 245(3) (ii) states that the requisite number of depositors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

LESSON ROUND UP

The provisions of Companies Act 2013 read with rules made under Chapter V, has brought several revamping aspects to protect the interest of depositors. The gist of provisions discussed above is as follows.

- Company may accept deposit from its members by passing a resolution in general meeting and subject to conditions as may be prescribed in the Rules including Credit rating, Deposit insurance etc.,
- Public companies may accept deposits, if it has a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits.
- No company under sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more deposit trustees for creating security for the deposits.
- Contract providing for deposit insurance at least thirty days before the issue of circular or advertisement.

- Companies accepting deposit from members or eligible companies as defined, has to fulfill the conditions specified in Companies(Acceptance of Deposits)Rules 2014.

GLOSSARY

Repatriation Capital flow from a foreign country to the country of origin. This usually refers to returning returns on a foreign investment in case of a corporation, or transferring foreign earnings home in case of an individual.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Explain the manner in which the Companies Act, 2013 regulates and controls the invitation for and acceptance of deposits by the companies from their members and the public at large.
 2. Discuss the limits of accepting 'deposits' as prescribed under the Companies (Acceptance of Deposits) Rules, 2014 as amended up-to-date.
 3. What are the legal requirements if a company wants to invite deposits from the public?
 4. What transactions are not deemed to be deposits?
 5. What are the particulars to be included in a circular or circular in the form of advertisement inviting deposits by a company?
 6. What is the validity period of such a circular or circular in the form of advertisement inviting deposits by a company?
 7. What kind of deposits are not deposits as per the definition of 'deposits' under the Companies (Acceptance of Deposits) Rules, 2014?
 8. Explain:
 - (a) Non-financial companies can accept deposits.
 - (b) Circular or circular in the form of advertisement in the context of public deposits.
 9. Write short notes on Return of deposits.

Lesson 21

I. Accounts and Audit

LESSON OUTLINE

- Requirement of keeping books of account.
- Maintenance of books in electronic mode
- Inspection of books of account.
- Financial statements and consolidated financial statements
- National Financial Reporting Authority (NFRA)
- Corporate social responsibility
- Internal audit
- Appointment, qualification, disqualification, removal of auditors
- Casual vacancy in the office of auditor
- Audit Report
- Branch audit
- Auditing standards
- Powers of tribunal
- Cost records and audit

LEARNING OBJECTIVES

The health of a business is shown by the books of account of the company. The company is maintaining the records through the books as required by statute or as per the need of the hour. But, the maintenance of the books of account is not enough. The verification and checking is also important.

The checking of books of account is known as auditing. The auditing is also known as post mortem of books. It is helpful in the future planning. The auditing is done by the auditor. In India, the statutory audit is conducted by statutory auditor. It is mandatory in nature. Every company is required to audit its books of account. It is not only statutory audit which is in existence; now a days, the cost audit, Secretarial audit, management audit etc. are also conducted by the companies. It is helpful in the formulation of the company's policies.

After reading this lesson, you will be able to understand the provisions about keeping books of account, inspection of books of account and other provisions for balance sheet and profit and loss account under the Companies Act. It also discusses provisions for audit and auditors, their appointment, qualifications, resignation, removal, duties and liabilities.

1. ACCOUNTS OF COMPANIES

The shareholders provide capital to the company for running the business. They are in a way, the owners of the company. But, all of them cannot take part in managing the affairs of the company as their number is usually much more. But they have every right to know as to how their money has been dealt with by the directors in a particular period. This is why perhaps compulsory disclosure through annual information to the shareholders by the directors about the working and financial position of the company enables them to exercise a more intelligent and purposeful control over the affairs of the company. For preparation of annual accounts the maintenance of proper books of account is a must. Section 128 of the Companies Act, 2013 contains the provisions for books of account etc. to be kept by company.

REQUIREMENT OF KEEPING BOOKS OF ACCOUNT (SECTION 128)

Maintenance of books of account would mean records maintained by the company to record the specified financial transaction. It has been specifically provided that every company shall keep proper books of account. This section specifies the main features of proper books of account as under –

- (i) The company must keep the books of account with respect to items specified in clauses (i) to (iv) of sub-section 2(13) of the Companies Act, 2013 hereinafter referred as Act, which defines “books of account”.
- (ii) The books of account must show all money received and expended, sales and purchases of goods and the assets and liabilities of the company.
- (iii) The books of account must be kept on accrual basis and according to the double entry system of accounting.
- (iv) The books of account must give a true and fair view of the state of the affairs of the company or its branches.

“books of account” as defined in Section 2(13) includes records maintained in respect of—

- (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- (ii) all sales and purchases of goods and services by the company;
- (iii) the assets and liabilities of the company; and
- (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

Place of Keeping Books of Account

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place.

Maintenance of Books of account in electronic form

The maintenance of books of account and other books and papers in electronic mode is permitted and is optional. Such books of accounts or other relevant books or papers maintained in electronic mode shall

remain accessible in India so as to be usable for subsequent use (the Companies (Accounts) Rules, 2014 hereinafter referred in this Chapter as Rule) (Rule 3(1)).

The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered (Rule 3(2)).

The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches (Rule 3(3)).

The information in the electronic record of the document shall be capable of being displayed in a legible form (Rule 3(4)).

There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:

Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis. (Rule 3(5))

The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement -

- (a) the name of the service provider;
- (b) the internet protocol address of service provider;
- (c) the location of the service provider (wherever applicable);
- (d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider. (Rule 3(6)).

Books of Account in Respect of Branch Office

The branches of the company, if any, in India or outside India shall also keep the books of account in the same manner as specified in sub- section (1), for the transaction effected at the branch office. Further the branch offices are required to send the proper summarized return at quarterly intervals to the company at its registered office and kept open to directors for inspection.

Accrual basis and Double-entry system of accounting

According to sub-section (1), books of account are required to be kept on accrual basis and in accordance with the double entry system of accounting.

Accrual basis of accounting is an accounting assumption or an accounting concept followed in preparation of the financial statements. Accrual concept is one of the four principles or accounting concepts, which involves recording income and expenses as they accrue, as distinct from when they are received or paid. The main feature of the accrual concept is that the accounting period covers only the revenue and expense transactions of that period and ignores the timing of actual cash receipts and payments. In this method, revenues and expenses are identified with specific period of time, such as a month or a year, and are recorded as 'incurred' along with acquired assets, without regard to the date of actual receipt or payment of cash in any form.

Double entry book-keeping is a method of recording any transactions of a business in a set of accounts, in

which every transaction has a dual aspect of debt and credit and therefore, needs to be recorded in at least two accounts. For example, when a person (debtor) pays cash to a business for goods he has purchased, the cash held by the business is increased and the amount due from the debtor is decreased by the same amount; similarly, when a purchase is made on credit, the purchase account is debited and the amount owed to creditor is increased by the same amount. This double aspect enables effective control of business because all the books of accounts must balance. Thus, double entry book-keeping is a method in which every transaction is recorded in a business in such a manner that it involves one or more debit entries and one or more credit entries. The debit entries / amount must equal the credit entries / amount for each transaction recorded.

Inspection by directors

As provided in sub-section (3) of Section 128, any director can inspect the books of accounts and other books and papers of the company during business hours. The expression "Books and Papers" has been defined in section 2(12) which includes accounts, deeds, vouchers, writings and documents. The company is, therefore, required to make available the aforesaid books and papers for inspection by any directors. Such inspection may be done by any type of director- nominee, independent, promoter or whole time.

The proviso to sub-section 3 provides that a director of the Company can inspect the books of accounts of the subsidiary, only on authorisation by way of the resolution of Board of Directors. Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought and the period for which such information is sought (Rule 4(2)). The said information shall be provided to director within 15 days of receipt of request (Rule 4(3)). The director can seek the information only individually and not by or through his attorney holder or agent or representative (Rule 4(4)).

The right to inspect books of accounts and other books and papers under this section has been provided to the directors only.

Period for which books to be preserved

The books of accounts, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year. In case of a company incorporated less than eight years before the financial year, the books of accounts for the entire period preceding the financial year together with the vouchers shall be so preserved. The provisions of Income Tax Act shall also be complied with in this regard.

As per proviso to sub-section 5, where an investigation has been ordered in respect of a company under Chapter XIV of the Act related to inspection, inquiry or investigation, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.

Persons responsible to maintain books

The person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of accounts etc. shall be: (sub-section 6)

- (i) Managing Director,
- (ii) Whole-Time Director, in charge of finance
- (iii) Chief Financial Officer
- (iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

Penalty

In case the aforementioned persons referred to in sub-section (6) (i.e. MD, WTD, CFO etc.) fail to take reasonable steps to secure compliance of this section and thus, contravene such provisions, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or both.

SECTION 129: FINANCIAL STATEMENT

This Section seeks to provide that the financial statements shall give a true and fair view of the state of affairs of the companies in the form as provided for different class or classes in Schedule III and shall comply with accounting standards. Insurance companies, banking company, companies engaged in generation / supply of electricity or any other class of companies shall make financial statements in the form as has been specified in or under the Act governing such companies. The financial statement shall be laid in the annual general meeting of that financial year. In case of subsidiary companies, the company shall prepare a consolidated financial statement of the Company and all subsidiaries and lay before the annual general meeting. The Central Government shall have the power to exempt a class or classes of companies from any of the requirements of this section. The section also provides the penalty where company contravenes the provision of this section.

Definition of Financial Statement

Financial Statement is defined under Section 2 (40), to include -

- Balance Sheet
- Profit and Loss account or Income and Expenditure account
- Cash flow Statement
- Statement of change in equity, if applicable
- any explanatory notes annexed to or forming part of financial statements, giving information required to be given and allowed to be given in the form of notes.

However, the financial statement with respect to one person company, small company and dormant company, may not include the cash flow statement.

Financial statements should be prepared for financial year and shall be in form as per Schedule III.

True and Fair view

As per provisions of sub-sections (1) and (2), every financial statement of the company must give true and fair view of the state of affairs of the company at the end of financial year. True and Fair view in respect of financial statement means-

- financial statements and items contained should comply with accounting standards notified under section 133;
- financial statement shall be in form or forms as provided for different class or classes of companies in Schedule III;
- in case of any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, not treated to be disclosing a true and fair view of the state of affairs of the company, merely by the reason of the fact that they do not disclose -

- in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
- in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
- in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
- in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Other Requirements for financial statements

- (a) Financial statements shall lay before the board of the directors in every annual general meeting of a company.
- (b) Where a company has one or more subsidiaries, in addition to financial statement provided in sub-section 2, it shall prepare a consolidated financial statement of the company with salient features of financial statements of subsidiary and subsidiaries in such form as prescribed and the same shall be laid before board in annual general meeting.
- (c) Central Government may prescribe for the consolidation of accounts of companies.
- (d) Where financial statements of the company do not comply with the applicable accounting standards, the company shall disclose the following:
 - (i) the deviation from the accounting standards
 - (ii) the reason for such deviation and
 - (iii) financial effects arising out of such deviation
- (e) Central Government may exempt any class or classes of the companies from complying with any of the requirements of this section or the rules there under, either conditionally or unconditionally as may be specified in the notification.
- (f) Central Government may notify the class of companies to mandatorily file their financial statements in Extensible Business Reporting Language (XBRL) format and also the manner of such filing. (Rule 9.3(1))
- (g) Financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes.

Persons responsible for compliance

The persons responsible to take all reasonable steps to secure compliance by the company with the requirement of Section 129 are (sub-section 7)-

- Managing Director
- Whole-Time Director
- CFO
- Other person of a company charged by the Board with the duty of complying with requirements of section 129.

Where any of the aforementioned officers are absent, all the directors shall be responsible and punishable.

Penalty

In case persons referred to in sub-section (7) fail to take reasonable steps to secure compliance or contravene provisions of this section, they shall in respect of each offence be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

Form of Financial Statements (Schedule III)

The financial statements shall be in the form or forms as may be provided for different class or classes of companies. Schedule III contains general instructions for preparation of balance sheet and statement of profit and loss account.

Balance sheet

In balance sheet, assets and liabilities shall be divided into current and non-current. Company shall disclose the details of the following in the Notes to accounts –

- (a) share capital
- (b) reserves and surplus
- (c) long term borrowings
- (d) other long term liabilities
- (e) long term provisions
- (f) short term borrowings
- (g) other current liabilities
- (h) short term provisions
- (i) tangible assets
- (j) intangible assets
- (k) non-current investments
- (l) long term loans and advances
- (m) other non-current assets
- (n) current investments
- (o) inventories
- (p) trade receivables
- (q) cash and cash equivalents
- (r) short term loans and advances
- (s) other current assets
- (t) contingent liabilities and commitments (to the extent not provided for)
- (u) proposed dividend to equity and preference shareholders including arrears of fixed cumulative dividend on preference shares
- (v) unutilised amount from issue of securities made for specific purpose

- (w) Board's opinion on realisation value of assets other than fixed assets and non-current investments if such value is less than its value as stated in balance sheet.

Statement of Profit and Loss

Statement of profit and loss should disclose the following –

- (1) revenue from operators
- (2) other income
- (3) total revenue (1 + 2)
- (4) expenses
- (5) profit before exceptional and extra ordinary items and tax (3 - 4)
- (6) exceptional items
- (7) profit before extraordinary items and tax (5-6)
- (8) extra ordinary items
- (9) profit before tax (7-8)
- (10) tax expense
- (11) profit (loss) for the period from continuing operations (9 – 10)
- (12) profit (loss) from discontinuing operations
- (13) Tax expense of discontinuing operations
- (14) Profit (loss) from discontinuing operations after tax (12 – 13)
- (15) Profit (loss) for the period (11 +14)
- (16) Earnings per equity share
 - (i) basic
 - (ii) diluted

It also contains general instructions for preparation of statement of profit and loss. These provisions shall also apply to the income and expenditure account.

Consolidated financial statements

All companies including unlisted companies and private companies having one or more subsidiary company is required to prepare consolidated financial statements. The clause does not exclude any company from such requirement except that Central Government may exempt any class or classes of companies from complying with any such requirement, conditionally or unconditionally, in public interest. Like financial statements, consolidated financial statements shall also comply with accounting standards.

The consolidated statements is required only if the company has one or more subsidiaries. The word 'subsidiary' includes both, associate company and joint venture. The term 'joint venture' has not been defined. Associate includes a joint venture. If the company has only a joint venture or an associate company but no subsidiary, even then, consolidation of financial statements shall be required.

The statement containing the salient feature of the financial statement of a company's subsidiary or subsidiaries, associate company or companies and joint venture or ventures under the first proviso to sub-

section (3) of section 129 shall be in Form AOC-1 (Rule 5).

The Consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III and Accounting Standards, subject however, that if the company is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act (Rule 6)

RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS (This section not notified)

Section 130 provides for provisions relating to re-opening or re-casting of books of accounts of the company. Accordingly,

- (i) A company shall not re-open its books of accounts and shall not recast its financial statements, unless an application in this regard is made by any one or more of the following -
 - (a) the Central Government, or
 - (b) the Income-tax authorities, or
 - (c) the Securities and Exchange Board of India (SEBI), or
 - (d) any other statutory regulatory body or authority or any person concerned, and
 - (e) an order in this regard is made by a court of competent jurisdiction or the Tribunal.
- (ii) The re-opening and recasting of financial statements is permitted only for the following reasons –
 - (a) the relevant earlier accounts were prepared in a fraudulent manner; or
 - (b) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.
- (iii) The Court or the Tribunal, as the case may be, shall give the notice to-
 - (a) the Central Government,
 - (b) the Income-tax authorities,
 - (c) the Securities and Exchange Board,
 - (d) any other statutory regulatory body or authority concerned and shall take into consideration the representations, if any, made by Central Government or the income tax authorities, Securities and Exchange Board or the body or authority concerned before passing any order under this section.
- (iv) The accounts so revised or re-cast under this section shall be final.

It may be noted that the Tribunal will include National Company Law Tribunal (NCLT). This provision provides for both, reopening of books after accounts have been closed and recast of financial statements.

Director's report of the year in which such provisions are invoked, should provide for the reasons or circumstances in which such revisions were warranted.

VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT (This section not notified)

Section 131 allows the directors to prepare revised financial statement or a revised Board's report if it appears to them that the company's financial statement or the Board's Report did not comply with the

requirements of Section 129 or Section 134, after obtaining approval of the Tribunal. The company is required to apply to the Tribunal. The application to the Tribunal shall be made within 2 weeks of the decision taken by the Board and the company shall disclose in the application if the majority of directors and auditors have been changed immediately before such decision. The Tribunal will issue notice and hear the auditor of original financial statement.

Tribunal shall give notice and take into account the representations, if any, of the Central Government and of the Income Tax Department. Such revised financial statements or report shall not be prepared or filed more than once in financial year. Further, where copies of financial statements or report has been sent out to members or delivered to registrar or laid before general meeting, the revisions must be confined to specified limits provided in the Section and .

A certified copy of the Order of the Tribunal shall be filed with the Registrar within 30 days of the date of receipt of the certified copy.

Such revision in financial statements or report cannot be prepared or filed more than once in a financial year. The detailed reasons for revision of such financial statements or report shall be disclosed in the Board's report in the relevant financial year in which such revision is being made.

On receipt of approval from Tribunal a General Meeting may be called. Notice of such General meeting along with reasons for change in Financial Statements may be published in Newspaper in English and in vernacular language. In such General Meeting, the said revised financial statements, statement of directors and the statement of auditors may be put up for consideration before a decision is taken on adoption of the revised financial statements.

On approval of the General Meeting, the revised financial statements along with the statement of auditors or revised report of the Board, as the case may be shall be filed with the Registrar within 30 days of the date of approval by the general meeting.

The Central Government may make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the correction to be made. The previous financial statement or report may be replaced by revised financial statement or revised report of the board, and supplemented by:

- (a) A summarised statement of revisions effected
- (b) The copy of the Order of the Tribunal.
- (c) The revised auditor's report on the revised financial statement, if applicable

It shall be ensure that the word "revised" is prefixed prominently on all the documents forming part of the revised financial statements/ revised board report.

The functions of the auditor pursuant to an order of the Tribunal allowing revision of the financial statement shall be as under:

- (i) To carry out the audit procedures necessary in the changed circumstances.
- (ii) To review the steps taken by the company to ensure that anyone who is in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
- (iii) To ensure that the revised audit report specifically refers to the revision of the financial statements.
- (iv) To issue a revised auditor's report on the revised financial statements and sign the same.

- (v) To ensure that the revised auditor's report contains a paragraph in bold explaining the reasons for the revision of the financial statements with cross reference to the earlier report issued by the auditor.
- (vi) If the Auditor qualifies his report, the Board shall address the same in the manner provided in sub-section (3) of section 134 of the Act.

Steps to be taken by Directors

- (1) The proposed revision shall be presented to the directors who authenticated the original financial statements or Report of the Board and to the auditors who attested the said financial statements, and the opinion of the auditors, if any, shall be obtained and considered by the Board, before approving any revision of financial statements or report of the Board. Dissent and dissent vote, if any, at the Board meeting, on such revision of financial statements or report of the Board, should be recorded with reasons in the minutes of the meeting of the Board.
- (2) The revision shall be reported upon by the auditor who is presently holding the position of auditor. However, if the original financial statement was audited by a different auditor, then, the revised financials shall be accompanied by a consent letter from the auditor who reported upon the financial statement which is sought to be revised. In case such auditor does not agree or the company is unable to procure the consent letter, reasons for such different opinion or inability to procure the consent shall be explained.
- (3) It shall be the duty of the Board to send a copy of the revised financial statements and the revised auditor's report to the members, and in case of a listed company, to the stock exchange(s) and other regulatory authorities and it shall fix the date for convening general meeting for the approval of the revised financial statements and the revised auditor's report, or revised report of the Board, as the case may be.
- (4) The revised financial statements or revised report of the Board shall be signed in the manner specified in section 134 of the Act. Any such revised financial statement or revised report of the Board shall be accompanied by the reasons justifying the proposed revision.
- (5) The members shall approve the revised financial statements and the revised auditor's report at the general meeting.
- (6) Management has to necessarily revise the financial statements for all the relevant period, subsequent to the financial year for which the revision of financial statement is sought to be made by the Board of Directors.

NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA) (This section not notified)

Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards. The Companies Act, 1956 empowers the Central Government to form a Committee for recommendations on Accounting Standards which is National Advisory Committee on Accounting Standards (NACAS). This is now being renamed with enhanced independent oversight powers and authority as National Financial Reporting Authority (NFRA).

NFRA shall be responsible for monitoring and enforcing compliance of auditing and accounting standards and for that purpose, oversee the quality of professions associated with ensuring such compliances. The Authority shall investigate professional and other misconducts which may be committed by Chartered

Accountancy members and firms. There is also a provision for appellate authority.

The National Financial Reporting Authority shall be a quasi – judicial body to regulate matters related to accounting and auditing. With increasing demand of non – financial reporting, it may be referred to as a National level business Reporting Authority to regulate standards of all kind of reporting- financial as well as non – financial, by the companies in future.

National Financial Reporting Authority shall give its recommendations on accounting standards and auditing standards. It shall only recommend and it is the Central Government who shall prescribe such standards.

Objective

The objectives of National Financial Reporting Authority inter alia shall be as follows:

- (1) Make recommendations on formulation of accounting and auditing policies and standards for adoption by companies, class of companies or their auditors;
- (2) Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;
- (3) Oversee the quality of service of professionals associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service, and
- (4) Perform such other functions as may be prescribed in relation to aforementioned objectives.

These objectives simply bring chartered accountants, cost accountants, management accountants, company secretaries as well as independent directors / members audit committees under jurisdiction of NFRA.

Constitution of NFRA

The constitution of National Financial Reporting Authority, which is supposed to be constituted as an oversight regulatory body to recommend accounting and auditing standards, shall be governed by sub - section (3) and (4) of section 132. Accordingly,

- (i) It shall consist of a chairperson, who shall be a person of eminence & having expertise in accountancy, auditing, finance, business administration, business law, economics or similar disciplines, to be nominated by Central Government, and such other prescribed members not exceeding 15.
- (ii) The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full – time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.
- (iii) The head office of National Financial Reporting Authority shall be at New Delhi and it may, meet at such other places in India, as it deems fit.
- (iv) Its accounts shall be audited by Comptroller and Auditor General of India (CAG) and such accounts as certified by CAG, together with audit report, shall be forwarded annually to the Central Government.

For the constitution of National Financial Reporting Authority, the Act doesn't prescribe for nomination of members from MCA, ICSI, ICAI, ICMAI, as opposed to what was prescribed under the Companies Act, 1956 in respect of constitution of National Advisory Committee on Accounting Standards. The same shall be prescribed by Central Government so far as terms, conditions and manner of appointment is concerned. Members appointed could be full time members or part time members.

Jurisdiction, Powers of and Imposition of Penalties by NFRA

The National Financial Reporting Authority shall have jurisdiction over bodies corporate and persons for matters of professional and other misconduct committed, by any member or firm of Chartered Accountants registered under the Chartered Accountants Act, 1949. No other institute or body (including professional institutes) shall initiate or continue any proceeding in such matters of misconduct where the authority has initiated an investigation under this section.

The Authority shall have powers as are vested in a civil court under Code of Civil Procedure in respect of following matters:

1. Discovery and production of books of accounts and other documents
2. Summoning and enforcing the attendance of persons and examining them on oath
3. Inspection of any books, registers and other documents of any person
4. Issuing commission for examination of witness or documents.

Sub-section (4) is a non-obstante clause, providing a bar on anybody or any institute, in initiating or continuing the proceedings in matters relating to misconduct as referred to in Chartered Accountants Act 1949.

The Authority shall have powers to make an order in relation to:

- A. Imposing penalty of
 - (i) not less than one lakh rupees which may extend to five times of the fees received in case of individuals and
 - (ii) not less than ten lakh rupees which may extend to ten times of the fees received in case of firms
- B. Debarring member or the firm from engaging himself or itself from practice for a period of six months to ten years.

Appeals and Appellate Authority

Any person aggrieved by any order of the National Financial Reporting Authority may prefer appeal to Appellate Authority, set up for this purpose.

The Appellate Authority shall consist of a chairperson and not more than two members. However, the Appellate Tribunal constituted under the Chartered Accountants Act, 1949 will not act as Appellate Tribunal under this section.

SECTION 133: CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Till the constitution of NFRA, National Advisory Committee on Accounting Standards (NACAS) is still empowered to do the work allocated to NFRA under new Act. The standards of accounting as specified under the Companies Act, 1956 shall be deemed to be the accounting standards until accounting standards are prescribed by the Central Government.

SECTION 134: FINANCIAL STATEMENT, BOARD'S REPORT ETC.

Section 134 deals with financial statements as well as board's report. The Board's Report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented and approved by the Board of directors before they are signed and submitted to auditors for their report.

The auditor's report is to be attached to every financial statement. A report by the Board of directors containing details on the matters specified, including director's responsibility statement, shall be attached to every financial statement laid before company. The Board's report and every annexure has to be duly signed. A signed copy of every financial statement shall be circulated, issued or published along with all notes or documents, the auditor's report and Board's report. The clause also provides for penal provisions for the company and every officer of the company, in case of any contravention.

Requirements as to financial statements

- Financial statement of the company including consolidated financial statements, if applicable, should be approved by the Board of Directors, before such statements are signed.
- Financial statement should be signed on behalf of the board by atleast
 - chairperson of company, duly authorised board, or
 - two directors of whom one should be the managing director, and
 - chief executive officer, if he is director, chief financial officer and company secretary, if any in the company
- One person company's financial statements shall be signed by only one director.
- Such sign is required for submission of financial statements to the auditor for his report.
- Auditors report is required to be attached to every financial statement.
- Board report shall be attached to the statements laid before the company in general meeting.

The details of prescriptions under Companies Act regarding Board's Report including disclosures are dealt in lesson 23.

Penal provisions

Any contravention of provisions of Section 134 is punishable to the following extent –

- (a) company is punishable with fine of not less than rupees fifty thousand but which may extend upto rupees twenty five lakhs, and
- (b) every officer in default is punishable with –
 - (i) imprisonment upto a term of three years, or
 - (ii) monetary fine from fifty thousand rupees to rupees five lakh, or
 - (iii) both (i) and (ii) above

SECTION 135 : CORPORATE SOCIAL RESPONSIBILITY

This section seeks to provide that every company having specified net worth or turnover or net profit during any financial year shall constitute the Corporate Social Responsibility Committee of the Board. The

composition of the committee shall be included in the Board's Report. The Committee shall formulate policy including the activities specified in Schedule VII. The Board shall disclose the content of policy in its report and place on website, if any of the company. The section further provides that the Board shall ensure that atleast two per cent of average net profits of the company made during three immediately preceding financial years shall be spent on such policy every year. If the company fails to spend such amount the Board shall give in its report the reasons for not spending.

There was no corresponding provision in the Companies Act, 1956 but Ministry of Corporate Affairs, Government of India had brought 'Corporate Social Responsibility Voluntary Guidelines, 2009' in December, 2009. According to these guidelines, each business entity should formulate a CSR policy to guide its strategic planning and provide a roadmap for its CSR initiatives, which should be an integral part of overall business policy and aligned with its business goals. The policy should be framed with the participation of various level executives and should be approved by the Board.

The CSR Policy is expected to normally cover following core elements:

- (a) Care for all stakeholders
- (b) Ethical functioning
- (c) Respect for workers' rights and welfare
- (d) Respect for human rights
- (e) Respect for environment
- (f) Activities for social and inclusive development

What is CSR

CSR has many interpretations but can be understood to be a concept imposing a liability on the Company to contribute to the society (whether towards environmental causes, educational promotion, social causes etc.) along with the reinforced duty to conduct the business in an ethical manner.

Corporate Social Responsibility (CSR) is a form of self-regulation integrated into a business model. It is also known as corporate conscience, corporate citizenship, social performance or sustainable business/responsible business.

CSR involves both internal as well as external stakeholders. Internal stakeholders include the employees of the company whereas external stakeholders include community & environment, customers, vendors, shareholders, government etc. To carry out CSR effectively, it is essential that it has to be driven from top. So leadership is very important in all CSR activities and it is the need of the hour to develop next generation of globally responsible leaders.

Benefits of CSR

The benefits of CSR could be listed as follows:

- Strengthened brand positioning
- Enhanced corporate image and reputation
- Satisfaction of economic and social contribution to society

- Contribution to the surrounding society
- Increased ability to attract, motivate and retain employees
- Enhanced sales and market share
- Increased appeals to investors and financial analysts
- Local economy gains in all dimensions

Application of Provision

Companies having net worth of ₹ 500 crores or more or turnover of ₹1,000 crores or more or net profit of ₹5 crores or more during any financial year shall constitute a CSR Committee of Board comprising of 3 or more directors, one of whom shall be an independent director.

Composition of CSR Committee

The CSR committee shall consist of three or more directors, out of which one director shall be an independent director. The presence of an Independent Director shall ensure that the Committee is not just a quasi-committee addressing the whims of the Board, but is in fact, taking up an initiative. The composition of such Corporate Social Responsibility Committee shall have to be disclosed in the Board's Report as required under Section 134(4).

An unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee with independent director.

A private company having only two directors on its Board shall constitute its CSR Committee with two such directors.

With respect of foreign company, the CSR Committee shall comprise of at least two persons of which one person resident in India and another person shall be nominated by the foreign company.

The CSR Committee shall Institute a transparent monitoring mechanism for implementation of CSR projects or programs or activities undertaken by the company.

CSR Policy

The CSR Policy of the company shall, inter alia includes the following, namely :

- (a) A list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedule for the same; and
- (b) Monitoring process of such projects or programs.

But the activity should not be undertaken in pursuance of normal course of business of a company.

The Board shall ensure that the activities included by the company in its CSR Policy are related to the activities mentioned in Schedule VII of the Act.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of business profit of a company.

Functions of the CSR Committee

The Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which

shall indicate the activities to be undertaken by the company as specified in Schedule VII of the Act.

The Committee shall also initiate a CSR Policy, which shall stipulate how, where, and when they want to invest their funds with respect to this requirement.

The Committee shall recommend the amount of expenditure to be incurred on the activities referred to above. Further, the CSR Committee is under an obligation to monitor the implementation of the CSR policy from time to time.

CSR Activities

The Companies Act, 2013 does not prescribe the methodology by which CSR activities are to be undertaken by the company. Companies have been given flexibility to decide the activity within the framework, choose programmes, implement in the manner it desires, monitor it and ensure compliance of its own CSR policy. However, the CSR activities may be undertaken by way of the following methods:-

- (a) By Charity: Company can donate money to various charitable trusts, societies, NGOs etc. who work for social economic welfare of society.
- (b) By Contract: Company can hire an NGO or any other agency like that which can carry out the projects on behalf of the company.
- (c) By Itself: Company can take up a project on its own or create its own trust and use its own staff for its proper working/ monitoring or through other trusts/ societies.

The companies may adopt any one, or all of the above ways for the purpose of CSR activities.

- (1) The CSR activities undertaken by the company, as per its CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.
- (2) The board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or company established by the company or its holding or subsidiary or associate company.
- (3) If such Trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects.
- (4) The company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects or programs and the monitoring and reporting mechanism.
- (5) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with rules.
- (6) The CSR projects or programs or activities should not be exclusively only for the benefit of employees of the company or their families.
- (7) Only those CSR projects or programs or activities would be taken into considerations that are undertaken within India.
- (8) Companies may build CSR capacity of their own personnel as well as those of their implementing

agencies through Institutions with established track records of atleast three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

- (9) Contribution of any amount directly or indirectly to any political party shall not be considered as CSR activity.

Schedule VII describes the following activities to be undertaken by the company in CSR activities which are as detailed below:

- (i) eradicating hunger, poverty and malnutrition, providing preventive health care and sanitation and making available safe drinking water;
- (ii) promoting education including special education and employment enhancing vocation skills especially among children, Women, elderly, and the differently abled and livelihood enhancement projects;
- (iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- (iv) ensuring environment sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;
- (v) protection of national heritage, art and culture including restoration of building and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- (vi) measures for the benefits of armed forces veterans, war widows and their dependents;
- (vii) training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;
- (viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- (ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- (x) rural development projects

Role of the Board

The Board of every company shall –

1. The Board to compose a Corporate Social Responsibility Committee.
2. After receiving recommendation and policy made by the Corporate Social Responsibility Committee, approve and take steps to implement / execute the CSR policy for the company and disclose such policy –
 - (i) in the Board's Report as per sub-section (3) of section 134 pertaining to a financial year commencing on or after the 1st day of April, 2014; and
 - (ii) also place the contents of policy on its Company's website, if any, in form prescribed under Companies (Corporate Social Responsibility Policy) Rules, 2014.

3. Ensure that the activities which formulate by CSR Committee in the Policy are duly undertaken by the company.
4. Ensure that the company spends in every financial year, at least two per cent of the average net profits (to be calculated in accordance with the provisions of Sec. 198) of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities as per CSR Policy.
5. If the company fails to spend such amount, the Board shall, in its report made under Section 134(3)(o) specify the reasons for not spending the amount. The intention is that company should spend on approved CSR activities or explain the reasons for not so spending in its Board report.

CSR Contribution / Expenditure

For a contribution to qualify as a CSR contribution, the nature of contribution is to be kept in mind. Any contribution to CSR may not result in any direct or indirect commercial benefit to the company. However, it should be ensured that CSR expenditure complies with company's CSR Board approved CSR policy and the legal provisions. CSR expenditure include all expenditure including contribution to corpus for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include the expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

Penalty

The Companies Act requires that -

- (i) The Board's report shall disclose the composition of the Corporate Social Responsibility Committee as per sub- section (3) of section 134;
- (ii) If the company fails to spend such amount (i.e. at least two percent of the average net profit), the Board shall disclose and specify the reasons for not spending the amount in its report as per Clause (o) of sub-section (3) of section 134.

As per section 134 of Companies Act, 2013 if the Company fails to disclose such information,it shall be punishable with fine ,which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

FORMAT FOR THE ANNUAL REPORT ON CSR ACTIVITIES TO BE INCLUDED IN THE BOARD'S REPORT

1. A brief outline of the company 's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The composition of the CSR Committee.
3. Average net profit of the company for last three financial years
4. Prescribed CSR Expenditure (two percent of the amount as in the Item 3 above)
5. Details of CSR spent during the financial year.
 - (a) Total amount to be spent for the financial year;

- (b) Amount unspent, if any;
- (c) Manner in which the amount spent during the financial year is detailed below.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S. No.	CSR Project or Activity Identified	Sector in which the project is covered	Projects or Programs (1) Local (2) Specify the State and district where projects or programs was under- taken.	Amount outlay (budget) project or programs wise	Amount spent on the project or programs Sub-heads: (1) Direct expenditure on projects or programs (2) Over- heads:	Cumu- lative s the expendi- ture upto to the Sub-heads: (1) Direct period expenditure on projects or programs (2) Over- heads:	Amount pent : Direct or through imple- menting agency
1							
2							
3							
Total							

* Give details of implementing agency.

6. In case the company has failed to spend the two percent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

Sd/-

(Chief Executive Officer
or Managing Director
or Director)

Sd/-

(Chairman CSR
Committee)

Sd/-

(Person specified under clause (d)
of sub-section (1) of section 380
of the Act)
(wherever applicable)

Students may refer to Circular No. 21/2014 dated June 18, 2014 by Ministry of Corporate Affairs for more clarification.

SECTION 136: RIGHT OF MEMBER TO COPIES OF AUDITED FINANCIAL STATEMENT

This section seeks to provide that a copy of financial statements including consolidated financial statement, if any, auditor's report along with annexures/ attachments shall be sent to every member, every trustee for the debenture holder and all other persons who are so entitled, twenty one days before the date of general meeting. The provision of this section shall be deemed to be complied if a listed company may make available the copies of the documents for inspection at its registered office during working hours for a period

of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in Form AOC-3 prescribed by the Central Government or the documents and sent the same to every stake holder.

In case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent:

- (a) by electronic mode to such members whose shareholding is in dematerialised format and whose email Ids are registered with Depository for communication purposes;
- (b) where Shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode; and
- (c) by despatch of physical copies through any recognised mode of delivery as specified under section 20 of the Act, in all other cases.

Member's, Debenture trustee's right to get copies of annual accounts

According to sub-section (1) of this section, every member of the company, the trustee for the debenture-holders and every other person being the person so entitled, is entitled to get from the company, every year, a copy of financial statement including consolidated financial statements (if applicable), which are to be laid at a general meeting of the company, comprising of:-

- (i) Balance Sheet
- (ii) Profit and Loss Account
- (iii) Cash Flow Statement
- (iv) Statement of change in equity
- (v) Auditor's Report
- (vi) Director's Report
- (vii) Every other document required by law to be annexed or attached to the financial statement.

This right to have copies of financial statements is over and above the provisions of Section 101 which provides for right to receive notice of general meeting.

Obligation of listed company

Proviso to sub-section (1) provides that in the case of a company whose shares are listed on a recognised stock exchange, provisions shall be deemed to have been complied with, if the copies of the documents are made available for inspection at its registered office, during working hours, for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting.

Every listed company is required to supply a copy of the complete financial statements with auditor's report and director's report, to such shareholders who ask for full financial statements.

Every listed company is also required to place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

Financial statements of subsidiaries

Every company (listed or unlisted) having subsidiary or subsidiaries shall:

- (d) place separate audited financial statements in respect of each of its subsidiary on its website, if any.
- (e) provide copy of separate audited financial statements if any shareholder demands a copy of the separate audited financial statements in respect of each of its subsidiary.

Right to inspect

Every company shall be under an obligation to allow every member or trustee of the holder of any debentures issued by the company to inspect the financial statements and documents to be attached thereto stated under sub-section (1) at its registered office during business hours.

In case of listed companies, copies of documents shall be available for inspection at its registered office during working hours for a period of 21 days before the date of meeting and company may send the salient features of financial statements to members and debenture trustees in prescribed form. That will be sufficient compliance of sub section (1).

Penal provisions

If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of –

- (i) twenty-five thousand rupees and
- (ii) every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

Both penalties shall be imposed simultaneously.

SECTION 137: COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR

Section 137 requires every company to file the financial statements including consolidated financial statement together with Form AOC- 4 with the Registrar within 30 days from the day on which the annual general meeting held and adopted the financial statements with such fees or additional fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

If the financial statements are not adopted at the annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents be filed with the Registrar with in thirty days of the date of annual general meeting. The Registrar shall take them in his record as provisional, until the adoption at annual general meeting.

The One Person Company shall file the copy of financial statements duly adopted by its members within a period of one hundred and eighty days from the closure of financial year.

The company shall also attach the accounts of subsidiaries incorporated outside India and which have not established their place of business in India with the financial statements.

The class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format and the Central Government may specify the manner of such filing under such notification for such class of companies (Rule 12(2)).

If annual general meeting has not been held, the financial statement duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty

days of the last days before which the annual general meeting should have been held.

If company fails to comply with the requirement of submission of financial statement before Registrar, the company shall be punishable with fine of one thousand rupees for every day during which failure continues subject to maximum of rupees ten lakh. The managing director and CFO if any, and, in the absence of such managing director or CFO, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, in the absence of such director, all directors of the company shall be punishable with imprisonment for a term which may extend upto six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees or with both.

SECTION 138: INTERNAL AUDIT

Classes of companies requiring Internal Audit

The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors:-

- (a) every listed company;
- (b) every unlisted public company having –
 - (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or
 - (ii) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
 - (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (c) every private company having –
 - (i) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

The company board shall be free to appoint any practicing Chartered Accountant or a Cost Accountant or any other person whom it deems fit to be appointed as its internal auditor. For this purpose, company board may consider the nature and volume of business of company; qualifications, experience and capabilities of such person being appointed as auditor and scope of internal audit.

Who can be an Internal Auditor

- (a) a Chartered Accountant or;
- (b) a Cost Accountant or;
- (c) such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

For this sub-section, Chartered Accountant means a Chartered Accountant, who is a member of the Institute of Chartered Accountants of India and has a valid certificate of practice and Cost Accountant means a member of The Institute of Cost Accountants of India. Other professionals, as may be decided by the company's board, may also be appointed as an internal auditor.

For carrying out internal audit smoothly and effectively, it would be desirable on the part of internal auditor to—

- (a) Obtain knowledge of legal and regulatory framework within which the auditee entity operates .
- (b) Obtain knowledge of the entity's accounting, internal control systems and procedure alongwith accounting policies .
- (c) Determine the effectiveness of internal control and check procedures adopted by the entity .
- (d) Understand the business and other technical details of the auditee entity .
- (e) Determine nature, timing and extent of procedures to be carried out or performed.

SECTION 148 : MAINTENANCE OF COSTING AND STOCK RECORDS

A company engaged in production, processing, manufacturing or mining activity, is also required to maintain particulars relating to utilization of material, labour or other items of cost as the Central Government may prescribe for such class of companies.

II AUDIT AND AUDITORS

1. APPOINTING AUTHORITY FOR AUDITORS IN COMPANY

In term of section 139(1) of the Companies Act, 2013 read with rule 3 of Companies (Audit and Auditors) Rules, 2014 every company shall at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting (AGM) and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as prescribed under:

- In case of a company that is required to constitute an Audit Committee under section 177, such committee, and, in cases where such a committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

For the purpose of constitution of Audit Committee section 177 of the Act read with Companies (Meetings of Board and its Powers) Rules, 2014 provides that:

The Board of directors of every listed companies and the following classes of companies shall constitute an Audit Committee of the Board-

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

- Before considering the appointment of auditor, the Audit Committee or the Board, as the case may be, shall consider any pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court. Further they may call for such other information from the proposed auditor as it may deem fit.
- Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
- If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of auditor to the members in the AGM otherwise, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- Thereafter if the Audit Committee decides not to reconsider its original recommendation, then Board shall record reasons for its disagreement with the Audit committee and send its own recommendation for consideration of the members in the AGM and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.
- The auditor appointed in the AGM meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has

been made being counted as the first meeting.

- Such appointment shall be subject to ratification in every AGM till the sixth AGM by way of passing of an ordinary resolution. If the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.

Section 139(6) of the Act stipulated that first Auditor of the Company other than Government Company, shall be appointed by the Board within 30 days of its date of registration and in case of failure to do so by Board of Directors, the members shall be informed and they shall appoint the same within 90 days from incorporation, who shall hold office till conclusion of first annual general meeting.

Conditions for appointment and notice to Registrar-

Rule 4 of the Companies (Audit and Auditors) Rules, 2014 hereinafter referred in this chapter as Rule

As per second proviso of section 139(1) read with rule 4 stipulates that written consent of the auditor must be taken before appointment. The auditor appointed shall submit a certificate that:

- (a) the individual/firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
- (b) the proposed appointment is as per the term provided under the Act;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Act;
- (d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

The Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Act.

The Company shall inform the auditor concerned of his or its appointment and also file a notice of such appointment with the Registrar in Form ADT-1 within 15 days of the meeting in which the auditor is appointed.

2. APPOINTMENT OF AUDITOR IN GOVERNMENT COMPANY- Section 139(5), 139(7), 139(8), 139 (11)

The appointment of auditor in Government company or government controlled (directly/indirectly) company shall be held in accordance with the following provisions:

The First auditor shall be appointed by the Comptroller and Auditor General within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days. In case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

The Act also provides that in case the Company has an Audit Committee, then all appointments of Auditor including filling of casual vacancy, shall be made after taking into account the recommendations of the Committee.

3. ELIGIBILITY & QUALIFICATIONS OF AUDITOR

Section 141 (1) & (2) of the Act prescribed the following eligibility and qualifications of auditor which are as under:-

- (i) Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.
- (ii) Where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

4. DISQUALIFICATIONS OF AUDITOR

Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of a company, namely:

- A body corporate, except LLP;
- An officer or employee of the company;
- Any partner/employee of officer or employee of company;
- A person who himself or his relative/partner is holding any security or interest in the company, or any company which is its holding, subsidiary, associate;
- A person whose relative is holding security or interest not exceeding Rs. one Lac face value in companies as mentioned above. Provided that this condition be also applicable in the case of a company not having share capital or other securities, wherever relevant. Provided further that in the event of acquiring any security or interest by a relative, above the threshold limit i.e. Rs. one lac, the corrective action to maintain the limits (Rs. one lac) shall be taken by the auditor within 60 days of such acquisition or interest;
- A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment;
- A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment;
- A person or a firm who, whether directly or indirectly, has "business relationship" with the company, or its subsidiary, or its holding or associate company;

The term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except –

- (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- (ii) commercial transactions which are in the ordinary course of business of the company at arm's

length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

- A person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- A person who is in full time employment elsewhere;
- Person who is auditor of more than 20 companies;
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

According to section 141 (4) where a person appointed as an auditor of a company incurs any of the disqualifications mentioned as above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

5. TERM OF AUDITOR- Section 139 (2) and Rule 5

Listed company or all unlisted public companies having paid up share capital of Rs. 10 crore or more, all private limited companies having paid up share capital of Rs. 20 crore or more, all companies having public borrowings from financial institutions, banks or public deposits of Rs. 50 (fifty) crores or more shall not appoint or re-appoint an individual as auditor for more than one term of 5 consecutive Years; and an audit firm as auditor for more than two terms of 5 consecutive years. These auditor (either individual/audit firm) can be re-appointed after cooling off period of 5 years. Three years transition period will be given to comply with this requirement.

No audit firm shall be appointed as auditor of the company for a period of five years, if same firm presently having a common partner(s) to the previous audit firm, whose tenure has expired in a company immediately preceding the financial year.

The right of the company to remove the auditor or the right of the auditor to resign from such office of the company is not affected by this sub-section. Thus, an auditor can resign or be removed by the shareholders before completion of his term as discussed above. The firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008.

6. RE-APPOINTMENT OF RETIRING AUDITOR- Section 139 (9)

At any annual general meeting, a retiring auditor shall be reappointed as auditor of the company except under the following circumstances:

- (a) he is not qualified for re-appointment.
- (b) he has given the company a notice in writing of his unwillingness to be re-appointed.
- (c) a special resolution has been passed at that meeting appointing somebody else instead of him or providing expressly that retiring auditor shall not be re-appointed.

Section 139 (10) lays that where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

7. ROTATION OF AUDITORS- Section 139(3)

Members of a company can provide for following by passing a resolution:

- (a) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
- (b) The audit shall be conducted by more than one auditor.

A transition period of 3 years from the commencement of the Act has been prescribed for the company existing on or before the commencement of the Act, to comply with the provisions of the rotation of auditor.

8. ROTATION OF AUDITORS ON EXPIRY OF THEIR TERM -Section 139 (4) and Rule 6

Rotation of auditors on expiry of auditor's term then same procedure will be followed as required for appointment of auditors. The procedure is as under:-

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

For the purpose of rotation, the period for which the auditor is holding office prior to the commencement of this act will also be counted in calculating the period of 5 years or 10 years as the case may be. The incoming auditor/audit firm shall not be eligible if such auditor/audit firm is associated with the outgoing auditor/audit firm under the same network of audit firms i.e. includes the firms operating/ functioning under the same brand name, trade name or common control, hitherto or in future. If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Where a company has appointed two or more persons as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

9. CASUAL VACANCY IN THE OFFICE OF AUDITOR - Section 139 (8)

The provisions for filling of casual vacancy in the office of auditor are as follows :

- (a) The Board of the company shall have power to fill the casual vacancy in the office of auditor within 30 days in any case except where -
 - (i) the casual vacancy occurred due to resignation of the auditor, or
 - (ii) the company accounts are not subject to audit by an auditor appointed by the Comptroller and Auditor- General of India.
- (b) In case casual vacancy has occurred due to resignation of auditor, such appointment should be approved by the company in general meeting convened within 3 months of the recommendation of the Board and auditor shall hold the office till the conclusion of the next annual general meeting.
- (c) In case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor- General of India, such vacancy should be filled by the Comptroller and

Auditor-General of India within 30 days. In case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

- (d) Appointment of auditors to fill casual vacancy shall be made after taking into account the recommendation of the audit committee.

10. REMOVAL OF AUDITOR-Section 140 (1) and Rule 7

The auditor appointed under section 139 may be removed from his office before the expiry of the term only by –

- (i) Obtaining the prior approval of the Central Government by filling an application in form ADT-2 within 30 days of resolution passed by the Board
- (ii) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.
- (iii) The auditor concerned shall be given a reasonable opportunity of being heard.

11. RESIGNATION OF AUDITOR- Section 140 (2), 140 (3)and Rule 8

The auditor who has resigned from the company shall file a statement in Form ADT-3 indicating the reasons and other facts as may be relevant with regard to his resignation as follows:

- (i) In case of other than Government Company, the auditor shall within 30 days from the date of resignation, file such statement to the company and the registrar.
- (ii) In case of Government Company or government controlled company, auditor shall within 30 days from the resignation, file such statement to the company and the Registrar and also file the statement with the Comptroller and Auditor General of India (CAG).

The onus to file such statement containing relevant facts and reasons for resignation is on the resigning auditor and any contravention of sub clause (2) is punishable with monetary fine which could be minimum ₹50,000 and maximum ₹5 lakh.

12. REMUNERATION OF AUDITOR – Section 142

Section 142 of the Act prescribed that the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. Board may fix remuneration of the first auditor appointed by it. The remuneration will be in addition to the out of pocket expensed incurred by the auditor in connection with the audit of the company and any remuneration paid to him for any other service rendered by him at the request of the company.

13. AUDITOR'S RIGHT TO ATTEND GENERAL MEETING Section 146

All notices of any general meeting shall be forwarded to the auditor of the company and he must attend any general meeting either by himself or through his authorised representative (qualified to be an auditor) and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

14. POWERS AND DUTIES OF AUDITORS

Section 143(1) provided that Every auditor can access at all times to the books of accounts, vouchers and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f). It is the duty of every auditor to make

proper enquiry regarding these matters, besides other matters and if he is satisfied, it is not necessary to disclose this fact in his report. However, on enquiry, if he finds some adverse features, it is his duty to report the same. Specific enquiries to be made by the auditor under this sub-Section are as under—

(a) *Loans and Advances made by the Company*

Auditor shall inquire into “whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its members.” It is applicable to all loans and advances made on the basis of security. The auditor should verify that the security held against the loans and advances made by the company are legally enforceable and also ascertain the valuation of securities to see whether the loan is fully secured or partly secured.

(b) *Transactions represented by book entries*

Auditor is required to inquire “whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company”. He should verify the all book entry transactions and determine whether such transactions have actually taken place and are not prejudicial to the interest of the company.

(c) *Sale of investments*

Auditor should inquire, “whether so much of the assets of the company (except an investment company or a banking company) as consists of shares, debentures and other securities, have been sold at a price less than that at which they were purchased by the company”. Auditor must verify the cases where securities are sold at a price less than their cost of acquisition and if he finds that such sale is bona fide and the price realised is considered to be reasonable, having regards to the circumstances of each case, no further reporting is required.

(d) *Loans and Advances shown as deposits*

Auditor must verify “whether loans and advances made by the company have been shown as deposits”. The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.

(e) *Charging of Personal expenses to revenue account*

Auditor should inquire as to “whether personal expenses have been charged to revenue account”. Auditor must ensure that no personal expenses of directors and officers of the company have been charged to revenue account.

(f) *Allotment of shares for cash*

Auditor should inquire as to “whether cash has actually been received in respect of shares stated to have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading”. In this connection, auditor must ensure in respect of shares allotted in cash by the company that cash has actually been received in respect of such allotment by the company.

He should verify and report the cases where cash was not received and that the position, as stated in books of accounts and balance sheet, is correct, regular and not misleading.

Auditor will have access to books of accounts and vouchers, not only to those kept at registered office of the company but also to those kept at any other place. Such access shall be available at all times. Also, auditor

of a holding company shall have access to the books of all of its subsidiary companies for the purpose of consolidation of financial statements of holding company and its subsidiaries.

15. AUDIT REPORT

Section 143 (2) prescribed that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company. The Audit report should take into consideration the provisions of this Act, the Accounting and Auditing standards and matters which are required under this Act or rules made thereunder or under any order made u/s 143(11).

The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company's affair as at the end of the financial year and the profit or loss and the cash flow for the year and such other matters as may be prescribed.

Section 143 (3) laid down that auditor's report shall also state other details which are as under:

- (a) whether he has sought and obtained all the information and explanations which were necessary and if not, the details thereof and the effect of such information on the financial statements;
- (b) whether, in his opinion, proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- (c) whether the branch audit report prepared by a person other than the company's auditor has been sent to him;
- (d) whether the company 's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, the financial statements comply with the accounting standards;
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- (g) whether any director is disqualified from being appointed as a director under section 164 (2);
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
- (j) Rule 11 prescribed that Auditor's Report shall also include their views and comments on the following matters, namely:-
 - (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
 - (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
 - (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. {Section 143 (4)}

16. POWERS OF COMPTROLLER AND AUDITOR-GENERAL OF INDIA IN CASE GOVERNMENT COMPANY [Section143 (5) to 143 (7)]

In case of Government Company, the Audit Report among other things, shall include the directions, if any, issued by the Comptroller and Auditor –General of India (CAG), the action taken and the impact thereof on the Company's accounts and financial statement.

The CAG shall have a right to conduct a supplementary audit of financial statement of the company and comment upon or supplement such audit report within 60 days from the date of receipt of the audit report u/s 143 (5).

Provided that any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements u/s 136 (1) and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

The CAG may, by an order, cause test audit to be conducted of the accounts of company covered u/s 139 (5) or 139 (7) and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

17. BRANCH AUDIT - SECTION 143 (8) AND RULE 12

Branch Auditor: Accounts of branch office can be audited by –

1. The company's auditor; or
2. Any other person, qualified to be and appointed as an auditor as per the provisions of the Act as branch auditor; or
3. In case of foreign branch, by the company 's auditor or by an accountant or a competent person appointed in accordance with the prevailing laws of the foreign country.

The branch auditor shall prepare a report on the accounts of the branch examined by him and the company's auditor shall deal with such report in his audit report in a manner as he considers necessary.

Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.-

- (1) The duties and powers of the company 's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143 i.e. right of access to books of accounts, ensure about the mandatory books of accounts maintained, prepare auditors' report and state the reasons of qualification in report, if any etc .
- (2) The branch auditor shall submit his report to the company's auditor.
- (3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

18. AUDITING STANDARDS - SECTION 143 (9) & (10)

Every auditor must comply with the auditing standards. While the Central Government prescribes the Auditing Standards or addendums thereto, it shall consult with and take recommendations of the Institute of

Chartered Accountants of India (ICAI) and the National Financial Reporting Authority (NFRA). Till such time the Auditing Standards are notified by the Central Government, the auditing standards specified by the ICAI are deemed to be the auditing standards.

19. REPORTING OF FRAUDS BY AUDITOR- Section 143(12) to 143 (15) & Rule 13

Section 143 (12) and Rule 13 provides that if the auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than 60 days of his knowledge and after following the procedure indicated herein below:

- (i) auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days;
- (ii) on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days of receipt of such reply or observations;
- (iii) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

The report shall be in the form of a statement as specified in Form ADT-4 on the letter-head of the auditor containing postal address, e-mail address, contact number, Membership Number and be signed & sealed by the auditor and same shall be sent through Registered Post with AD/speed post followed by an e-mail in confirmation to the Secretary, MCA of the same

The provision of section 143 applies mutatis-mutandis to Cost Accountants in practice conducting Cost Audit under section 148 or the Company Secretary in practice conducting secretarial audit under section 204. If any auditor, cost accountant or company secretary in practice fails to comply with the provisions of section 143 (12) for reporting of an offence involving fraud, they will be punished with a fine of minimum Rs. 1 lakh and upto Rs. 25 lakhs but they will not be punished if Auditor has done such reporting in good faith.

20. AUDITOR NOT TO RENDER CERTAIN SERVICES (PROHIBITED SERVICES)-Section 144

An auditor shall provide to the company only such other services as are approved by the Board of Directors/ the audit committee, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:-

- (a) accounting and book keeping services;
- (b) internal audit;
- (c) design and implementation of any financial information system;
- (d) actuarial services;
- (e) investment advisory services;
- (f) investment banking services;
- (g) rendering of outsourced financial services;

- (h) management services; and
- (i) any other kind of services as may be prescribed.

21. APPOINTMENT OF AUDITOR OTHER THAN RETIRING AUDITOR BY SPECIAL NOTICE- Section 140 (4)

Special notice shall be required from members proposing to move a resolution at the next annual general meeting to appoint a person other than the retiring auditor or to provide that the retiring auditor shall not be re-appointed.

Such special notice shall not be required in case where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139.

Following points are relevant for the purpose of special notice:

- (i) Company, on receipt of such special notice for removing auditor, should forthwith send a copy of the same to the retiring auditor.
- (ii) If the auditor makes a representation in writing to the company and requests for its notification to the members, the company shall
 - (a) state the fact of representation in any notice of resolution, and
 - (b) send copy of representation to members to whom notice of meeting is sent, whether before or after the receipt of representation by the company.
 - (c) if the copy of representation is not so sent, copy thereof should be filed with the Registrar.
- (iii) such representation should be of a reasonable length and not too long.
- (iv) For circulation to members, it should not be received by the company too late.
- (v) Auditor may require the company to read out the representation in the meeting if it is not so notified to members because it was too late or because of company's default.

Provided that If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub- section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting. {*This Proviso is yet to be notified}*}

22. POWERS OF TRIBUNAL- Section 140 (5)

A National Company Law Tribunal (NCLT) can either –

- (i) suo moto or
- (ii) on an application from Central Government, or
- (iii) on an application from person concerned,

can direct the company to change the auditor if it is satisfied that the Auditor of a Company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

In the case of application being made by the Central Government and the NCLT being satisfied that change of auditor is required, it shall within 15 days of the receipt of such application, make an order that the Auditor shall not function as an auditor of the company and the Central Government may appoint another auditor in

his place. This will happen only when an application is made by the Central Government and not by any other person.

Where the auditor, whether individual or firm, against whom the final order as aforementioned is passed by the NCLT under this section, he shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of such order. Further, the auditor shall also be liable for action under Section 447 which provides for punishments for frauds. {*This Proviso is yet to be notified*}

It has been clarified by way of explanation that in case a firm is appointed as auditor of the company, the liability shall be of the firm and every partner or partners who acted in fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers shall be liable and not be eligible to be appointed as auditor of any company for a period of 5 years.

23. SIGNING OF AUDIT REPORTS - Section 145

Auditor shall sign the auditor's report of the company. Any qualifications, observations or comments on financial transactions matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

24. PUNISHMENT FOR CONTRAVENTION – Section 147

For the Company

1. If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000 and every officer in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 10,000 but which may extend to Rs. 1,00,000 or with both.

For the Auditor

2. If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000. if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company/shareholders/creditors/authorities, he shall be punishable with imprisonment for a term which may extend to 1 year and with fine which shall not be less than Rs. 1,00,000 which may extend to Rs. 25,00,000.
3. Where an auditor has been convicted under sub-section (2), he shall be liable to refund the remuneration received by him to the company; and pay for damages to the company/ statutory bodies/authorities/to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.
4. The Central Government shall specify any statutory body/ authority/an officer for ensuring prompt payment of damages to the company/ statutory bodies/authorities/ any other persons by issuing notification and such body shall after payment of damages to such company/persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the notification.
5. Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner(s) of audit firm have acted in a fraudulent manner/abetted/ colluded in any fraud by, or in

relation to or by, the company/its directors/ officers, the civil/criminal liability as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

25. COST RECORDS & AUDIT– Section 148

Section 148(1) states that notwithstanding anything contained in Chapter X of Companies Act 2013, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

However the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

Section 148(2) states that if the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

Section 148(3) states that the audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed.

Further that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records and the auditor conducting the cost audit shall comply with the cost auditing standards.

For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

Section 148(4) states that an audit conducted under this section shall be in addition to the audit conducted under section 143.

Section 148(5) states the qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

Further the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

Section 148(6) states that a company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

Section 148(7) states that if, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Section 148(8) states that if any default is made in complying with the provisions of this section,—

- (a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
- (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

The Companies (Cost Records and Cost Audit) Rules, 2014 notified on 30.06.2014 has following highlights:

- Applicability for cost audit: Section 148(2) read with Rule 4 of the Companies (Cost Records and Cost Audit) Rules, 2014 provides the Central government, by order, may direct for the audit of cost records of class of companies, as mentioned in Rule 4 of the Companies (Cost Records and Cost Audit) Rules, 2014 and which have a net worth /turnover of such amount as may be prescribed shall be conducted in the manner specified in the order.
- Maintenance of records: Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.
- Cost audit: The categories of companies specified in Rule 3 and the threshold limits laid down in Rule 4, shall within 180 days of the commencement of every financial year, appoint a cost auditor.
- Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestion, if any in form CRA-3.

[The students may refer to Companies (Cost Records and Audit) Rules, 2014 for further details.]

LESSON ROUND-UP

- Proper books of accounts shall be deemed to have been kept by a company if such books exhibit and explain the transactions and financial position of the business of the company, including books containing sufficiently detailed entries of daily cash receipts and payments.
- Every company is required to keep books of account at its registered office in respect of specified transactions. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide.
- As per the Act, books of account and other books and papers should be available for inspection by any director on working days during business hours.
- The expression 'annual accounts' embraces both balance sheet and statement of profit and loss.
- The term 'Balance Sheet' means a statement prepared from the books of a concern showing the debit and credit balances after the trading and profit and loss accounts have been prepared – a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date.
- Profit and loss account is a Statement by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation to its capital, and enables them to judge about the administration and management of the affairs of the company.
- The Act provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- The Act requires that at every annual general meeting of the company, the Board of directors must lay before

the shareholders of the company a balance sheet and a profit and loss account for the period as specified therein; and in the case of non-profit companies, an income and expenditure account.

- The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report. The Act gives other provisions also for authentication of annual accounts. The Act also requires the company to file such annual accounts with the Registrar of Companies.
- The Act provides that there shall be attached to every balance sheet laid before a company in general meeting (in practice, the annual general meeting) a report by its Board of directors, with respect to items as specified therein. The Board's Report shall also include a Directors' Responsibility Statement as required under the Act.
- The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. An audit of accounts is conducted with two-fold purpose: (i) detection and prevention of errors; (ii) detection and prevention of fraud.
- The Act provides that every company shall, at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next annual general meeting. The Act also provides for methods of appointment of auditors along with their qualifications and disqualifications.
- The Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India within the limits specified.
- The Act provides that the auditors report shall be signed only by the person appointed as an auditor of the company ..
- The Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs.
- By and large the notes on accounts are self-explanatory. The notes on accounts are intended to clarify and elucidate the financial position of a company as disclosed in its balance sheet and profit and loss account.

SELF-TEST QUESTIONS

1. Explain the term Key Managerial Personnel under the Companies Act, 2013. Is it necessary for every company to appoint a Key Managerial Personnel?
2. state the provisions of appointing a Key Managerial Personnel According to Companies Act 2013.
3. what are the provisions on punishment for the contravention of section 203 of the companies Act 2013?
4. discuss the role of Company Secretary .
5. Enumerate the duties and liabilities of a Secretary.
6. Discuss the role of company secretary as a statutory officer, as co-ordinator and as an administrative officer.
7. State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980.
8. Define Secretary in whole-time practice.

Lesson 22

Divisible Profits and Dividends

LESSON OUTLINE

- Definition and Meaning of Dividend
- Difference between dividend and interest
- Types of Dividend
- Sources of Dividend
- Dividend in case of absence of inadequacy of profits
- Transfer of unpaid dividend to unpaid dividend account
- Investor Education and Protection Funds(Sources and uses)
- Penalties and exceptions

LEARNING OBJECTIVES

Declaration and Payment of Dividend is dealt in Chapter VIII of Companies Act 2013 read with Companies (Declaration and Payment of Dividend) Rules, 2014. It broadly covers transfer of profits to reserves, maximum dividend that can be declared, in case of inadequacy of profits, maintenance of separate bank account for distribution of dividend, transfer of Unpaid Dividend to Unpaid Dividend Account and Investor Protection and enhanced penalty etc.,

After reading this lesson you will be able to understand the legal and procedural aspects relating to distribution of dividend, transfer of unpaid or unclaimed dividend to Unpaid Dividend Account and transfer of unpaid dividend to Investor Education and Protection Fund (IEPF), utilization of IEPF etc.,

The great problem of having corporate citizens is that they aren't like the rest of us. As Baron Thurlow in England is supposed to have said, "They have no soul to save, and they have no body to incarcerate." — Robert Monks

DEFINITION AND MEANING OF DIVIDEND

Dividend means the portion of the profit received by the shareholders from the company's net profits, which is legally available for distribution among the members. Therefore, dividend is a return on the share capital subscribed for and paid to its shareholders by a company.

Dividend defined under section 2(35) of the Companies Act, 2013, includes any interim dividend.

DIFFERENCE BETWEEN DIVIDEND AND INTEREST

While dividend is paid on preference and equity shares, interest is paid on debentures and long term and short term loans/borrowings including fixed deposits. Interest is a debt which like all debts is paid out of the company's assets generally. A dividend however becomes a debt only after it has been declared by the company. Dividend cannot be paid out of the assets of the company, generally it can be declared only out of the profit available for the purpose. Interest is a charge on profits while dividend is an appropriation of profits. The power to pay dividend is inherent in a company and is not derived from the Companies Act, 1956 or the Memorandum or Articles of Association although the Act and the Articles regulate the manner in which dividends are to be declared.

Right to claim dividend will only arise after a dividend is declared by the company in general meeting and until and unless it is so declared, the shareholder has no claim against the company in respect of it. The observation of the Bombay High Court in Bacha F Guzdar v. CIT (1952) 22 Com Cases 198 (Bom) was improved upon by the Supreme Court saying that the right to participation in the profits exists independent of any declaration by the company with only difference that the enjoyment of profits is postponed until dividends are declared [Bacha F Guzdar (Mrs.) v. CIT (1955) 25 Com Cases 1 at p. 6]

TYPES OF DIVIDEND

Final dividend

Dividend is said to be a final dividend if it is declared at the annual general meeting of the company. Final dividend once declared becomes a debt enforceable against the company. Final Dividend can be declared only if it is recommended by the Board of Directors of the Company. In accordance with Section 134(3)(k), Board of directors must state in the Directors' Report the amount of dividend, if any, which it recommends to be paid.

Interim dividend

Dividend is said to be an interim dividend, if it is declared by the Board of Directors between two annual general meetings of the company. However, all the provisions relating to the payment of dividend shall be applicable on the interim dividend also.

Board is authorized to declare interim dividend

Section 123(3) provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.

In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared

at a rate higher than the average dividend declared by the company during the immediately preceding three financial years.

PAYMENT OF DIVIDEND TO BE AUTHORISED BY THE ARTICLES

Section 51 of the Act, states that a company may, if so authorized by its articles, pay dividend in proportion to the amount paid up on each share. If not, the Articles has to be amended accordingly.

SOURCES OF DECLARATION OF DIVIDEND

Section 123(1) of Companies Act 2013 provides that no dividend shall be declared or paid by a company for any financial year except—

- (a) (i) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or
- (ii) out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or
- (iii) out of both; or

For the above purpose, depreciation shall be provided in accordance with the provisions of Schedule II.

- (b) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

Transfer of profits to reserves

A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

Dividend In Case Of Absence Or Inadequacy Of Profits:-

Second proviso to Section 123(1) states that owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.

Rule 3 of Companies (Declaration and Payment of Dividend) Rules, 2014

Rule 3 of Companies (Declaration and Payment of Dividend) Rules, 2014 provides that in the event of adequacy or absence of profits in any year, a company may declare dividend out of surplus subject to the fulfillment of the following conditions, namely:-

- (1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year:
Provided that this sub rule shall not apply to a company which has not declared any dividend in each of preceding 3 financial years.
- (2) The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
- (3) The amount so drawn shall first be utilized to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

- (4) The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.
- (5) No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Dividend to be declared from free reserves only

Third proviso to Section 123(1) states that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Manner of providing depreciation

According to Section 123(2) for the purpose of declaration of dividend by a company as per Section 123(1)(a), it shall provide depreciation in accordance with Schedule II.

Declaration of interim dividend

Section 123(3) of the Companies Act, 2013 provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account as well as profit of the financial year in which the interim dividend is sought to be declared. When the company has incurred any loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding the three financial years.

Amount of Dividend to be Deposited in Special Account of a Schedule Bank

Section 123(4) provides that the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend. where if the articles of the company does not authorize so, it has to be amended accordingly.

Dividend only to registered shareholder

Section 123(5) explains that no dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash.

Capitalization of Profits

Nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

Mode of payment

If any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

No dividend to be declared/paid in case of failure of repayment of deposits

Section 123(6) provides that a company which fails to comply with the provisions of sections 73(prohibition of acceptance of deposits except in the manner provided) and 74 (Repayment of deposits etc accepted before commencement of Companies Act 2013) shall not, so long as such failure continues, declare any dividend

on its equity shares.

Let us Remember!

The amount of dividend shall be deposited in a schedule bank in a separate account within 5 days from the date of declaration.

Dividend may be paid by cheque or warrant or in any electronic mode to the shareholders entitled to the payment of dividend.

Transfer of unpaid dividend to unpaid Dividend Account (Section 124)

Section 124 (Corresponding to Section 205A and 205B of Companies Act, 1956) is not yet enforced.

Section 124(1) states that when a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

Section 124(4) states that any person claiming to be entitled to any money transferred under sub-section (1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

Details of unpaid dividend to be placed at the website

Section 124 (2) provides that the company shall, within a period of ninety days of making any transfer of an amount under Section 124(1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

Let us Remember!

When the dividend is not paid or claimed within 30 days, the company shall, within 7 days transfer the amount to Unpaid Dividend Account which shall be opened in a scheduled bank.

EFFECT OF NON-TRANSFER OF THE DIVIDEND

Section 124(3) provides that if any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent. per annum and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

According to Section 124(4) any person claiming to be entitled to any moneys transferred can apply to the company for payment of money claimed by them.

TRANSFER TO INVESTOR EDUCATION AND PROTECTION FUND

Section 124 (5) states that any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of

such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under sub-section (1) of section 125 (Investor Education and Protection Fund) and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

Shares in respect of unpaid dividend also to be transferred to IEPF

Section 124(6) provides that all shares in respect of which unpaid or unclaimed dividend has been transferred under sub section (5) shall also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed.

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

OFFENCE & PENALTY

Section 124(7) provides that if a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Let us Remember!

- In case of any default in transferring the unpaid or unclaimed dividend within 7 days from the expiry of 30 days of declaration, the company shall be liable to pay interest at the rate of 12% on the amount remaining unpaid along with interest accrued thereon for 7 years shall be transferred to Investor Education and Protection Fund.
- All shares in respect of which unpaid or unclaimed dividend has been transferred, shall also be transferred by the company in the name of Investor Education and Protection Fund

What shall be credited to IEPF? (not yet enforced)

Section 125(2) prescribes the following the list which shall be credited to the Fund—

- (a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;
- (b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;
- (c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub section (5) of section 124;
- (d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;
- (e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

- (f) the interest or other income received out of investments made from the Fund;
- (g) the amount received under sub-section (4) of section 38;
- (h) the application money received by companies for allotment of any securities and due for refund;
- (i) matured deposits with companies other than banking companies;
- (j) matured debentures with companies;
- (k) interest accrued on the amounts referred to in clauses (h) to (j);
- (l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
- (m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and
- (n) such other amount as may be prescribed.

Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

UTILISATION OF INVESTOR EDUCATION AND PROTECTION FUND

Section 125 (3) Provides the Fund shall be utilised for—

- (a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
- (b) promotion of investors' education, awareness and protection;
- (c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
- (d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
- (e) any other purpose incidental thereto, in accordance with such rules as may be prescribed:

Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

Rule 4 of Companies (Declaration and Payment of Dividend) Rules, 2014 provides that the Statement of amounts to be credited to investor protection fund shall be filed in Form DIV 5.

RIGHT TO DIVIDEND RIGHTS AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES:-

Section 126 provides that when any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provision of this Act,—

- (a) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer; and

- (b) keep in abeyance in relation to such shares, any offer of rights shares under clause (a) of sub-section (1) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (5) of section 123.

PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS:-

Section 127 of Companies Act 2013 provides that when a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent. per annum during the period for which such default continues.

Exceptions

Proviso to section 127 has provided a list where no offence under this section shall be deemed to have been committed:—

- (a) where the dividend could not be paid by reason of the operation of any law;
- (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;
- (c) where there is a dispute regarding the right to receive the dividend;
- (d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

Test yourself

Can dividend be lawfully adjusted by a company against any claim due from the shareholder?

Answer : YES

DIVIDEND ON PREFERENCE SHARES

A Preference share carries a preferential right as to dividend in accordance with the term of issue and the articles of association, subject to the availability of distributable profits. The preferential right to a dividend could either be a fixed amount or an amount calculated at a fixed rate. It may be cumulative or non-cumulative. Preference shares can carry dividend of a fixed amount, before any dividend is paid on the equity shares. If there are two or more classes of preference shares, the shareholders of the class which has priority are similarly entitled to their preferential dividend before any dividend is paid in respect of the other class. But these rights in respect of dividends are subject to three conditions.

Firstly, preference shares are part of the company's share capital, consequently, preference dividends can be paid only if the company has earned sufficient profits.

Secondly, a dividend becomes payable to the shareholders only when it is declared in the manner laid down in the Act and by the company's articles.

Thirdly, there should have been a formal declaration. Preference shareholders are not entitled to treat the

preference dividend as a debt and sue for its payment in the first instance. However, if the articles specify that the company's profit shall be applied, by way of payment of the preference dividend, the preference shareholder can sue for it even though it has not been declared [Evling v. Israel & Oppenheimer Ltd. (1918) 1 Ch. 101].

LESSON ROUND- UP

- Under Section 2(35) of the Companies Act ,2013 , 'dividend' includes any interim dividend.
- Dividend is the share of the company's profit distributed among the members.
- The Board may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account at any time between two AGM of the company.
- Final Dividend means a Dividend which declared at the Annual General Meeting of the company.
- In case of inadequacy of profits the company can declare the dividend with accordance with the Rule 3 of Companies (Declaration and Payment of Dividend) Rules 2014.
- The amount of dividend shall be deposited in a schedule bank in a separate account within 5 days from the date of declaration.
- Dividend may be paid by cheque or warrant or in any electronic mode to the shareholders entitled to the payment of dividend.
- Where the dividend is not paid or claimed within 30 days, the company shall, within 7 days transfer the amount to Unpaid Dividend Account which shall be opened in a scheduled bank.
- In case of any default in transferring the amount, the company shall be liable to pay interest on the amount as has not been transferred.
- The amount remaining unpaid along with interest accrued thereon for 7 years shall be transferred to Investor Education and Protection Fund.
- In case of non-payment of dividend the every party in default be punishable with imprisonment of upto two years and with fine.

SELF TEST QUESTIONS

- (1) Define the term 'Dividend'. State briefly the provisions.
- (2) Distinguish between 'Dividend' and 'Interest'
- (3) State the procedure for transfer of unpaid or unclaimed dividend to the Investor Education and Protection Fund.
- (4) Explain the law relating to declaration and payment of final dividend.
- (5) Define Interim Dividend. Distinguish between 'Interim Dividend' and 'Final Dividend'.
- (6) Write short notes on the following:-
 - (i) Investor Education and Protection Fund(IEPF).
 - (ii) Punishment of failure to distribute dividend and exceptions.

Lesson 23

Board's Report and Disclosures

LESSON OUTLINE

- Introduction
- Disclosures under Companies Act, 2013
- Disclosure pursuant to rules made under Companies Act, 2013
- Disclosures Pursuant to the listing agreement of stock exchanges
- Approval of the Board's Report
- Signing and dating of the Board's Report
- Filing of the Board's Report
- Right of members to copies of Balance sheet, Board's Report etc.
- Liability of mis-statement

LEARNING OBJECTIVES

Disclosure and transparency are of utmost importance in a fiduciary relationship between the directors and shareholders. Boards' Report or Directors' Report is an important tool for the stakeholders to judge or analyse the performance and corporate governance measures adopted by the company.

Company Secretary guides the directors in preparation of this report; they are expected to be well versed with the related provisions.

After reading this lesson you will be able to understand the contents of the directors' report whether mandated by law or adopted as a good corporate practice.

"When you practice reporting for as long as I have, you keep yourself at a distance from True Believers. Either conservatives or liberals or Democrats or Republicans."

— **Bob Woodward**

1. INTRODUCTION

The Board of Directors of a company must strive to maximize wealth while adhering to good corporate governance principles and practices. The efficacy of the Board of Directors is not determined simply by gauging whether it fulfills its legal requirements but, more importantly, by its philosophy and the manner in which it translates the understanding of its responsibilities for the benefit of the stakeholders of the company.

The Board's Report is an important means of communication by the Board of Directors, serving to inform the stakeholders about the performance and prospects of the company, relevant changes in management, capital structure, major policies, recommendations as to the distribution of profits, future programmes of expansion, modernization and diversification, capitalization of reserves, further issue of capital, etc.

The matters to be included in the Board's Report have been specified in Section 134(3) of the Companies Act, 2013. Apart from this, Sections 67[proviso to sub section (3)], 177(8) &(10), proviso178(4), 188(2), 197(12) & (14), and 204(1) of the Companies Act, 2013 and some Rules of 2014 also contain provisions in relation to the Board's Report. The Board's Report of Companies whose shares are listed on a stock exchange must include additional information as specified in the Listing Agreement. Further, the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992 and the regulations, rules, directions, guidelines, circulars, etc. issued thereunder, necessitate certain additional disclosures to be made in the Board's Report. ICSI issued Secretarial Standard 10, which seeks to lay down practices pertaining to the preparation and presentation of the Board's Report.

2. DISCLOSURES UNDER SECTION 134 OF THE COMPANIES ACT, 2013

This section seeks to provide that the financial statement including consolidated financial statement should be approved by the board of director before they are signed and submitted to auditors for their report. Report of the board of directors containing detail of the matter as specified under section 134(3) of the Act. The Board's Report shall be attached to every copy of financial statement laid before the company. The section also provide for penal provisions for the company and for the every officer of the company in the case of any contravention.

Section 134(3) Provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—

- (a) the extract of the annual return as provided under **Section 92(3)**. An extract of the annual return in such form as may be prescribed shall form part of the Board's report. (prescribed under rule 12(1) and form MGT 9, Companies(management and administration) Rule 2014

Rule 12(1) of Companies(Management and Administration) Rules 2014 states that the extract of annual return to be attached with the board's Report shall be in Form No. MGT 9

- (b) number of meetings of the Board;
- (c) Directors' Responsibility Statement
- (d) a statement on declaration given by independent directors under section 149(6)
- (e) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters as given under sub-section (3) of section 178.

- (f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
 - (i) by the auditor in his report; and
 - (ii) by the company secretary in practice in his secretarial audit report.
- (g) particulars of loans, guarantees or investments under section 186.
- (h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form.
 - (i) the state of the company's affairs.
 - (j) the amounts, if any, which it proposes to carry to any reserves.
 - (k) the amount, if any, which it recommends should be paid by way of dividend.
 - (l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report.
- (m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.
- (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
- (o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year.
- (p) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
- (q) such other matters as may be prescribed.

REVIEW QUESTIONS!!!!

- (i) Whether explanation or comment by Board on *adverse remark* given by the Auditors/Company Secretary are required to be disclose ?

Ans: Yes, any explanation or comment given by board shall be disclosed in the Board's Report

- (ii) Whether policy developed and implemented on *Corporate Social Responsibility* are required to be disclosed in Board's Report

Ans: Yes

- (iii) Which rule are required to be referred in section 134(3)(*disclosure in Board's Report*)

Ans: Rule 8 of Companies (Accounts)rules 20013

The Directors' Responsibility Statement

Section 134(5) referred to in clause (c) section 134(3) shall state that—

- (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

- (b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
 - (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
 - (d) the directors had prepared the annual accounts on a going concern basis; and
 - (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.
- Explanation to clause(e)* defines the term “internal financial controls as the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;
- (f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

3. OTHER DISCLOSURES UNDER THE COMPANIES ACT, 2013

➤ Independent Director

An Independent Director is a person who is not related to the promoters or the other members of the company. As per section 149(10) an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. [Subject to the provision of 152 i.e. Appointment of Directors)]

➤ Audit Committee

Board's Report shall disclose the composition of audit committee under section 177(8) and also discloses the recommendation of the audit committee which is not accepted by the board along with reason thereof.

Proviso to section 177(10) prescribes that the disclosure in board's report includes the detail of establishment of vigil mechanism under section 177(9). Vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. It shall also be disclosed by the company on its website.

VIGIL MECHANISM- It is the whistleblowing provision which is a mandatory requirement under section 177(9). This mechanism would enable a company to evolve a process to encourage ethical corporate behaviour. Every listed company shall establish a Vigil mechanism for their Directors and Employees to report their genuine concern or grievances.

LET US REMEMBER!!!!

- (i) Re-appointment of an Independent Director shall be disclosed in the Board's Report.
- (ii) The composition of Audit committee shall be disclosed in Board's Report.
- (iii) The details of the establishment of Vigil Mechanism shall also be disclosed in Board's Report.

Nomination and Remuneration committee

Section 178(1) mandates all the listed company and such other class or classes, as may be prescribed to have nomination and Remuneration committee.

As per Rule 6 of the Companies (Meeting of Board and its Powers) Rules, 2014 the following class of companies shall have constitute Nomination and Remuneration Committee:-

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Proviso to section 178(4) The board's Report shall disclose such policy according to which the Nomination and Remuneration Committee ensure that –

- (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully.
- (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
- (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goal.

➤ **Secretarial Audit for Bigger Companies**

As per section 204(1) every listed company and other prescribed companies in Rule 9 Companies (Appointment & Remuneration of Managerial Personnel)Rules 2014 shall annex the secretarial audit report given by a Company Secretary in practice with Board's Report. Board in its report shall explain any qualification or other remarks made by the Company Secretary in Practice. Secretarial audit report given by a Company Secretary shall be in the Form no. MR3.

4. PENAL PROVISIONS UNDER THE COMPANIES ACT, 2013

Section134(8) states that if a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakhs rupees. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees, or with both

LET US REMEMBER!!!!!!

What are the punishment for not complying with section 134 of the Act?

Ans: (i) For company:- Fine

(a) Minimum - ₹50,000; and

(b) Maximum - ₹25,00,000.

(ii) For employees, who is in default:

(a) Imprisonment for maximum upto 3 years; or

(b) Fine Minimum. ₹50,000 and Maximum. upto ₹5,00,000

5. DISCLOSURES UNDER VARIOUS RULES MADE UNDER COMPANIES ACT, 2013

I. Matters to be included in Board's report [Rule 8 of Companies(Accounts) Rules 2014].-

As per Rule 8 of Companies(Accounts)Rules 2014 following matters to be disclose in the Board's Report:-

- (1) The Board's Report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.
- (2) The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form **AOC-2**.
- (3) The report of the Board shall contain the following information and details, namely:-

(A) Conservation of energy-

- (i) the steps taken or impact on conservation of energy;
- (ii) the steps taken by the company for utilising alternate sources of energy;
- (iii) the capital investment on energy conservation equipments;

(B) Technology absorption-

- (i) the efforts made towards technology absorption;
- (ii) the benefits derived like product improvement, cost reduction, product development or import substitution;
- (iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year)-
 - (a) the details of technology imported;
 - (b) the year of import;
 - (c) whether the technology been fully absorbed;
 - (d) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
- (iv) the expenditure incurred on Research and Development.

(C) Foreign exchange earnings and Outgo-

The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange

outgo during the year in terms of actual outflows.

- (4) Every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.
- (5) In addition to the information and details specified in sub-rule (4), the report of the Board shall also contain –
 - (i) the financial summary or highlights;
 - (ii) the change in the nature of business, if any;
 - (iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;
 - (iv) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;
 - (v) the details relating to deposits, covered under Chapter V of the Act,-
 - (a) accepted during the year;
 - (b) remained unpaid or unclaimed as at the end of the year;
 - (c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-
 - (i) at the beginning of the year;
 - (ii) maximum during the year;
 - (iii) at the end of the year;
 - (vi) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
 - (vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;
 - (viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

Disclosures about CSR Policy.- The disclosure of contents of Corporate Social Responsibility Policy in the Board's report and on the company's website, if any, shall be as per annexure attached to the Companies (Corporate Social Responsibility Policy) Rules, 2014.

II. Disclosure under Companies(Share Capital and Debenture) Rules, 2014

Disclosure in pursuit to issue of shares with Differential rights

The Board of Directors shall, *inter alia*, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details, namely:-

- (a) the total number of shares allotted with differential rights.
- (b) the details of the differential rights relating to voting rights and dividends.
- (c) the percentage of the shares with differential rights to the total post issue equity share capital with

differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital.

- (d) the price at which such shares have been issued.
- (e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued.
- (f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights.
- (g) the diluted Earning Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards.
- (h) the pre and post issue shareholding pattern along with voting rights in the format specified under rule 4(2).

Disclosure in pursuit to Issue of Sweat Equity Shares

As per sub rule (13) of rule 8 the Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares namely:-

- (a) the class of director or employee to whom sweat equity shares were issued.
- (b) the class of shares issued as Sweat Equity Shares.
- (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them , if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital.
- (d) the reasons or justification for the issue.
- (e) the principal terms and conditions for issue of sweat equity shares, including pricing formula.
- (f) the total number of shares arising as a result of issue of sweat equity shares.
- (g) the percentage of the sweat equity shares of the total post issued and paid up share capital.
- (h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares.
- (i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Disclosure pursuit to Employee Stock Option and Employee Stock Purchase Schemes

As per the rule 12(9) of Companies(Share Capital and Debenture)Rules 2014, the Board of directors, shall, *inter alia*, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

- (a) options granted;
- (b) options vested;
- (c) options exercised;
- (d) the total number of shares arising as a result of exercise of option;
- (e) options lapsed;
- (f) the exercise price;

- (g) variation of terms of options;
- (h) money realized by exercise of options;
- (i) total number of options in force;
- (j) employee wise details of options granted to:-
 - (a) key managerial personnel;
 - (b) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
 - (c) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

Disclosure pursuant to purchase of its own shares by employees or by trustees for the benefit of employees

Section 67(2) provides that no public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

Section 67(3) also provides that nothing in sub-section (2) shall apply to—

- (a) the lending of money by a banking company in the ordinary course of its business;
- (b) the provision by a company of money in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paidup shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company;
- (c) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership:

NOTED THAT!

The disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed in rules made under Chapter IV

Rule 16(4) Companies (Share Capital and Debentures) Rules, 2014

When the voting rights are not exercised directly by the employees in respect of shares to which the scheme relates, the Board of Directors shall, *inter alia*, disclose in the Board's report for the relevant financial year the following details, namely:-

- (a) the names of the employees who have not exercised the voting rights directly;
- (b) the reasons for not voting directly;
- (c) the name of the person who is exercising such voting rights;
- (d) the number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of the company;

- (e) the date of the general meeting in which such voting power was exercised;
- (f) the resolutions on which votes have been cast by persons holding such voting power;
- (g) the percentage of such voting power to the total voting power on each resolution;
- (h) whether the votes were cast in favour of or against the resolution.

III. Rule 5 of Companies (Appointment & Remuneration of Managerial Personnel) Rules 2014:-

Rule 5(1) of Companies (Appointment & Remuneration) Rules,2014 made under Chapter IV provides the following disclosure by the listed companies in the Board's Report:-

- (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;
- (ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;
- (iii) the percentage increase in the median remuneration of employees in the financial year;
- (iv) the number of permanent employees on the rolls of company;
- (v) the explanation on the relationship between average increase in remuneration and company performance;
- (vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;
- (vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;
- (viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;
- (ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;
- (x) the key parameters for any variable component of remuneration availed by the directors;
- (xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and
- (xii) affirmation that the remuneration is as per the remuneration policy of the company.

Explanation.- For the purposes of this rule.-(i) the expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

(ii) if there is an even number of observations, the median shall be the average of the two middle values.

Rule 5(2) of Companies (Appointment and Remuneration) Rules,2014 made under Chapter IV provides the following disclosure on particulars of employees:-

The board's report shall include a statement showing the name of every employee of the company, who-

- (i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees;
 - (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than five lakh rupees per month;
 - (iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.
- (3) The statement referred to in sub-rule (2) shall also indicate -
- (i) designation of the employee;
 - (ii) remuneration received;
 - (iii) nature of employment, whether contractual or otherwise;
 - (iv) qualifications and experience of the employee;
 - (v) date of commencement of employment;
 - (vi) the age of such employee;
 - (vii) the last employment held by such employee before joining the company;
 - (viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and
 - (ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Proviso(i) says that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board's report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Proviso(ii) says that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Proviso(iii) says that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

IV. Rule 8 of Companies (Corporate Social Responsibility) Rules,2014

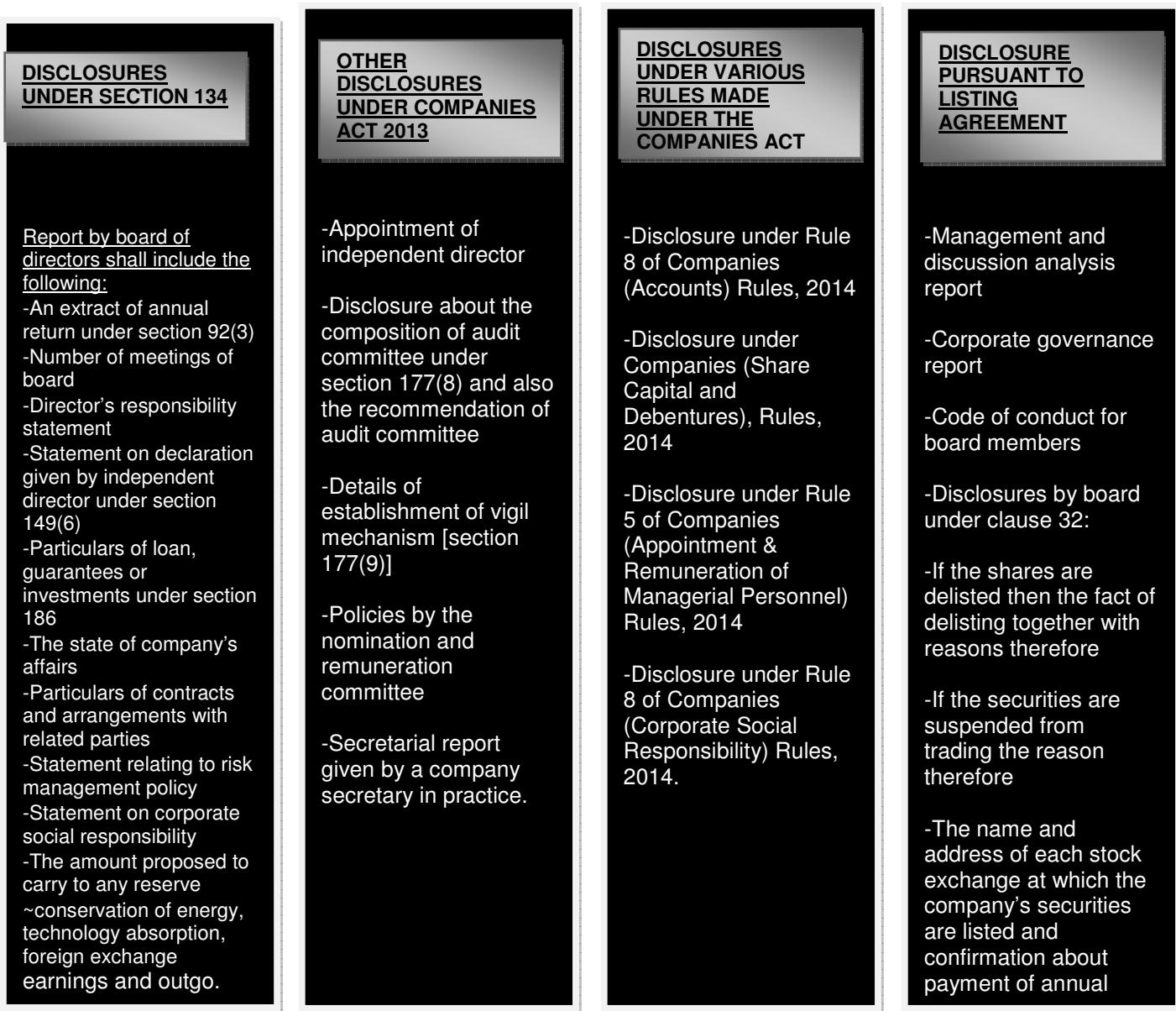
Section 135(2) provides that the Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.[also refer the rule 8 of Companies(Corporate Social Responsibility)Rules 2014]

Rule 8 of Companies (Corporate Social Responsibility) Rules, 2014 prescribes that the following CSR reporting:-

The Board's Report of a company under these rules pertaining to a financial year commencing on or after 1st day of April, 2014 shall include an Annual Report on CSR containing particulars specified in Annexure.

In case of a foreign company, the balance sheet filed under section 381(1)(a) shall contain an Annexure regarding report on CSR.

DISCLOSURES BY BOARD



5. SIGNING AND DATING OF THE BOARD'S REPORT

The Board's report and any annexures thereto under section 134(3) shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.[section 134(3)]

Section 134(7) prescribes that a signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

- (a) any notes annexed to or forming part of such financial statement;
- (b) the auditor's report; and
- (c) the Board's report referred to in section 134(3).

6. COPY OF FINANCIAL STATEMENT ALONG WITH BOARD'S REPORT TO BE FILE WITH REGISTRAR

Section 137 provides that after the financial statement have been laid before the company at an annual general meeting, a copy of the financial statement, including consolidated financial statement, if any, along with all documents required to be annexed or attached thereto should be filed with the Registrar of Companies within 30 days, along with the prescribed fees. The Board's Report has to be attached to the balance sheet.

NOTED THAT:

Section 134(2) The audited reports' shall be attached to every financial statement and also refer rule 8 Of Companies (Accounts)Rules 2014

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

If the Auditor's Report contains any adverse remarks as regards any reservation, the Board is not bound to give any explanation or clarification regarding the matter.

- True
- False

Correct answer: False

7. RIGHT OF THE MEMBERS TO COPIES OF BOARD'S REPORT AND OTHER DOCUMENTS

Section 136(1) provides that a copy of the financial statement, Board's Report and auditor's report, which are to be laid before a company in its general meeting, should be sent to every member, trustee for the debenture-holders, and all the other specified person at least 21 days before the date of the annual general meeting. Company shall also allow every member or trustee of debenture-holders to inspect the document at it registered office during business hours [sub section (2) of section 136]

Companies are also required to place its financial statement (including consolidated financial statement) with other Companies document on its website [proviso(ii)]

➤ ***Where documents are available of Inspection***

Proviso (1) to section 136(1), which contains an exception to this rule, if the listed companies made available the copies of the documents for inspection at its registered office for the period of 21 days before the meeting and a statement containing the salient feature of the documents in Form No. AOC.3, are deemed to comply with section 136(1). Companies are not required to sent a copies of document to every members unless it is specifically asked.

➤ ***Right of the members to copies of Board's and in other documents in case of Subsidiary companies***

Proviso (iv) to section 136 provides that every company having a subsidiary or subsidiaries shall,—

- (a) place separate audited accounts in respect of each of its subsidiary on its website, if any;
- (b) provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the company who asks for it.

➤ ***Penalty for Non-compliance***

Section 136(3) states that If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

8. LIABILITY FOR MIS-STATEMENT

Section 448 provides that same as otherwise provided in this Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

NOTED THAT!!!

Punishment of Fraud(Under Section 447)

Any person who is found to be guilty of fraud shall be punishable with Imprisonment Mini- 6 months , Maxi- 10 years; and Fine Mini- amount of fraud , Maxi-3 times of amount of Fraud

9. DISCLOSURES PURSUANT TO THE LISTING AGREEMENT OF STOCK EXCHANGES

I. Management Discussion and Analysis Report

Clause 49 (IV) (F) of the listing agreement provides that as a part of the directors' report or as an addition thereto, a Management Discussion and Analysis Report(MDAR) should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:

1. Industry structure and developments.
2. Opportunities and Threats.

3. Segment-wise or product-wise performance.
4. Outlook.
5. Risks and concerns.
6. Internal control systems and their adequacy.
7. Discussion on financial performance with respect to operational performance.
8. Material developments in Human Resources / Industrial Relations front, including number of people employed.

Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team (excluding the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.

MDAR should be considered and approved by the Board in a meeting of the Board and not through resolution passed by circulation.

II. Corporate Governance Report

Corporate governance aims to improve the company's image, efficiency, effectiveness and social responsibility. It encompasses in itself a range of corporate controls and accountability mechanisms designed to meet the aims of corporate stockholders. It deals with issues regarding transparency accounting integrity, composition of the board of directors, the role of non-executive directors and their accountability to shareholders, etc.

Clause 49 (VI) of the listing agreement relates to reporting on corporate governance. It provides that there shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure- I C and list of non-mandatory requirements is given in Annexure – I D.

Gist of Annexure I C

1. A brief statement on company's philosophy on code of governance.
2. Details relating to Board of Directors
3. Details relating to Audit Committee, Shareholders Committee and other committees
4. Details with respect to General Body meetings: Location and time, where last three AGMs held, special resolutions passed in the previous 3 AGMs etc.
5. Detailed disclosures with respect to materially significant related party transactions, non-compliance by the company etc.
6. Details of Means of communication adopted by the company
7. General Shareholder information relating to Date of Book closure, Stock Code, Dividend Payment Date, Market Price Data, Plant Locations etc.

Gist of Annexure I D (Non- Mandatory Requirements)

1. Tenure of Independent Directors
2. Constitution of remuneration committee
3. Training of Board Members

The company shall obtain a certificate from, either the auditors or practicing company secretaries, regarding compliance of conditions of corporate governance as in clause 49 of the listing agreement and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

The reference of inclusion of report on corporate governance in the annual report should be made in the Board's Report and, as a good corporate practice, information relating to any non-compliance of the requirements of Clause 49 of the listing agreement should be incorporated in the Board's Report.

III. Code of Conduct

Clause 49 (I)(D) of the listing agreement provides that the Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company. The clause further provides that all Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO. Unless it is reported elsewhere, this information should be furnished in Board's Report.

IV. Disclosures as required by other clauses of Listing Agreement

The following disclosures are also to be made by the Board in its report under clause 32:

- (i) in case the shares are delisted, the fact of delisting, together with reasons therefore;
- (ii) in case the securities are suspended from trading, the reasons therefore;
- (iii) the name and address of each stock exchange at which the company's securities are listed and also confirmation that annual listing fee has been paid to each such exchange.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Management Discussion and Analysis Report (MDAR) should either form a part of the Board's report or be given as an addition thereto in the annual report to the shareholders.

- True
- False

Correct answer: True

SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 provide that the Board shall disclose, either in the Board's Report or in an annexure to the Board's Report, various details with regard to ESOS and ESPS.

LESSON ROUND-UP

- Attaching Board's report to every balance sheet is mandatory. Apart from giving a complete review of performance of company for the year under report, it highlights various disclosures having impact on business. It also highlights the future strategy of the company.
- The matters to be included in Board's Report should be under the provisions of Companies Act, Listing Agreements, SEBI Guidelines and RBI directions.
- Under Companies Act the matters to be included should be with respect to state of company's affairs, the amount which it proposes to carry to any reserves, recommendation of amount of dividend, material changes, conservation of energy, technology absorption, foreign exchange earning and outgo, particulars in respect of certain employees, director's responsibility statement.
- As per listing agreement, Management Discussion and Analysis Report, Report on Corporate Governance, fact of delisting, suspension of securities are the matters to be included in the Board's Report.
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 provides for disclosures regards to ESOS and ESOP.
- As per RBI's directions, certain disclosures are required to be made by non-banking companies receiving deposits.
- Board's report should be signed by the Chairman of the Board, if so authorized and if not so authorized then by not less than two directors of the company, one of whom shall be managing director, where there is one.
- The Board shall be collectively responsible for any statement in its Report which is false in any material particular or for any omission of a material fact.
- If a practicing company secretary gives a false statement relating to materially relevant fact or omit a material fact in the compliance certificate etc. penal provisions of section 448 of the Companies Act, 2013 will be attracted. He shall be punishable with imprisonment for a term which may extend to ten years and shall also be liable to fine.

GLOSSARY

E-filing	The process of using a computer program to transmit information electronically to another party. This allows the user to complete and submit the information in a timely fashion. The electronic filing system prevents the user from making small mistakes by alerting them if something does not register correctly.
Listing Agreement	A document which a company signs when being listed on the Stock Exchange, in which it promises to abide by stock exchange regulations.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. State the disclosures in Board's Report under listing agreement.
2. State the provisions for signing and dating of Board's Report.
3. What is the need and scope of Compliance Certificate.
4. Discuss Management Discussion Analysis Report.
5. Enumerate the liability for mis-statement.

Lesson 24

Registers, Forms and Returns

LESSON OUTLINE

- Statutory Books/register
- Secretarial Standard on Registers and Records. (SS-4)
- Statutory books elaborated (covering Annual Return)
- Procedure for keeping registers and returns at a place other than the registered office
- Non-statutory Registers
- Electronic forms
- Filing of various forms/Returns with Registrar of Companies
- Preparation and filing of returns with the Registrar of Companies
- Guidelines for preparing/filing forms, documents, returns etc.
- Condonation of Delay
- Penalty for filing false documents/statements with the Registrar.

LEARNING OBJECTIVES

The company has to maintain certain registers and records for statutory, statistical, disclosure, information management/MIS purposes. They also file returns with the regulatory authorities to intimate them as to material changes as prescribed. The objective behind such returns is not only statutory requirement, but these are also helpful for the smooth functioning of the company. These records make the company's working more systematic. The company is required to keep these records with in the vicinity of the place prescribed for it by the laws.

After reading this lesson you will be able to understand the maintenance, authentication, preservation and inspection of statutory book/registers prescribed under various provisions of the Company Law, non-statutory books, various forms/returns required to be filed to Registrar of Companies and the provisions relating to Annual Return.

"Life is like a cash register, in that every account, every thought, every deed, like every sale, is registered and recorded."

— Fulton J. Sheen

1. STATUTORY BOOKS/REGISTERS

The Companies Act, 2013 lays down that every company incorporated under this Act must maintain and keep at its registered office certain books, registers and copies of certain returns, documents etc. and to give certain notices, file certain returns, forms, reports, documents etc. with the Registrar of Companies within certain specified time limits and with the prescribed filing fees. These books are known as Statutory Books. Some of the statutory registers are required to be kept open by the company for inspection by directors, members, creditors of the company and by other persons. The company is also required to allow extracts to be taken from certain documents, registers, returns etc. and furnish copies of certain documents on demand by a member or by any other person on payment of specified fees.

Every company incorporated under the Act is required to keep at its registered office, *inter alia*, the following statutory books and registers –

- Register of securities bought back. (Section 68 and Rule 17(12) of companies (Share Capital and Debenture) Rules, 2014
- Register of deposits. [Section 73 and Rule 14 Companies (Acceptance of Deposits) Rules, 2014
- Register of charges. (Section 85 and Rule 7 of Companies (Registration of Charges) Rules 2014)
- Register of members(section 88(1) and Rule 3(1) of Companies(Management and Administration) Rules 2014
- Index of members. [Sections 88(2) and the Rule 6 of Companies (Management and Administration) Rules, 2014]
- Register of debenture holders [section 88 (1)]
- Index of debenture holders. (Section 88 (2))
- Register and index of beneficial owners. (Section 88 (3))
- “Foreign register” containing the names and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India.(Section 88 (4))
- Register of Renewed and Duplicate Share Certificates. [Rule 6 of the Companies (Share Capital and Debenture) Rules, 2014]
- Register of sweat equity shares [Section 54 and Rule 8 (14) of Companies (Share Capital and Debenture) Rules, 2014]
- Annual Return (Section 92) and Rule 11 of The Companies (Management and Administration) Rules 2014
- Register of Postal Ballot [Section 110 and Rule 22 of the Companies (Management and Administration) Rules, 2014]
- Books containing minutes of general meeting and of Board and of committees of Directors. [Section 118]
- Books of accounts. [Section 128]
- Register of Directors/ Key Managerial Personnel. [(Section 170 (1)]
- Register of investments in securities not held in company's name. [Section 18 and Rule 14 of Companies (Meetings of Board and its Powers) Rules, 2014]

- Register of loans, guarantees given and security provided or making acquisition of securities (Section 186(9) and Rule 12 Companies Meetings of Boards and its Powers Rules 2014)
- Register of contracts with companies/firms in which directors are interested. [Section 189(5) and Rule 16 of Companies (Meetings of Boards and its Powers) Rules, 2014]

Register of securities bought back. (Section 68 Rule 17(12) of Companies (Share Capital and Debenture) Rules, 2014

When a company buys back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed. According to the rules the register of shares or securities boughtback shall be maintained in Form SH-10, at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. Entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

Register of deposits. [Section 73, Rule 14 Companies (Acceptance of Deposits) Rules, 2014

- (1) Every company accepting deposits shall, from the date of such acceptance, keep at its registered office one or more separate registers for deposits accepted/renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:
 - (a) Name, address and PAN of the depositor/s;
 - (b) Particulars of guardian, in case of a minor;
 - (c) Particulars of the nominee;
 - (d) Deposit receipt number;
 - (e) Date and amount of each deposit;
 - (f) Duration of the deposit and the date on which each deposit is repayable;
 - (g) Rate of interest;
 - (h) Due date(s) for payment of interest;
 - (i) Mandate and instructions for payment of interest and for non-deduction of tax at source, if any;
 - (j) Date or dates on which payment of interest will be made;
 - (k) Details of deposit insurance including extent of deposit insurance;
 - (l) Particulars of other security/ charge created;
 - (m) Any other particulars relating to the deposit;
- (2) Entries in the register shall be made within seven days from the date of issuance of the deposit receipt and such entries shall be authenticated by a director or secretary of the company or by any other officer authorized by the Board for this purpose.
- (3) The register or registers referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

Register of charges. [Section 85; Rule 7 of Ccompaniees (Registration of Charges Rules 2014]

Section 85 provides that every company shall keep at its registered office a register of charges in Form No. CHG.7 which shall include therein all charges and floating charges affecting any property or assets of the

company or any of its undertakings, indicating in each case such particulars as may be prescribed. The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be. Such register of charges shall contain the particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge. All the entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose. The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company. A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

Register of Members

Section 88 requires every company to keep and maintain the following Registers along with the Index thereof:

- register of members for each class of equity and preference shares (separately);
- register of debenture holders;
- register of any other security holders; and
- foreign register of members and debenture holders etc.

Every company shall, from the date of its registration, keep and maintain a register of its members in one or more books in Form No. MGT.1. [Rules 3(1) of Companies (Management and Administration) Rules, 2014

Rule 3(2) In case of existing companies, registered under the Companies Act, 1956, particulars shall be compiled within six months from the date of commencement of these rules. Further, in the case of a company not having share capital, the register of members shall contain the following particulars in respect of each member -

- (a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/Mother's/Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;
- (b) date of becoming member;
- (c) date of cessation;
- (d) amount of guarantee, if any;
- (e) any other interest if any; and
- (f) instructions, if any, given by the member with regard to sending of notices etc.

In the case of existing companies, registered under the Companies Act, 1956, particulars shall be compiled within six months from the date of commencement of these rules.

Maintenance of the Register of Members etc. [Rule 5]

Every company shall maintain the Registers of members, Register of debenture holders or any other security holders in the following manner:-

- (1) Entries in the registers maintained under section 88 shall be made within seven days after the

Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

- (2) The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.
- (3) Consequent upon any forfeiture, buy-back, reduction, subdivision, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.
- (4) If any change occurs in the status of a member or debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries thereof explaining the change shall be made in the respective register.
- (5) If any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.
- (6) If any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.
- (7) In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.
- (8) If promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within fifteen days from such an event.

Index of Names to be included in Register [Rule 6]

- (1) Every register maintained under sub-section (1) of section 88 shall include an index of the names entered in the respective registers. The index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found.

The company shall make the necessary entries in the index simultaneously with the allotment or transfer of any security in such Register.

The maintenance of index is not necessary in case the number of members is less than fifty. [Proviso to Rule 6(1)]

Closure of Register of Members etc.

In terms of Section 91, a company may close its Register of members or Register of Debenture holders or

Register of other security holders for a period not exceeding forty five days in a year. However, the Register can not be closed for more than thirty days at any one time. A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice or such lesser period and in such manner, as may be specified by Securities and Exchange Board, if such company is a listed company or companies intends to get its securities listed. The notice shall be by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company as provided in the Rules.

The requirement of advertisement giving notice of closure of register of members is not applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members/debenture holders/other security holders.

- Declaration in Respect of Beneficial Interest in any Shares

Section 89 provides that a declaration is to be given to the company by any person who is a member but not holding the beneficial interest in such shares stating therein the name and other particulars of the person holding the beneficial interest. The declaration to that effect is required to be filed in Form No.MGT.4 in within thirty days from the date on which his name is entered in Register of members. In case of any change, the registered owner is required to make a declaration of the change in ownership within thirty days of such change. Further, the person holding beneficial interest (beneficial owner) shall declare the nature of his interest and particulars on the person in whose name shares stand registered. The beneficial owner is required to make the declaration within thirty days after acquiring the beneficial interest. Likewise, in case of any change, the beneficial owner is required to make a declaration to the company within thirty days of such change.

Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name (hereinafter referred to as "the beneficial owner") shall file with the company, a declaration disclosing such interest in Form No. MGT.5 in duplicate, within thirty days after acquiring such beneficial interest in the shares of the company.

In terms of section 89(6), where any declaration is received by the company, the company shall make a note of such declaration in the register of members and shall file, within thirty days from the date of receipt of declaration by it, a return in Form No. MGT. 6 with the

Registrar in respect of such declaration with fee. Section 90 provides that the Central Government may appoint one or more competent persons to investigate and report as to the beneficial ownership with regard to any share or class of shares.

Register of Debenture Holders or any other Security Holders

Every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders, as the case may be, for each type of debentures or other securities in one or more books in Form No. MGT.2.

Foreign Register of Members, Debenture Holders, other Security Holders or Beneficial Owners residing outside India (Section 88 and Rule 7)

— In terms of sub-section (4) of Section 88, a company, if authorized by its Articles of Association, can

also keep any part of the Register in any other country. Hence, in all such countries, where the Company has large number of shareholders, a Register of Members containing information about the members from that particular country may be kept. To be called "foreign register", this Register should contain the names and particulars of the members, debenture holders, other security holders or beneficial owners residing in that country.

- The Rules provides as under with regard to the foreign register, the company shall, within thirty days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office in Form No.MGT.3 along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within thirty days from the date of such change or discontinuance, as the case may be, file notice in Form No.MGT.3 with the Registrar of such change or discontinuance. [Rule 7(2)]
- A foreign register shall be deemed to be part of the company's register of members or of debenture holders or of any other security holders or beneficial owners, as the case may be. The foreign register shall be maintained in the same format as the Principal Register. [Rule 7(3) and 7(4)]
- A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, mutatis mutandis, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept. [Rule 7(5)]
- Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be. [Rule 7(7)]
- The company shall—
 - (a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and
 - (b) keep at such office a duplicate register of every foreign register duly entered up from time to time. [Rule 7(8)]
- If a foreign register is kept by a company in any country outside India, the decision of the Tribunal in regard to the rectification of the register shall be binding. [Rule 7(6)]
- The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company in the same part of the world or to the principal register. [Rule 7(11)]

Authentication of Entries in the Registers [Rule 8 of Companies (Management and Administration) Rules, 2014]

The Rules provide that the entries in the registers maintained under section 88 and index included therein shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose and the date of the board resolution authorising the same shall be mentioned.

Entries in the foreign register shall be authenticated by the person authorized by the Board by appending his signature to each entry. Shares held by the Members in Electronic Mode

Sub-section (3) of Section 88 provides that in the case of shares held by the members in electronic mode, the register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index.

Register of Renewed and Duplicate Share Certificates. [Rule 6 of the Companies (Share Capital and Debenture) Rules, 2014]

Particulars of every share certificate issued shall be recorded in a Register of Renewed and Duplicate Share Certificates. Such register shall be maintained in Form No. SH-2 indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column. Such register shall be kept at the registered office of the company or at such other place where the Register of Members is kept. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. All entries made in the Register of Renewed and Duplicate Share Certificates shall be authenticated by the company secretary or such other person as may be authorized by the Board for purposes of sealing and signing the share certificate.

Register of sweat equity shares [Section 54 and rule 8 (14) of Companies (Share Capital and Debenture) Rules, 2014]

A Register of Sweat Equity Shares shall be maintained by the company in Form No. SH-3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54. The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide. Entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Register of Postal Ballot [Section 110 and Rule 22(10) of the Companies (Management and Administration) Rules, 2014]

The scrutineer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.

Books containing minutes of general meeting and of Board and of committees of Directors. [Section 118]

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned.

In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting.

As per section 118(10) every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

Rule 25 contains provisions with regards to minutes of meetings. A distinct minute book shall be maintained

for each type of meeting namely:

- (i) general meetings of the members;
- (ii) meetings of the creditors;
- (iii) meetings of the Board; and
- (iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minute books of general meetings shall be kept at the registered office of the company. Minutes of the Board and committee meetings shall be kept at the registered Office or at such other place as may be approved by the Board.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act.

Books of accounts. [Section 128]

REQUIREMENT OF KEEPING BOOKS OF ACCOUNT (SECTION 128)

Maintenance of books of account would mean records maintained by the company to record the specified financial transaction. It has been specifically provided that every company shall keep proper books of account. This section specifies the main features of proper books of account as under –

- (i) The company must keep the books of account with respect to items specified in clauses (i) to (iv) of sub-section 2(13) of the Companies Act, 2013, which defines "books of account".
- (ii) The books of account must show all money received and expended, sales and purchases of goods

and the assets and liabilities of the company.

- (iii) The books of account must be kept on accrual basis and according to the double entry system of accounting.
- (iv) The books of account must give a true and fair view of the state of the affairs of the company or its branches. "books of account" as defined in Section 2(13) includes records maintained in respect of—
 - (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
 - (ii) all sales and purchases of goods and services by the company;
 - (iii) the assets and liabilities of the company; and
 - (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

Place of Keeping Books of Account

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place.

Maintenance of Books of account in electronic form

The maintenance of books of account and other books and papers in electronic mode is permitted and is optional. Such books of accounts or other relevant books or papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent use (the Companies (Accounts) Rules, 2014 (Rule 3(1))).

The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered (Rule 3(2)).

The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches (Rule 3(3)).

The information in the electronic record of the document shall be capable of being displayed in a legible form (Rule 3(4)).

There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:

Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis. (Rule 3(5))

The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement -

- (a) the name of the service provider;

- (b) the internet protocol address of service provider;
- (c) the location of the service provider (wherever applicable);
- (d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider. (Rule 3(6)).

Books of Account in Respect of Branch Office

The branches of the company, if any, in India or outside India shall also keep the books of account in the same manner as specified in subsection (1), for the transaction effected at the branch office. Further the branch offices are required to send the proper summarized return at quarterly intervals to the company at its registered office and kept open to directors for inspection.

Accrual basis and Double-entry system of accounting

According to Section 128(1), books of account are required to be kept on accrual basis and in accordance with the double entry system of accounting. Accrual basis of accounting is an accounting assumption or an accounting concept followed in preparation of the financial statements. Accrual concept is one of the four principles or accounting concepts, which involves recording income and expenses as they accrue, as distinct from when they are received or paid. The main feature of the accrual concept is that the accounting period covers only the revenue and expense transactions of that period and ignores the timing of actual cash receipts and payments. In this method, revenues and expenses are identified with specific period of time, such as a month or a year, and are recorded as 'incurred' along with acquired assets, without regard to the date of actual receipt or payment of cash in any form. Double entry book-keeping is a method of recording any transactions of a business in a set of accounts, in which every transaction has a dual aspect of debt and credit and therefore, needs to be recorded in at least two accounts. For example, when a person (debtor) pays cash to a business for goods he has purchased, the cash held by the business is increased and the amount due from the debtor is decreased by the same amount; similarly, when a purchase is made on credit, the purchase account is debited and the amount owed to creditor is increased by the same amount. This double aspect enables effective control of business because all the books of accounts must balance. Thus, double entry book-keeping is a method in which every transaction is recorded in a business in such a manner that it involves one or more debit entries and one or more credit entries. The debit entries / amount must equal the credit entries/amount for each transaction recorded.

Inspection by directors

As provided in Section 128(3), any director can inspect the books of accounts and other books and papers of the company during business hours. The expression "Books and Papers" has been defined in section 2(12) which includes accounts, deeds, vouchers, writings and documents. The company is, therefore, required to make available the aforesaid books and papers for inspection by any directors. Such inspection may be done by any type of director- nominee, independent, promoter or whole time. The proviso to sub-section 3 provides that a director of the Company can inspect the books of accounts of the subsidiary, only on authorisation by way of the resolution of Board of Directors.

Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought and the period for which such information is sought (Rule 4(2)).

The said information shall be provided to director within 15 days of receipt of request (Rule 4(3)).

The director can seek the information only individually and not by or through his attorney holder or agent or representative (Rule 4(4)).

The right to inspect books of accounts and other books and papers under this section has been provided to the directors only.

Period for which books to be preserved

The books of accounts, together with vouchers relevant to any entry in such books, are required to be preserved in good order by the company for a period of not less than eight years immediately preceding the relevant financial year. In case of a company incorporated less than eight years before the financial year, the books of accounts for the entire period preceding the financial year together with the vouchers shall be so preserved. The provisions of Income Tax Act shall also be complied with in this regard. As per proviso to sub-section 5, where an investigation has been ordered in respect of a company under Chapter XIV of the Act related to inspection, inquiry or investigation, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.

Persons responsible to maintain books

The person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of accounts etc. shall be: (sub-section 6)

- (i) Managing Director,
- (ii) Whole-Time Director, in charge of finance
- (iii) Chief Financial Officer
- (iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

Penalty

In case the aforementioned persons referred to in sub-section (6) (i.e. MD, WTD, CFO etc.) fail to take reasonable steps to secure compliance of this section and thus, contravene such provisions, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or both.

Register of Key Managerial Personnel– Section 170 (1) & Rule 17 of Companies (Appointment and Qualification of Directors) Rules, 2014

- (1) Every company shall keep at its registered office a register of its directors and key managerial personnel containing the following particulars:-
 - (a) Director Identification Number (Optional for KMP);
 - (b) present name and surname in full;
 - (c) any former name or surname in full;
 - (d) father's name, mother's name and spouse's name(if married) and surnames in full;
 - (e) date of birth;
 - (f) residential address (present as well as permanent);
 - (g) nationality (including the nationality of origin, if different);
 - (h) occupation;
 - (i) date of the board resolution in which the appointment was made;

- (j) date of appointment and reappointment in the company;
 - (k) date of cessation of office and reasons therefor;
 - (l) office of director or key managerial personnel held or relinquished in any other body corporate;
 - (m) membership number of the Institute of Company Secretaries of India in case of Company Secretary;
 - (n) PAN mandatory for KMP who is not having DIN
- (2) In addition to the details of the directors or key managerial personnel, the company shall also include in the aforesaid Register the details of securities held by them in the company, its holding company, subsidiaries, subsidiaries of the company's holding company and associate companies relating to:
- (a) the number, description and nominal value of securities;
 - (b) the date of acquisition and the price or other consideration paid;
 - (c) date of disposal and price and other consideration received;
 - (d) cumulative balance and number of securities held after each transaction;
 - (e) mode of acquisition of securities ;
 - (f) mode of holding – physical or in dematerialized form; and
 - (g) whether securities have been pledged or any encumbrance has been created on the securities.

Register of investments in securities not held in company's name. [section 187 , Rule 14 of Companies(Meetings of Board and its Powers) 2014]

- (1) Every company shall, from the date of its registration, maintain a register in Form MBP 3 and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.
- (2) Further, the company shall also record whether such investments are held in a third party's name for the time being or otherwise.
- (3) The register shall be maintained at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.
- (4) Entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.

The said register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Register of loans, guarantees given and security provided or making acquisition of securities (Section 186(9) Rule 12 Companies Meetings of Boards and its Powers Rules 2014)

- (1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter

therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

- (2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.
- (3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.
- (4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.
- (5) A register can be maintained either manually or in electronic mode.
- (6) The extract from the register may be furnished to any member of the company on payment of fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

Register of contracts with companies/firms in which directors are interested. [Section 189(5) Rule 16 of Companies (Meetings of Boards and its Powers) Rules, 2014]

Every company is required to keep one or more registers in Form MBP 4 giving separately the particulars of all contracts or arrangements and shall enter therein the particulars of (Rule 16(1))-

- (a) company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest as mentioned in sub-section (1) of section 184. But the particulars of the company or companies or bodies corporate in which a director himself together with any other director holds two percent or less of the paid-up share capital would not be required to be entered in the register.
- (b) contracts or arrangements with a body corporate or firm or other entity as mentioned under sub-section (2) of section 184, in which any director is, directly or indirectly, concerned or interested; and
- (c) contracts or arrangements with a related party with respect to transactions to which section 188 applies; The entries in the register shall be made at once, whenever there is a cause to make entry, in chronological order and shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose. (Rule 16(2)) Such register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose. (Rule 16(3)) Such register or registers are required to be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Every director within thirty days of his appointment or relinquishment is required to disclose his concern or interest in other associations, which are required to be included in the register. The register be kept at the registered office of the company and also open for inspection during business hours. The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding ten rupees per page. (Rule 16(4))

Place of keeping Registers

Section 94 provides that the registers and indices maintained pursuant to section 88 and copies of returns prepared pursuant to section 92 shall be kept at the registered office of the company. The registers or copies of returns may also be kept at any place in India in which more than one-tenth of the total number of

members entered in the register of members reside if approved by a special resolution passed at general meeting of the company and the Registrar has been given a copy of the proposed resolution at least one day before the date of general meeting of the company in Form No. MGT. 14. Inspection etc. of Registers, Returns etc.

The registers and copies of return shall be open for inspection during business hours by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding fifty rupees for each inspection. Any such member, debenture holder, security holder or beneficial owner or any other person may require a copy of any such register or entries therein or return on payment of such fee as may be specified in the articles of association of the company but not exceeding ten rupees for each page.

Copies of the Registers and Annual Return

Copies of the registers maintained under section 88 or entries therein and annual return filed under section 92 may be furnished to any member, debenture-holder, other security holder or beneficial owner of the company or any other person on payment of such fee as may be prescribed in the Articles of Association of the company but not exceeding rupees ten for each page.

Preservation of Register of Members etc. and Annual Return

The provisions with regard to preservation of records are contained in Rule 15

- The register of members along with the index shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose; and
- The register of debenture holders or any other security holders along with the index shall be preserved for a period of 15 years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.
- Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the Registrar.
- The foreign register of members shall be preserved permanently unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of 15 years from the date of redemption of such debentures/ securities. The foreign register shall be kept in the custody of the person authorized by the Board for authentication of the entries made therein.

CHAPTER-WISE LIST OF E-FORMS /PHYSICAL FORMS REQUIRED UNDER THE COMPANIES ACT 2013 (Based on notified sections and rules)

Chapter No/ Name/Sections	List of important e-forms prescribed in the Rules	List of physical forms prescribed
Chapter II - Incorporation of the company and matters incidental	INC-1 -Application for reservation of name INC-2- Form for Incorporation and nomination (One Person Company)	INC 8- Declaration from the professional as to compliance INC 9 – Affidavit from subscribers

thereto (Section 3-22)	<p>INC-3- Form for consent of nominee of One Person Company</p> <p>INC-4- Form for change in member/nominee of One Person Company</p> <p>INC-5- Form for intimation of exceeding threshold of One Person Company</p> <p>INC-6- Application for Conversion</p> <p>INC-7- INC 12 Application for grant of license under Section 8</p> <p>Application for Incorporation of Company (Other than One Person Company)</p> <p>INC-18- Application to Regional Director for conversion of section 8 company into any other kind of company</p> <p>INC-20 Intimation to Registrar of revocation or surrender of license issued under section 8</p> <p>INC-21 Declaration prior to the commencement of business</p> <p>INC-22 Notice of situation or change of situation of registered office and verification</p> <p>INC-23- Application to Regional director for approval to shift the registered office from one state to another state or from jurisdiction of one registrar to another within the state</p> <p>INC-24- Application for approval of Central Government for change of name</p> <p>INC-27- Conversion of public company into private company or private company into public</p>	<p>INC 10- Form for verification of signature of subscribers by witness.</p> <p>INC 11 – Certificate of Incorporation</p> <p>INC 13- Memorandum of Association</p> <p>INC 14 & IC 15 – Declaration regarding section 8 Company</p> <p>INC 16 & 17- License for Section 8 Company</p> <p>INC 19 – Notice by applicant under Section 8</p> <p>INC 25- Certificate of incorporation pursuant to change of name</p> <p>INC 26 – advertisement to be published in news paper for license for existing companies</p>
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	company INC-28- Notice of order of the Court or other authority	
Chapter III - Prospectus and allotment of securities(Sections 23-42)	PAS 2 – Information Memorandum PAS-3- Return of allotment	PAS 1- Advertisement giving the details of special resolution varying the terms of contract referred in the prospectus. PAS 4- Private placement offer letter PAS 5- Record of private placement offer.
Chapter IV- Share capital and debentures(Section s 43-72)	SH-7- Notice to Registrar for alteration of share capital SH-8- letter of offer SH-9-Declaration of solvency SH-11 Return in respect of buy back of securities	SH 1 – Share Certificate SH2- Register of renewed or duplicate share certificates. SH3- Register of Sweat equity shares.SH 4- Securities transfer form SH 5- Notice for transfer of partly paid-up shares SH 6 – Register of Employee Stock Option SH 10 – Register of Securities bought back SH 12- Debenture Trust Deed SH 13- Nomination form SH 14- Cancellation or variation of nomination SH 15- Certificate of compliance in respect of buy back of securities.
Chapter V- Acceptance of deposits by companies(Section s 73-76)		DPT 1- Circular in the form of advertisement inviting deposits. DPT 2- Deposit Trust deed DPT 3 – Return of Deposits DPT 4 – Statement regarding deposits existing on the commencement of the Act

Chapter VI Registration of charges(Sections 77-87)	<p>CHG-1- Application for registration of creation, modification of charge (other than those related to debentures) including particulars of modification of charge by Asset Reconstruction Company in terms of Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI)</p> <p>CHG-4- Particulars for satisfaction of charge</p> <p>CHG-6- Notice of appointment or cessation of receiver or manager</p> <p>CHG-9- Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures</p>	<p>CHG 2- Certificate of Registration of charge.</p> <p>CHG 3- Certificate of registration of Modification of Charge</p> <p>CHG 5- Memorandum of satisfaction of charge.</p> <p>CHG 7- Register of charges</p>
Chapter VII Management and administration(Sections 88-122)	<p>MGT-6- Form of return to be filed with the Registrar</p> <p>MGT-14- Filing of Resolutions and agreements to the Registrar under section 117</p>	<p>MGT1- Register of Members</p> <p>MGT 2- Register of debenture holders/other security holders</p> <p>MGT 3- Notice regarding place of keeping the registers</p> <p>MGT 4- Declaration of beneficial interest (by registered owners)</p> <p>MGT 5- Declaration of beneficial interest by persons holding beneficial interest.</p> <p>MGT 6- Return to registrar regarding beneficial interest.</p> <p>MGT 7- Annual Return</p> <p>MGT 8- Certificate by Company Secretary in practice</p> <p>MGT 9- Extract of Annual Return</p> <p>MGT 10 – Changes in the shareholding position of promoters and top ten shareholders.</p> <p>MGT 11- Proxy form</p>

		MGT 12 –polling paper MGT 13- Report of the Scrutinizer MGT 15- Form for filing the report on AGM.
Chapter IX Accounts of companies(Section s 128-138)		AOC 1- Statement containing salient features of the financial statement of subsidiaries/associate companies/joint ventures AOC 2- Related party disclosure AOC 3- Statement containing salient features of Balance Sheet and Profit and Loss Account AOC 4- Form for filing financial statement and other documents with the registrar.
Chapter X Audit and auditors(Sections 139-148)		ADT 1- Notice of appointment of Auditors ADT 2- Application for removal of auditors before the expiry of term. ADT 3- Notice of Resignation of Auditor ADT 4- Report to Central Government, suspecting offence involving fraud.
Chapter XI Appointment and qualifications of directors(Sections 149-172)	DIR-3- Application for allotment of Director Identification Number DIR-6- Intimation of change in particulars of Director to be given to the Central Government	DIR 1- Application for inclusion in databank of independent directors DIR 2- Consent to act as director DIR 4- verification of applicant for application for DIN DIR 5- Application for surrender of DIN DIR 7- Verification of applicant for change in DIN particulars DIR 8- intimation by director about other directorships/previous disqualification if any etc., DIR 9- report by a company to registrar DIR 10 – Form of application for removal of disqualification.
Chapter XII Meetings of the board and its		MBP-1- Notice of interest by Director MBP 2- Register of loans etc

powers(Sections 173-195)		MBP 3- Register of investments not in own name MBP 4- Register of contracts with related party.
Chapter XIII Appointment and remuneration of managerial personnel(Sections 196-205)	MR-1 Return of appointment of managing director or whole time director or manager MR-2 Form of application to the Central Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration to directors	MR3- Secretarial Audit Report
Chapter XXI Companies authorized to register under this act(Sections 366-378)	URC-1 Application by a company for registration under section 366	URC 2- Advertisement giving notice about registration under Part I of Chapter XXI
Chapter XXII Companies incorporated outside India(Sections 379-393)	FC-1 Information to be filed by foreign company FC-2 Return of alteration in the documents filed for registration by foreign company FC-3 List of all principal places of business in India established by foreign company FC-4 Annual Return	FC 5- Nomination by IDR holder
Chapter XXIV Registration offices and fees(Sections 1-2)	GNL-1 Form for filing an application with Registrar of Companies GNL-2 Form for submission of documents with Registrar of Companies GNL-3 Particulars of person(s) or director(s) or charged or specified for the purpose of section 2(60)	--
Chapter XXVI Nidhis (Sections 406)		NDH 1- Return of statutory compliances NDH 2- Application for extension of time

		HDH 3- Half yearly Retung
Chapter XXIX Miscellaneous(Sections 447-470)	ADJ Memorandum of Appeal MSC-1 Application to ROC for obtaining the status of dormant company MSC-3 Return of dormant companies MSC-4 Application for seeking status of active company	MSC 2- Certificate of status of a Dormant Company MSC5- Certificate of Status of an Active Company

LESSON ROUND-UP

- The Companies Act, 2013 lays down that every company incorporated under this Act must maintain and keep at its registered office certain books, registers and copies of certain returns, documents etc. and to give certain notices, file certain returns, forms, reports, documents etc. with the Registrar of Companies within certain specified time limits and with the prescribed filing fees. These books are known as Statutory Books.
- Every company incorporated under the Act is required to keep at its registered office, *inter alia*, the following statutory books and registers –
 - Register of securities bought back. (Section 68 Rule 17(12) of companies (share Capital and Debenture) Rules, 2014
 - Register of deposits. [Section 73, Rule 14 Companies (Acceptance of Deposits) Rules, 2014
 - Register of charges. (Section 81 rule 7 of companies registration of charges rules 2014)
 - Register of members(section 88(1) and Rule 3(1) of Companies(management and administration) Rules 2014
 - Index of members. [Sections 88(2) and the Rule 6 of Companies (Management and Administration) Rules, 2014]
 - Register of debenture holders section 88 (1)
 - index of debenture holders. (Section 88 (2))
 - Register and index of beneficial owners. (Section 88 (3))
 - “foreign register” containing the names and particulars of the members, debentureholders, other security holders or beneficial owners residing outside India.(Section 88 (4))
 - Register of Renewed and Duplicate Share Certificates. [Rule 6 of the Companies (share capital and debenture) Rules, 2014]
 - Register of sweat equity shares [Section 54 and rule 8 (14) of Companies (share capital and debenture) Rules, 2014]
 - Annual Return (Section 92) rule 11 of The Companies(management and administration rules 2014

- Register of Postal Ballot [Section 110 and rule 22 of the Companies (management and administration) Rules, 2014]
- Books containing minutes of general meeting and of Board and of committees of Directors. [Section 118]
- Books of accounts. [Section 128]
- Register of Directors/ key managerial personnel. (Section 170 (1)'
- Register of investments in securities not held in company's name. [section 187 , Rule 14 of Companies(meetings and board powers) 2014]
- Register of loans, guarantees given and security provided or making acquisition of securities (Section 186/9 rule 12 companies meetings of boards and its powers rules 2014)
- Register of contracts with companies/firms in which directors are interested. [Section 189(5) rule 16 of Companies (meetings of Boards and its powers) rules, 2014]

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Write the provisions of maintenance, preservation and signing of the following registers:
 - (a) Register of Directors
 - (b) Minute Book
2. What are the particulars to be entered in the
 - (i) Register of Securities bought back
 - (ii) Register of Fixed Deposits
 - (iii) Register of Charges
 - (iv) Register of Postal Ballot.
3. What is the procedure for keeping the Register and Returns at a place other than the Registered office?
4. Briefly explain the important returns which are required to be filed with the Registrar of Companies.

The Institute in bringing out a detailed Referencer on Secretarial Audit.

Lesson 25

Inspection and Investigation

LESSON OUTLINE

- Inspection – introduction
- Powers of Registrar
- Duties of directors and other employees
- Conduct of inspection
- Punishment for non- compliance
- Report on inspection
- Investigation and its types
- Scope of investigation
- Powers of inspectors
- Punishment of contravention
- Inspectors report on investigation
- Investigation of foreign companies

LEARNING OBJECTIVES

A check on the performance and compliance of the company is generally exercised by the scrutiny of any document filed by the company with the Registrar who is empowered to call for information and explanation with respect to any matter to which such documents or any information received by him purports to relate. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate the level of efficiency in the conduct of the companies.

The Companies Act 2013 empowers the registrar to call for information, to order an enquiry, to enter and search the place or places where the books are kept. Further the act also empowers central government to order an investigation into the affairs of the company. The act also mandates constitution of Serious Fraud Investigation Office(SFIO) and assign certain offenses to be investigated by SFIO which has power even to arrest in respect of certain offences. After reading this lesson you will be able to understand the provisions relating to inspection, investigation, powers of regulatory authorities including registrars, central government, SFIO etc relating to inspection and investigation into the affairs of the company.

"Truth is confirmed by inspection and delay; falsehood by haste and uncertainty."

-Tacitus

Introduction

Chapter XIV (Section 206 – 229) of the Companies Act 2013 deals with the aspects Inspection, inquiry and investigation. The broad regulatory framework covers aspects such as powers of registrar/central government to call for information, to inspect books and to conduct enquiries, procedure for inspection, powers of registrar in the course of inspect and the duties of officers in providing the information in the course of inspection, search/seizure, powers the central government to order an investigation into the affairs of the company, constitution Serious Fraud Investigation Office(SFIO), investigation into the affairs of the company by SFIO and other operational aspects.

INSPECTION

Section 206 of the Companies Act 2013 deals with inspection of documents and books and papers of any company. The section empowers the Registrar or Inspectors appointed by Central Government to conduct inspection in order to ascertain that all the transactions have been validly entered into and recorded in appropriate books and those applicable laws, rules and procedures have been compiled by the company. The section provides some penal provisions for the every defaulting officer of the company if it is clear from the inspection that the company is being or has been carried on for a fraudulent or unlawful purpose.

Purpose of conducting Inspection

Section 206 does not specify the circumstances or pre conditions which must be satisfied to invoke these provisions. Some of the objectives of conducting such inspections may be thus:

1. To detect concealment of income by falsification of accounts.
2. To secure knowledge about the mismanagement of the business of a company and transactions entered into with an intent to defraud creditors, shareholders or otherwise for fraudulent or unlawful purposes.
3. To ascertain whether the statutory auditors have discharged their functions and duties in certifying the true and fair view of a company's accounts and their proper maintenance.
4. To enable the Government to ascertain the quantum of profits accrued but not adequately accounted for.
5. To detect misapplication of funds leading a company tp a state of perpetual financial crisis.
6. To keep a watch on performance of a company.
7. To detect misuse of fiduciary responsibilities by the company's management for personal aggrandizement.

Inspection is intended to be a routine and not ad hoc or special affair. However, if sufficient evidence of the company's affairs being mismanaged and/or managed in fraudulent way is revealed, the inspection can lead to orders for investigation into the affairs of the company.

Powers of registrar to call for information

As per section 206 of the Companies Act, 2013, if on a scrutiny of any document filed or any information received by him the Registrar is of the opinion that any further information or explanation or any further

document relating to the company is necessary , he may call such other information by a written notice and require the company

- (a) to furnish the information or explanation in writing or
- (b) to produce such document

Within the reasonable time specified in notice.

Company's duty to furnish required information

In accordance with section 206(2) of the Act , it is the duty of the company and of every other officer concerned to furnish the information or explanation to the best of their knowledge and power and to produce the documents as required by the registrar within the specified time mentioned in the notice under section 206(1) or the time extended by the Registrar.

Past employees to furnish information

Proviso to section 206(2) states that if such information or explanation is related to any past period then the officers who had been in the employment of the company for such period are also required to furnish such information or explanation to the best of their knowledge when the notice has been served by the Registrar to such past employees.

Further notice by the registrar, if no information is provided or information provided is inadequate.

Section 206(3) provides that

- where no information or explanation is furnished to the Registrar within the time specified under section 206(1) or if the Registrar on inspection of documents furnished finds that the information furnished is inadequate

OR

- If on scrutiny the Registrar is of opinion that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required,

he may , by another written notice, call on the company to produce for his inspection such further books of account, books, papers, and explanations as he may require at such place and at such time as he may specify in the notice.

The Proviso to section 206(3) states that before sending any such notice as mentioned in sub section 3, the Registrar shall record his reasons in writing for issuing such notice.

Powers of Registrar to call for information/explanation after informing the company of the allegations made against it

According to Section 206(4) the registrar, on the basis of information available or furnished to him or on a representation made to him by any person, is of the opinion that

- the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act or
 - if the grievances of investors are not being addressed, the Registrar may after informing the company of the allegations made against it by a written order,
- (1) call on the company to furnish in writing any information or explanation on matters specified in the

- (2) order within such time as he may specify therein and
- (3) carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard.

Powers of Central Government to direct the registrar/inspector to order an enquiry.

The first proviso to section 206(4) provides that the Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it for the purpose to carry out the inquiry under this sub-section 4.

When business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447.

Meaning of Fraud

Explanation (i) to Section 447 has defined fraud in relation to affairs of a company or any body corporate to include, any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. 'Wrongful gain' in terms of Explanation (ii), means "the gain by unlawful means of property to which the person gaining is not entitled".

On the other hand, explanation (iii) to section 47 has defined "wrongful loss" to mean the loss by unlawful means of any property to which the person losing is legally entitled".

Powers of Central Government to direct for an inspection

Sections 206(5) and 206(6) empowers the role of Central Government to direct for inspection of any company, by appointing an inspector or by directing a statutory authority.

Section 206(5) provides that without prejudice to the foregoing provisions of this section, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for the purpose.

Section 206(6) states that the central government may, having regard to the circumstances by general or special order authorise any statutory authority to carry out the inspection of books of account of the companies.

Punishment for non-compliance of section 206

Section 206(7) states that if any company fails to furnish any information or explanation or produce any document required under Section 206, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to one lakh rupees and in the case of a continuing failure, with an additional fine which may extend to five hundred rupees for every day after the first during which the failure continues.

Conduct of inspection and inquiry

Section 207 of the Companies Act lays down the procedure to be adopted for inspection, powers of inspectors during the course of inspection, duties of directors, officers and other employees etc.,

Duty of every director and officer of the company to render

According to section 207(1) where the Registrar or inspector calls for the books of accounts and other books

and papers under section 206, of a company—

- (i) It shall be the duty of every director, officer or other employee of the company to produce all such documents to the registrar or inspector and
- (ii) To furnish him with such statements, information or explanations in such form as the Registrar or inspector may require and
- (iii) To render all assistance to the registrar or inspector in connection with such inspection.

Right of Registrar or Inspector to take copies of books of account

Section 207(2) provides that the Registrar or inspector, making an inspection or inquiry under section 206 may, during the course of such inspection or inquiry, as the case may be,—

- (a) make or cause to be made copies of books of account and other books and papers; or
- (b) place or cause to be placed any marks of identification in such books in token of the inspection having been made.

Registrar or Inspector to have the powers of civil court

Section 207(3) states that notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the Registrar or inspector making an inspection or inquiry shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely:—

- (a) The discovery and production of books of account and other documents, at such place and time as may be specified by such Registrar or inspector making the inspection or inquiry;
- (b) Summoning and enforcing the attendance of persons and examining them On oath; and
- (c) inspection of any books, registers and other documents of the company at any place.

Punishment for the disobedience

Section 207(4)(i) states that if any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees.

Director or officer to vacate office if convicted

Section 207(4)(ii) states that when a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall,

- (i) on and from the date on which he is so convicted, be deemed to have vacated his office as such; and
- (ii) on such vacation of office, shall be disqualified from holding an office in any company.

Submission of report of inspection to Central Government

Section 208 of the Companies Act 2013 provides that the Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

Search and seizure by the registrar or inspector

The section 209(1) provides for search and seizure of documents by the Registrar with the permission of special court. The section provides that, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers,—

- (a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and
- (b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

The Registrar or inspector shall return the books and papers seized under section 209(1), as soon as may be, and in any case not later than 180th day after such seizure, to the company from whose custody or power such books or papers were seized. [Section 209(2)]

The first proviso to section 209(2) states that the books and papers may be called for by the Registrar or inspector for a further period of one hundred and eighty days by an order in writing if they are needed again:

Second proviso to section 209(2) holds that the Registrar or inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

Provisions related to code of criminal procedure, to apply for seizure under section 209.

Section 209(3) states that the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, mutatis mutandis, to every search and seizure made under this section.

INVESTIGATIONS

MEANING AND OBJECT

Shareholders have been vested with various rights including the right to elect directors under the Companies Act, 2013. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered, the shareholders are, by and large, sleeping and passive partners, and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Sections 210 to 229 of the Companies Act, 2013, contain provisions relating to investigation of the affairs of company.

Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken. The said expression also includes investigation of all its business affairs—profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary

companies too [*R. v. Board of Trade, Ex parte St. Martin Preserving Co. Ltd.*, (1964) 2 All. E.R. 561 (Q.B.D.)].



KINDS OF INVESTIGATION

The Companies Act, 2013 provides for carrying out the following kinds of investigation:

1. Investigation of the affairs of the company if its necessary to investigate into the affairs of the company in public interest (Section 210);
2. Investigation of the affairs of related companies (Section 218);
3. Investigation about the ownership of a Company
4. Investigation of foreign companies
5. Investigation by Serious Fraud Investigation Office directed by Central government under (section 212)
6. Investigation on the order of Tribunal. (Section 213 – Not yet enforced)

When the Central government may order for investigations into the affairs of the company?

Section 210 of the companies Act provides that

1. When the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—
 - on the receipt of a report of the Registrar or inspector under section 208;
 - on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
 - in public interest, it may order an investigation into the affairs of the company.
2. When an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the

affairs of that company.

For the purposes of this section, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct. [Section 210(3)]

ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE BY CENTRAL GOVERNMENT

Section 211(1) seeks to provide that the Central Government shall establish serious fraud investigation office (SFIO). The SFIO will be headed by a director and will consist of experts from various disciplines. The Central Government shall also appoint a Director in the SFIO not below the rank of Joint Secretary and may also appoint such experts and other officers as it considers necessary for the efficient discharge of functions. Until an SFIO is established under Section 211(1), the SFIO set up earlier vide Government of India resolution No.45011/16/2003-Admn1 dated 2nd July 2003 shall be deemed to be the Serious Frauds Investigation Office for the purpose of this section.

Investigation by Serious Fraud Investigation Office

Basis of ordering investigation by the Central Government

Section 212(1) provides that without prejudice to the provisions of section 210 (i.e., powers of Central Government to issue order to investigate into the affairs of the company) when the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company by the Serious Fraud Investigation Office—

- (a) on receipt of a report of the Registrar or inspector under section 208;
- (b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;
- (c) in the public interest; or
- (d) on request from any Department of the Central Government or a State Government,

the Central Government may, by order, assign the investigation into the affairs of the said company to the Serious Fraud Investigation Office and The Director of SFIO may designate such number of inspectors, as he may consider necessary for the purpose of such investigation.

Restrictions on other investigating agencies

Section 212(2) provides that where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.

Manner of investigation and submission of report

Section 212(3) states where the investigation into the affairs of a company has been assigned by the Central Government to Serious Fraud Investigation Office, it shall

- conduct the investigation in the manner and follow the procedure provided in this Chapter; and
- submit its report to the Central Government within such period as may be specified in the order.

Investigating officer to exercise powers of Inspector

Where Section 212 (4) provides that the Director, Serious Fraud Investigation Office shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the power of the .inspector under section 217(procedures, powers, etc., of inspectors).

Responsibility of company and its officers to provide information to the Investigating Officer

Sub section(5) of section 212 states that the company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation.

Limitations on grant of Bail for offences liable is punishment for fraud under CrPC, 1973

Section 212(6) states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the offences covered under the following sections of the Companies Act 2013 which attract the punishment of fraud in section 447 of the 2013 Act shall be cognizable:-

- Section 7(5) - Default on furnishing false and incorrect particulars to registrar in relation to incorporation of company
- Section 7(6) - punishment for incorporating a company on the basis of false information.
- Section 34 - criminal liability for mis-statement in prospectus.
- Section 36 - punishment for fraudulently inducing persons to invest money.
- Section 38(1) - punishment for personation for acquisition of securities.
- Section 46(5) - fraudulent issue of duplicate certificate of shares.
- Section 66(10) - punishment for concealing the name of a creditor.
- Section 140(5) - power of Tribunal to change the Audiot of the company on the grounds of fraudulent conduct.
- Section 206 (4) - power of Registrar to call for inquiry or furnishing of any document by the company.
- Section 213 - investigation into the affairs of the company by Tribunal.
- Section 229 - penalty for furnishing false statement, mutilation, destruction of document.
- Section 251(1) - fraudulent application for removal of name .
- Section 339(3) - punishment for fraudulent conduct of business in course of winding up of business.
- Section 448 - punishment for false statement

No person accused of any such offence under the above mentioned sections shall be released on bail or on his own bond unless—

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

Release on bail of certain specified persons

1st proviso to section 212(6) provides that a person, who, is under the age of 16 years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

Special court not to take cognizance of any offence except under specified circumstances

The second proviso to the same section provides further that the Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by—

- (i) the Director, Serious Fraud Investigation Office; or
- (ii) any officer of the Central Government authorised, by a general or special

order in writing in this behalf by that Government.

Limitation On Grant Of Bail - Section 212(7)

The limitation on granting of bail specified in section 212(6) is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail.

Arrest of suspected persons

If the Director, Additional Director or Assistant Director of Serious Fraud Investigation Office authorised in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in sub-section (6), he may arrest such person and such person shall soon be informed of the grounds of such arrest. [Section 210(8)]

Copy of order to SFIO

Section 212(9) states that the Director, Additional Director or Assistant Director of Serious Fraud Investigation Office shall, immediately after arrest of such person under sub-section (8), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Serious Fraud Investigation Office in a sealed envelope, in such manner as may be prescribed and the Serious Fraud Investigation Office shall keep such order and material for such periods may be prescribed.

Arrested person to be produced before a judicial magistrate

By virtue of section 212(10) every person arrested under section 212(8) shall within 24 hours, be taken to a Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction:

However the period of 24 hours shall exclude the time necessary for the journey from the place of arrest to the Magistrate's court. (proviso to section 212(10))

If directed by the Central Government, the Serious Fraud Investigation Office shall submit an interim report to the Central Government. [Section 212(11)]

On completion of the investigation, the Serious Fraud Investigation Office shall submit the investigation report to the Central Government. [Section 212(12)]

Copy of investigation report

Section 212(13) provides that notwithstanding anything contained in this Act or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

Directions by central government after receiving report section 212(14)

On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the Serious Fraud Investigation Office to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company.

Where sub section 15 of section 212 provides that notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973.

POINT TO REMEMBER

Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.

Proceedings to be continued under the companies act 1956

Any investigation or other action taken or initiated by Serious Frauds Investigation Office under the provisions of Companies Act 1956 shall continue to be proceeded with under the same Act.

TRIBUNAL'S ORDER FOR INVESTIGATION

[Section 213] (This section is not notified)

The Tribunal may

(a) On an application made by:

- (i) not less than one hundred members or members holding not less than one-tenth of the total voting power in the case of a company having share capital; or
- (ii) not less than one-fifth of the persons on the company's register of members in case the company has no share capital.

and supported by such evidence as may be necessary to show that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company

Or

(b) on an application made to the it by other persons or otherwise

If it is satisfied that there are circumstances suggesting that:

- (i) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose.
- (ii) Persons engaged in the formation of company or management of its affairs have been guilty of fraud, misfeasance or other misconduct towards the company or any of its members; or

- (iii) The members of the company have not been given all the information with respect to its affairs which they might reasonably expect including information relating to calculation of commission payable to a managing or other director or manager of the company,

order, after giving reasonable opportunity of being heard to the parties concerned that the affairs of the company ought to be investigated by inspector appointed by the Central Government.

In case such an order is passed, the Central Government shall appoint inspectors to investigate into the affairs of the company.

And to report thereupon in such manner as the Central Government may direct.

Security under the Act and the Rules

Where an investigation is ordered by the Central Government under section 210(1) or pursuant to Tribunal's order under section 213, then before appointing an Inspector 213(3) Clause (b) of the Central Government may require the applicants to give a security not exceeding `25,000 towards the costs and expenses of investigationas per the following criteria

S. No.	Turnover as per previous year balance sheet (₹)	Amount of security (₹)
1	Turnover upto ₹ 50 crore	₹10,000
2	Turnover more than ₹ 50 crore and up to ₹200 crore	₹15,000
3	Turnover more than ₹200 crore	₹25,000

(2) The security shall be refunded to the applicant if the investigation results in prosecution.

Punishment

If after investigation it is proved that:

- (i) the business of the company is being conducted with intent to defraud creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or that the company was formed for any fraudulent or unlawful purpose; or
- (ii) any person connected with formation or management of company has been guilty of fraud.

Then every officer of the company who is in default or persons concerned in its formation or management shall be punishable for fraud under Section 447.

WHO SHALL NOT BE APPOINTED AS INSPECTOR?

No firm, body corporate or other association shall be appointed as an inspector.

[SECTION 215]

Investigation of ownership of company [Section 216]

The Central Government may if it has reason to believe or shall upon the direction of the Tribunal that the affairs of the company ought to be investigated as regards membership of company, appoint one or more inspectors to investigate and report on matters relating to the company and its membership for determining the true persons:

- (a) who are or have been financially interested in the success or failure whether real or apparent of the

company; or

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

Sub-section (2) (yet to be notified) provides that the Central Government shall appoint one or more inspectors if the Tribunal, in the course of any proceedings before it, directs by an order that the affairs of the company ought to be investigated.

While appointing an inspector, the Central Government may define the scope, the matters and the period of investigation and in particular limit the investigation to matters connected with particular shares or debentures. The inspector's powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding is considered relevant for the purpose of investigation.

Procedures and powers of inspectors [SECTION 217(1)]

It shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219(Power of inspector to investigate the affairs of related companies), of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person—

- (a) to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and
- (b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

Inspector may direct any body corporate to furnish any information

Section 217(2) of the Companies Act 2013 provides that the inspector may require any body corporate, other than a body corporate referred to in above section 217(1),

- to furnish such information to, or
- to produce such books and papers before him or
- any person authorised by him in this behalf as he may consider necessary,

if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation.

TIME LIMIT FOR KEEPING UP OF BOOKS AND PAPERS BY THE INSPECTORS

Section 217(3) provides that the Inspector shall not keep in his custody any books and papers produced under section 217(1) and section 217 (2) for more than 180 days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced

However the books and papers may be called for by the inspector if they are needed again for a further period of 180 days by an order in writing (*proviso to section 217(2)*).

Examination on oath [section 217(4)]

An inspector may examine on oath—

- (a) any of the persons referred to in section 217 (1); and

- (b) with the prior approval of the Central Government, any other person, in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally.

Provided that in case of an investigation under section 212, the prior approval of Director, Serious Fraud Investigation Office shall be sufficient under clause (b).

Powers of inspectors [section 217(5)]

Notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the inspector, being an officer of the Central Government, making an investigation under this Chapter shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely:—

- (a) the discovery and production of books of account and other documents, at such place and time as may be specified by such person;
- (b) summoning and enforcing the attendance of persons and examining them on oath; and
- (c) inspection of any books, registers and other documents of the company at any place.

Punishment for disobedience of directions issued by the inspector

Section 217(6) (i) of this Act provides that if any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to 1 year and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees.

Vacation of office by the convicted director or officer and disqualification

Now section 217(6)(ii) holds that if a director or an officer of the company has been convicted of an offence under section 217, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office.

He shall be disqualified from holding an office in any company.

Notes to be used as evidence section 217(7)

The notes of any examination under section 217(4) shall be taken down in writing and the same shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

Failure to comply with section 217

Section 217(8) contains the provisions on punishment if the requirements under section 217 have not been complied with.

It states-

If any person fails without reasonable cause or refuses—

- (a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under section 217(1) or section 217(2) to produce;
- (b) to furnish any information which is his duty under section 217 (2) to furnish;

- (c) to appear before the inspector personally when required to do so under section 217(4) or to answer any question which is put to him by the inspector in pursuance of that sub-section; or
- (d) to sign the notes of any examination referred to in section 217(7), he shall be punishable with imprisonment for a term which may extend to 6 months and with fine which shall not be less than 25,000 rupees but which may extend to 1,00,000 rupees, and also with a further fine which may extend to 2000 rupees for every day after the first during which the failure or refusal continues.

Assistance to the inspector

Section 217(9) states that the officers of the Central Government, State Government, police or statutory authority shall provide assistance to the inspector for the purpose of inspection, inquiry or investigation, which the inspector may, with the prior approval of the Central Government, require.

Reciprocal arrangements with foreign governments for inspection, inquiry and investigation

In terms of Section 217(10), the Central Government may make reciprocal arrangements, with a foreign state to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that state. For this purpose, the Central Government may by notification apply this Chapter subject to modifications, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that state.

Under Section 217(11), if in the course of investigation into the affairs of a company, an application is made to the competent court in India by the inspector stating that the evidence is, or may be, available in a country or place outside India, such a court may issue a letter of request to the court or authority in such country or place.

As per the rules made under Chapter XIV the Letter of Request shall be transmitted in such manner as specified by the Ministry of Corporate Affairs.

The Court or authority in foreign country may be requested

- (a) to examine orally or otherwise any person supposed to be acquainted with the facts and circumstances of the case;
- (b) to record his statement made in the course of such examination and
- (c) to require such person to produce any document or thing which may be in his possession relating to the case, and
- (d) to forward all the evidence taken or collected or authenticated copies thereof to the court in India which had issued the letter of request. Every statement recorded or a document received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

Similarly, under Section 217(12), upon receipt of a request from a court or authority outside India, the Central Government may forward the same to the court concerned which shall thereupon summon the person before it and record his statement, or cause any document or thing to be produced, or send the letter to any inspector for investigation. The inspector shall investigate into the affairs of company in same manner as investigation is done under this Act. The inspector shall send the report to the court within 30 days or such extended time as the court may allow.

The evidence collected or its authenticated copies shall be forwarded by the court to the Central Government for transmission to the court or authority in a country outside India which had issued the letter of request.

Protection of employees during investigation

(This section is not notified yet)

Obligation of the company etc. to take Tribunals approval for any action against employee(s)

Notwithstanding anything contained in any other law for the time being in force, if—

(a) during the course of any investigation of the affairs and other matters of or relating to a company, other body corporate or person under section 210, section 212, section 213 or section 219 or of the membership and other matters of or relating to a company, or the ownership of shares in or debentures of a company or body corporate, or the affairs and other matters of or relating to a company, other body corporate or person, under section 216; or

- (a) during the pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company under Chapter XVI, such company, other body corporate or person proposes—
 - (i) to discharge or suspend any employee; or
 - (ii) to punish him, whether by dismissal, removal, reduction in rank or otherwise; or
 - (iii) to change the terms of employment to his disadvantage,

the company, other body corporate or person, as the case may be, shall obtain approval of the Tribunal of the action proposed against the employee and if the Tribunal has any objection to the action proposed, it shall send by post notice thereof in writing to the company, other body corporate or person concerned.

Action against employees, if does not receive approval within 30 days

Section 218(2) of this Act states if the company, other body corporate or person concerned does not receive within 30 days of making of application under section 218(1), the approval of the Tribunal, then and only then, the company, other body corporate or person concerned may proceed to take against the employee, the action proposed.

Appeal to appellate tribunal [section 218(3)]

If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of 30 days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal in such manner and on payment of such fees as may be prescribed.

Decision of appellate tribunal [section 218(4)]

The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

PREPARATION BY A COMPANY SECRETARY TO FACE INVESTIGATION

Before an inspector commences investigation into the affairs of a company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence. The aspects which should be considered by the secretary include:

1. *Basic information about the company*—Name of the company; date of incorporation; location of the

registered office, branches, factories and other offices; status of the company—public or private; objects of the company—capital structure; voting rights attached to the shares; shareholding pattern of the company.

2. *Business activities*—Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so the names of other companies falling within the same group.
3. Debentures, bank finance and deposits.
4. Foreign collaboration agreements.
5. *Management*—Brief history of past management set up; existing management set up; composition of Board of Directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to an office or place of profit.
6. Whether all the statutory registers including minute's books are being maintained up-to-date?
7. Whether the internal checks and internal control system is being properly followed?
8. *Working results and financial position*—General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
9. Compliance by the company and its officers with the provisions of the Companies Act, 1956.
10. Compliance with the provisions of other Acts applicable to the company.
11. Whether the loans taken and loans advanced to Directors, the firms in which they are partners or companies in which they are Directors are in accordance with the provisions of the Act.
12. The investments made by the company.
13. Sole selling agency agreement.
14. Instance of mismanagement and other irregularities.
15. Acquisition/disposal of substantial assets.
16. A scrutiny of abnormal/heavy expenditure items.
17. Complaints, if any, against the company and its management and steps taken to redress them.
18. Brief particulars of the litigations against the company and the reasons thereof.
19. Management's relations with the employees and labour.
20. Shareholders—Instance of oppression of minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc. and steps taken to redress Investors, complaints.
21. *Auditors*—Name and address of statutory auditors, compliance as per the provisions of .

Inspector's power to investigate the affairs of company

By virtue of section 219 if an inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, to

investigate also the affairs of—

- (a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;
- (b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;
- (c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or
- (d) any person who is or has at any relevant time been the company's managing director or manager or employee,

he shall, subject to the prior approval of the Central Government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

Seizure of documents [section 220(1)]

If in the course of an investigation under this Chapter (CHAPTER XIV), the inspector has reasonable grounds to believe that the books and papers of, or relating to, any company or other body corporate or managing director or manager of such company are likely to be destroyed, mutilated, altered, falsified or secreted, the inspector may—

- (a) enter, with such assistance as may be required, the place or places where such books and papers are kept in such manner as may be required; and
- (b) seize books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books and papers at its cost for the purposes of his investigation.

Inspector to return books and papers seized

Section 220(2) The inspector shall keep in his custody the books and papers seized under this section for such a period not later than the conclusion of the investigation as he considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person from whose custody or power they were seized:

Inspector may keep copies or extracts of books

Proviso to section 220(2) states that the inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such manner as he considers necessary.

NOTE THAT !!!!!!!

The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply *mutatis mutandis* to every search or seizure made under this section.

SECTION
220(3)

Freezing of assets of a company section 221 Section Not yet enforced)

Where it appears to the Tribunal,-

- (i) on a reference made to it by the Central Government or

- (ii) in connection with any inquiry or investigation into the affairs of a company under this Chapter or
- (iii) on any complaint made by such number of members as specified under Section 244(1) or
- (iv) a creditor having 1,00,000 rupees amount outstanding against the company or
- (v) any other person having a reasonable ground to believe that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest,

it may by order direct that such transfer, removal or disposal shall not take place during such period not exceeding three years as may be specified in the order or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under section 221(1),

- the company shall be punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 25,00,000 rupees and
- every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than 50,000 rupees but which may extend to 5,00,000 rupees, or with both.

Restriction on securities [section 222(1)] (Not yet enforced)

Section 222 (1) provides that where it appears to the Tribunal, in connection with any investigation under section 216 or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed, the Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding 3 years as may be specified in the order.

Section 222(2) provides that if a company issues and transfers any securities or acted upon the contravention of the order of the Tribunal, under section 222

- (i) the company shall be punishable with fine which shall not be less than 1,00,000 rupees but which may extend to 25,00,000 rupees
- (ii) and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than 25,000 rupees but which may extend to 500,000 rupees, or with both.,

Interim and final reports by inspector [section 223(1)]

An inspector appointed under this Chapter (Chapter XIV) may, and if so directed by the Central Government shall, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government.

Section 223(2) provides that every report made under section 223(1) shall be in writing or printed as the Central Government may direct.

A copy of the report made under section 223(1) may be obtained by making an application in this regard to the Central Government.

The report of any inspector appointed under this Chapter shall be authenticated either—

- (a) by the seal of the company whose affairs have been investigated; or
- (b) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872,

and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

(5) Nothing in this section shall apply to the report referred to in section 212.

Action pursuant to inspector's report [Section 224(1)]

If, from an inspector's report, made under section 223, it appears to the Central Government that any person has,

- (i) in relation to the company or
- (ii) in relation to any other body corporate or other person whose affairs have been investigated under this Chapter been guilty of any offence for which he is criminally liable,

the Central Government may prosecute such person for the offence and it shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution.

Petition to tribunal for winding up or for prevention of oppression and mismanagement [section 224(2)](Not yet enforced)

If any company or other body corporate is liable to be wound up under this Act and it appears to the Central Government from any such report made under section 223 that it is expedient so to do by reason of any such circumstances as are referred to in section 213, the Central Government may, unless the company or body corporate is already being wound up by the Tribunal, cause to be presented to the Tribunal by any person authorised by the Central Government in this behalf—

- (a) a petition for the winding up of the company or body corporate on the ground that it is just and equitable that it should be wound up;
- (b) an application under section 241; or
- (c) both.

Winding up proceedings [section 224(3)]

If from any such report as aforesaid, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated under this Chapter—

- (a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate; or
- (b) for the recovery of any property of such company or body corporate which
- (c) has been misappropriated or wrongfully retained, the Central Government may itself bring proceedings for winding up in the name of such company or body corporate.

Disgorgement of assets [section 224(5)] (Not yet enforced)

If the inspectors report states that that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, as the case may be, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

Reimbursement of expenses incurred by the central government

Section 225(1) states that the expenses of, and incidental to, an investigation by an inspector appointed by the Central Government under this Chapter (CHAPTER XIV) other than expenses of inspection under section 214 shall be defrayed in the first instance by the Central Government, but shall be reimbursed by the following persons to the extent mentioned below, namely:—

- (a) any person who is convicted on a prosecution instituted, or who is ordered to pay damages or restore any property in proceedings brought, under section 224, to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person, or ordering him to pay such damages or restore such property, as the case may be;
- (b) any company or body corporate in whose name proceedings are brought as aforesaid, to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings;
- (c) unless, as a result of the investigation, a prosecution is instituted under section 224,—
 - (i) any company, body corporate, managing director or manager dealt with by the report of the inspector; and
 - (ii) the applicants for the investigation, where the inspector was appointed under section 213, to such extent as the Central Government may direct.

Section 225(2) provides that any amount for which a company or body corporate is liable under section 225(1)(b) shall be a first charge on the sums or property mentioned in that clause.

Voluntary winding-up of company not to stop investigation [Section 226] (*This section not notified*)

An investigation under this Chapter (CHAPTER XIV) may be initiated notwithstanding, and no such investigation shall be stopped or suspended by reason only of, the fact that—

- (a) an application has been made under section 241;
- (b) the company has passed a special resolution for voluntary winding up; or
- (c) any other proceeding for the winding up of the company is pending before the Tribunal:

The first proviso to section 226(1) states that where a winding up order is passed by the Tribunal in a proceeding referred to in section 226(c), the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit:

The second proviso to section 226(1) Provides further that nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

Legal advisors and bankers not to disclose facts (Not yet enforced)

Section 227 of this Act provides that nothing in this Chapter shall require the disclosure to the Tribunal or to

the Central Government or to the Registrar or to an inspector appointed by the Central Government—

- (a) by a legal adviser, of any privileged communication made to him in that capacity, except as respects the name and address of his client; or
- (b) by the bankers of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person.

The provisions of this Chapter shall apply *mutatis mutandis* to inspection, inquiry or investigation in relation to foreign companies.

INVESTIGATION OF FOREIGN
COMPANIES
[SECTION 228]

Penalty for furnishing false statements [section 229]

Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation,—

- (a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;
- (b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or
- (c) provides an explanation which is false or which he knows to be false, he shall be punishable for fraud in the manner as provided in section 447.

LESSON ROUND-UP

- The Act provides exhaustive powers to the Registrar or inspectors or Serious Fraud Investigation Officer authorized by the Central Government or as the case may be, to conduct inspection in order to ascertain that all transactions have been validly entered into and recorded in appropriate books and that applicable laws, rules and procedures have been complied with by the company.
- Also, the books of account and other books and papers shall be open to inspection by any director during business hours. The Companies Act does not give any statutory right of inspection of books of account to a shareholder. However articles of a company may give such a right to the shareholders.
- The Act empowers the person making the inspection to make or cause to be made copies of books of account and other books and papers or place or cause to be placed any marks of identification thereon in token of inspection having been made.
- The person making an inspection is required to make a report to the Central Government after inspection of books of account and other books and papers of the company.
- If a default is made in complying with the provisions of inspection, every officer of the company, who is in default, shall be punishable with fine and imprisonment.
- In respect of inspection, the Company Secretary should take all possible steps to comply with the provisions of the Act and other laws. When inspection of books (by the Registrar or an officer of the Central Government or SFIO) is anticipated, he/she should make sure that the prescribed statutory registers and records are being maintained up to

date by the company.

- Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and see if any illegal acts or offences are disclosed and then decide the action to be taken.
- The Companies Act provides for carrying out investigation of the affairs of the company whose business is being conducted in fraudulent or unlawful manner or in a manner oppressive of any member or of the affairs of related companies or of ownership of the company for the purpose of determining the true persons who are or have been able to control or materially influence the policy of the company or who are or have been financially interested in the success or failure, whether real or apparent of the company.
- The Central Government has been empowered to conduct investigation into the affairs of the company in circumstances specified under the Act.
- Only an individual or individuals may be appointed as Inspector(s) to conduct the investigation into the affairs of the company and to report thereon in the prescribed manner. Inspectors have been given wide powers under the Companies Act.
- The inspector may, and if so directed by the Central Government, shall make interim reports to that Government and on the conclusion of the investigation, shall make a final report to the Central Government.
- On receipt of the report of the Inspector appointed to investigate the affairs of the Company, the Central Government may undertake prosecution for criminal offence, winding up of company or relief by the court, recovery of damages or property.
- Before an inspector commences investigation into the affairs of the company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged.
- In the public interest it may become necessary for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it. For this reason, the Central Government has been empowered under the Act to appoint one or more Inspectors to investigate and report on the membership of any company and other matters relating to the company.
- Under the Act, the employees of the company under investigation, who make disclosure during the course of investigation, are protected against dismissal, discharge, removal, etc.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these Questions are not to be submitted for revaluation)

1. Discuss the provisions of Companies Act, 2013 with respect to investigation of the affairs of company by the Central Government.
2. What are the powers of Registrar or inspector under Section 207(3)of the Companies Act, 2013?
3. As a company secretary what steps would you take in order to face Investigation?
4. Draft a resolution for the investigation of the affairs of company.
5. State the various grounds on which the investigation is assigned to Serious Fraud Investigation Office?
6. Discuss the provisions of Companies Act 2013 with respect to investigation of ownership of a company and its scope.
7. Discuss the provisions of Companies Act, 2013 which protects the employees of company during investigation.
8. Discuss the powers of Registrar to call for information or explanation.

Lesson 26

Majority Rule and Minority Rights

LESSON OUTLINE

- Concept of shareholders' democracy.
- Powers of majority.
- Principle of non-interference or Rule in *Foss v. Harbottle* along with its justification and advantages.
- Exceptions to the rule-Protection of minority rights and shareholders' remedies.
- Actions by shareholders in common law.
- Statutory remedy under the Companies Act.
- Meaning of oppression and its prevention.
- Winding up order under just and equitable clause.
- Prevention of mismanagement.
- Persons entitled to apply.
- Powers of the Company Law Board and Central Government to prevent oppression or mismanagement.
- Consequences of termination or modification of agreements.
- Powers to prevent changes in Board.

LEARNING OBJECTIVES

Democracy is always a better governance structure as compared to any other set up. It preserves the rights of every one either majority or minority. Most of the set ups are always preserving the rights of the section to whom it is presenting. The oppression of minority is a normal thing everywhere either in economics or politics or in the companies.

The greed for money is that the companies are mismanaged for personal gains. This greed lies with the majority holders. The best set up for a company is that in which the minority rights are protected and also in which the mismanagement is avoided.

After reading this lesson you will be able to understand the concept of shareholders' democracy, the majority powers and minority rights. The lesson describes the principle of non-interference in detail along with its justifications and advantages. It also deals with the provisions relating to protection of minority rights and shareholder's remedy. Provisions under the Companies Act for prevention of oppression and mismanagement have also been discussed herein.

It may be noted that Chapter XVI of the Companies Act 2013 (Section 241-246) and the rules made there under, covering the aspects of oppression and mismanagement are yet to be notified and the provisions of Companies Act 1956 in this regard would continue to apply.

"In a democracy the poor will have more power than the rich, because there are more of them, and the will of the majority is supreme." — Aristotle

It may be noted that Chapter XVI of the Companies Act 2013 (Section 241-246) and the rules made there under, covering the aspects of oppression and mismanagement are yet to be notified and the provisions of Companies Act 1956 in this regard would continue to apply and accordingly the provisions of Companies Act, 1956 are dealt in this Lesson.

1. SHAREHOLDERS' DEMOCRACY

Introduction

The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.

Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by the shareholders, and for the shareholders in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Under the Companies Act the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through General Meetings. Although constitutionally all the acts relating to the company can be performed in General Meetings but most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Under Section 291 of the Companies Act a general power has been conferred on the Board of directors. The section provides that "Subject to the provisions of this Act, the Board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do."

Proviso to this section restricts the power of the Board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association.

Thus the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

Businesses which can be transacted at shareholders' meeting only

1. Alteration of Memorandum of Association and Articles of Association.
2. Further issue of share capital.
3. To transfer some portions of uncalled capital to reserve capital to be called up only in the event of winding up of the company.
4. To reduce the share capital of the company.
5. To shift the registered office of the company outside the state in which the registered office is situated at present.

6. To decide a place other than the registered office of the company where the statutory books, required to be maintained under Sections 159 and 160 may be kept.
7. Payment of interest on paid-up amount of share capital for defraying the expenses on construction when plant cannot be commissioned for a longer period of time.
8. To appoint auditors in case of companies where 25% or more of the paid-up share capital is held by Central/State Government or public financial institutions or any of their constituents.
9. To approach Central Government for investigation into the affairs of the company.
10. Appointment of sole selling agents where paid-up share capital is beyond ₹ 50 lakhs and confirmation of appointment of sole selling agents in other cases.
11. To allow a director, partner or his relative to hold office or place of profit.
12. Payment of commission of more than statutory requirement to a managing or a whole-time director or a manager.
13. To make loans, to extend guarantee or provide security to other companies or make investment beyond the limit specified.
14. To borrow money and to charge out the assets of the company to secure the borrowed money where the sums to be borrowed along with money already borrowed exceeds the paid-up capital of the company and its free reserves i.e. reserves not set apart for any specific purpose.
15. To appoint directors.
16. To increase or reduce the number of directors within the limits laid down in Articles of Association.
17. To cancel, redeem debentures etc.
18. To make contribution to funds not related to the business of the company.

In view of the rights conferred on shareholders to be exercised at General Meetings, the Act casts an obligation on the directors to send notices for convening general meetings or else the meetings shall be declared to be void as also all proceedings transacted thereat.

Apart from the rights which are vested in the shareholders to be exercised in relation to the conduct of the business of the company, the directors of the company have certain obligations towards the shareholders.

The courts have determined two broad duties to be performed by a director:

1. Duty of utmost care and skill in managing the affairs of the company or else be liable for damages.
2. Fiduciary duty to act *bona fide* in the interest of the company, not to exercise powers for collateral benefit and not to earn profit from the position as a director.

2. MAJORITY POWERS AND MINORITY RIGHTS

Powers of Majority

As a company is an artificial person with no physical existence, it functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that *prima facie* a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.

According to Section 87 of the Companies Act, 1956, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. This rule is modified by the Act in certain cases. A special resolution, for instance, requires a majority of 3/4ths of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough [*Edwards v. Halliwell*, (1950) 2 All. E.R. 1064]. The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company [*North-West Transportation Co. v. Beatty* (1887) L.R. 12 A.C. 589].

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the majority of members is subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which being outside the ambit of the memorandum, is *ultra vires* of the company [*Ashbury Rly. Carriage and Iron Co. v. Riche*, (1875) L.R. 7 H.L. 653]. Also, where the articles authorise the directors to deal with any matters except those which are outside the scope of the authority of the directors; or with which the directors, having power, are unable or unwilling to deal. Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

The Principle of Non-interference (Rule in *Foss v. Harbottle*)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the Board of directors for carrying out their object at the cost of minority of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

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In *Foss v. Harbottle*, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action. The wrong done to the company was not which could be ratified by the majority of members. The company (i.e. the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide

whether to commence proceedings against the directors. The reasons for rule were nicely stated by Melish L.J. in *MacDougall v. Gardiner*, (1875) 1 Ch. D. 13 (C.A.) at p. 25 in the following words:

"If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."

In *Rajahmundry Electric Supply Co. v. Nageshwara Rao* AIR 1956 SC 213, the Supreme Court observed that:

"The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it."

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

In *Pavlides v. Jensen* (1956) Ch. 565, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, "It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company's mine at an undervalue, proceedings should not be taken against the directors".

In *Edwards v. Halliwell* (1950) 2 All. E.R. 1064, Jenkins, L.J. restated the rule in the following terms: "The rule in *Foss v. Harbottle* comes to no more than this. First, the proper plaintiff in respect of wrong alleged to be done to company is *prima facie* the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then *cadit quaestio...* (cannot be questioned). If on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company itself should not sue".

Justification and Advantages of the Rule in Foss v. Harbottle

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray v. Lewis*, (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in *Foss v. Harbottle* are of a purely practical nature and are as

follows:

1. **Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.
2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. **Litigation at suit of a minority futile if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall v. Gardiner*, (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of *Foss v. Harbottle* Rule in Indian context — The Delhi High Court in *ICICI v. Parasrampuria Synthetic Ltd. SSL*, July 5, 1998 has held that an automatic application of *Foss v. Harbottle* Rule to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding atleast 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss v. Harbottle* Rule would be unjust and unfair.

Exceptions to the Rule in *Foss v. Harbottle* — Protection of Minority Rights and shareholders remedies

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 1956.

Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases;

(1) Ultra Vires Acts

Where the directors representing the majority of shareholders perform an illegal or *ultra vires* act for the

company, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or *ultra vires* transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an *ultra vires* act.

In *Bharat Insurance Ltd. v. Kanhya Lal*, A.I.R. 1935 Lah. 792, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was : "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments". The Court observed:

"In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting *ultra vires* in the application of the funds of the company, a single member can maintain a suit".

It means that the rule in *Foss v. Harbottle* will operate in full force only when the majority of shareholders through their chosen directors act within the extent of the powers of the company.

(2) Fraud on Minority

Where an act done by the majority amounts to a fraud on the minority; an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in *Foss v. Harbottle* in a number of cases. In *Menier v. Hooper's Telegraph Works*, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

Though there is no clear definition of the expression "fraud on the minority", but the court decides a particular case according to the surrounding facts. The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is "bona fide for benefit of the company as a whole" [*Allen v. Gold Reefs of West Africa*, (1900) 1 Ch. 656]. As regards the meaning of the expression "bona fide for the benefit of the company as a whole" Evershed M.R. in *Greenhalgh Ardeme Cinemas Ltd.* (1950) 2 All E.R. 1120 has observed thus : "It mean that the shareholder must proceed on what, in his honest opinion, is for the benefit, of the company as a whole. Secondly, the phrase 'the company as a whole' does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body." In other words, it can be said that the court ought not to interfere with decision of the majority in a general meeting if that decision is arrived at fairly and honestly [*In Re. Transval Gold Exploration and Land Co. Ltd.* (1885) 1 T.L.R. 604]. and is not an act of fraud on the minority.

(3) Wrongdoers in Control

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [*Cf. Birch v. Sullivan*, (1957) 1 W.L.R. 1274]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [*Par Jenkins L.J. in Edwards v. Halliwell*, (1950) 2 All E.R. 1064, 1067].

In *Glass v. Atkin* (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the

two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: "While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action."

(4) Resolution requiring Special Majority but is passed by a simple majority

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid, formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [*Baillie v. Oriental Telephone and Electric Co. Ltd.*, (1915) 1 Ch. 503 (C.A.); refer also *Nagappa Chettiar v. Madras Race Club*, 1 M.L.J. 662].

(5) Personal Actions

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [*Salmon v. Quin and Aztens*, (1909) A.C. 442]. In *Nagappa Chettiar v. Madras Race Club*, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [*Joseph v. Jos*, (1964) 1 Comp LJ 105].

(6) Breach of Duty

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In *Daniels v. Daniels*, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court.

Held, by the Chancery Division, Templeman, J, the application of director should be dismissed. The exception to the rule in *Foss v. Harbottle* enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit to the directors; accordingly, on the facts alleged, the minority shareholders had a cause of action.

(7) Prevention of Oppression and Mismanagement

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

In *Bennet Coleman & Co. and Ors. v. Union of India & Ors.*, (1977) 47 Com Cases 92 (Bom), the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non-corporate management which may take the form of appointing an administrator or a special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

The exceptions to the rule in *Foss v. Harbottle* are not limited to those covered above. Further exceptions may be admitted where the rules of justice require that an exception to the rule should be made.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [*Panipat Woollen & General Mills Co.Ltd. v. R.L. Kaushik*, (1969) 39 Com Cases 249 (Punj & Har)].

Statutory Remedies (under the Companies Act)

Though the shareholders' democracy is supreme the Companies Act and the decided cases suggest that the majority shall not be allowed to act in an unfair, fraudulent, or oppressive way against the interests of the minority shareholders. Under Section 38, 167, 388-B, 397, 398, and 399 various powers are given to the shareholders. Further, under Section 265 a company may adopt principle of proportional representation. Under Section 408 the Central Government may direct the company to amend its articles providing for appointment of directors according to the principle of proportional representation under Section 265 and make fresh appointment in pursuance of the articles so amended within such time as may be specified. The Companies Act, 1956, extends protection to minority by granting various rights to minority shareholders which are discussed as below :

- (a) The variation of class rights: The rights attached to the shares of any class can be varied under Section 106 of the Act with the consent in writing of the holder of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. But the holders of not less than 10% of the shares of that class who had not assented to the variation may apply to the Court for the cancellation of the variation under Section 107 of the Act.
- (b) Schemes of reconstruction and amalgamation: The minority is accorded protection in cases where they dissent to the scheme of reconstruction or amalgamation.
- (c) Oppression and mismanagement: The principle of majority rule does not apply to cases where Sections 397 and 398 are applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the Company Law Board by petition under Section 397 of the Act. In *O.P. Gupta v. Shiv General Finance (P) Ltd. and others* [1977] 47 Comp. Cas. 297, the Delhi High Court held that a member's right to move the Court under Section 397 was a statutory right and cannot be affected by an arbitration clause in the articles of association of a company.
- (d) Alternative remedy to winding up: Any member or members, who complain that the affairs of the company are being conducted in a manner oppressive to some of the members including themselves, may apply to the Company Law Board for redressal (Section 397).
- (e) Investigation by the Government: Under Section 235 of the Act the Central Government may

appoint one or more competent persons as inspectors to investigate the affairs of any company and to report thereon in such manner as the Central Government may direct:

- (a) Where in case of a company, on a report by the Registrar, under Sub-section (6) or (7) of Section 234 read with Sub-section (6) of Section 234.
- (b) Where —
 - (i) in the case of a company having a share capital on the application either of not less than 200 members or of member holding not less than one-tenth of the voting power thereof; and
 - (ii) in the case of a company not having a share capital, on the application of not less than one fifth in number of persons on the company's register of members.

The Company Law Board, after giving the parties an opportunity of being heard, declare that the affairs of the company ought to be investigated by an inspector or inspectors.

Despite the powerful weapons handed over to the shareholders by the Companies Act, the shareholders have not been able to use them and most of the provisions remain dead provisions and have not been used by the shareholders as potential weapons to correct any wrongful act on the part of the directors or to give them any directions. Consequently, the Board of directors of a large number of companies are elected only by a few shareholders who attend the Annual General Meetings and those who can muster sufficient number of proxies and can demonstrate their voting power. Government Companies are an exception. In Government Companies all the directors are appointed on the advice of the Government by the President of India or the Governor of a State. Hence, theoretically it can perhaps be said that the shareholders democracy is absolute in such companies.

In other companies however, the shareholders democracy is dependent upon the voting strength of shareholders and also to a great extent on the availability of members attending their General Meetings either by themselves or through their proxy. This again depends on the proximity of Registered Office of the company to the place of residence of the shareholders. Apart from this most of the shareholders do not have enough time to spare from their busy schedules to concern themselves with the affairs of the company in which they have invested. Besides, they are not always educated enough and experienced enough to be conversant with the working of the joint stock companies. Although the concept of shareholders' democracy has been enshrined in the Companies Act, 1956, yet, because of the aforementioned deficiencies and flaws in the general body of shareholders as a whole, it is not reflected in the constitution of the Boards of directors of many companies in India.

For achieving the shareholders' democracy, the shareholders have to unite and organise themselves on national, state and district levels and get their associations registered under the Societies Registration Act or any other applicable statute so that their voice is heard and they can assert themselves and safeguard the interests of their members. Constitution of such associations should be suitably amended so as to insist upon all the non-Government companies to allot a minimum number of shares to such associations of shareholders so that these associations can attend the Annual General Meetings of all the companies and make sure that the directors elected to company Boards reflect a fair representation.

3. PREVENTION OF OPPRESSION AND MISMANAGEMENT

As observed in the preceding topic that one of the exceptions to the majority rule laid down in *Foss v. Harbottle* is the right of the oppressed minority to get relief against the wrongful conduct of the majority. This protection to the oppressed minority is also statutorily prescribed under section 397 of the Companies Act,

1956. This statutory protection for prevention of oppression and mismanagement is an alternative remedy for winding up of the affairs of the company. The reason is that the oppressed minority may file petition with the Company Law Board to wind up the company. However, the company may be a sound and profitable concern. In that case, the petitioners will not only be deprived of whatever dividends they might have been getting but also the value of the assets of the company might be substantially reduced. As Alfred Palmer rightly said:

"The liquidation of the company may result in the sale of its assets at break up value without regard to the value of the goodwill or 'know how' of the company and the minority shareholder who urged by the shareholder's oppression petitions for a winding up order may in effect play up his opponents game."

The oppressed minority, therefore, are willing in such cases not to end the company but to mend it. Section 397 of the Companies Act, 1956, is intended to give a remedy alternative to compulsory winding up in such cases.

Prevention of Oppression (Section 397)

The first remedy in the hands of an oppressed minority is to move the Company Law Board. Section 397 provides that any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief. Following requirements must be satisfied for seeking a relief under Section 397:

- (i) That the affairs of the company are being conducted: (a) in a manner prejudicial to public interest; or (b) oppressive to any members.
- (ii) That the fact justified the compulsory winding up order on the ground that it is just and equitable that the company should be wound up.
- (iii) That to wind up the company would unfairly prejudice the petitioners [*Ramji Lal Baiswala v. Britain Cable Ltd.*, (1964) 14 Raj. 135].

On being satisfied about the above requirements, the Company Law Board may make the necessary orders for ending the matters complained of. The first requirement relates to public interest or oppression. First we analyse and discover the precise connotation of the word "oppression" with the help of judicial decisions.

Meaning of Oppression

The words "oppression" and "mismanagement" are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term "oppression" as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Western Ltd.*, (1952) Scottish Cases 49, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in *Shanti Prasad v. Kalinga Tubes*, (1965) 1 Comp. L.J. 193 at 204 is as under :

"The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely."

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An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in *Re. Hindustan Co-operative Insurance Society Ltd.*, AIR. 1961 Cal. 443 wherein

the life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilise the compensation money for the new objects. This was held to be an "Oppression". The court observed: "The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards".

A similar relief was allowed by the House of Lord in *Scottish Co-operative Wholesale Society v. Mayer* (1959) AC 324. In this case, the society created a subsidiary company to enable it to enter in the rayon industry. Subsequently when the need for the subsidiary ceased to exist, the society adopted a policy of running down its business which depressed the value of its shares. The two petitioners who were managing directors and minority shareholders in the company successfully pleaded "oppression". The court ordered the society to purchase the minority shares at the value at which they stood before the oppressive policy started [This decision has also been followed in *Re. H.R. Harmer Ltd.*, (1959) 1 WLR 62].

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi v. Indian Motor Co.* A.I.R. 1962 Cal 127, the petitioner alleged that the Board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers travelling without ticket on the company's buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company had been disposed of at low price, that dividends were being declared at too low a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor [In *Re. Bellador Silk Ltd.*, (1965) 1 All ER 667].

The legal representatives of a deceased member whose name is still on the register of members are entitled to file a petition under Sections 397 and 398 of the Companies Act, 1956, for relief against oppression or mismanagement, *Worldwide Agencies Pvt. Ltd. and Another v. Mrs. Margaret T. Desor and Others*, Com Cases Vol. 67 (1990), 807 (S.C.).

The legal heirs to be registered on probate or will are also entitled to apply. [*K.S. Mothilal v. K.S. Kasimaris Ceranique (P) Ltd.*, (2007) 135 Com Cases 609 CLB].

A shareholder dies and his heirs apply for transmission of shares while their application for succession certificate was pending before the Civil Court. The legal heirs alleged illegal allotment of shares by respondent to themselves, reducing the legal heirs to minority. It has held that the legal heirs are entitled to file a petition alleging oppression and mismanagement. [*Rajkumar Devraj & Aur. v. Jai Mahal Hotels Pvt. Ltd. & Others* (CLB) CA. No. 133 of 2006 in C.P. No. 30 of 2006.

In *Re Five Minute Car Wash Service Ltd.* (1966) 1 All ER 242, a petition founded on the ground that the managing director has been unwise, inefficient and careless in the performance of his duties could not succeed.

It should not, however, be supposed that these special remedies against oppression or mismanagement are

available only to minorities. "In an appropriate case, if the court is satisfied about the act of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. "Accordingly, a relief under the section was allowed to a majority group by Mitra, J., of the Calcutta High Court in *In Re. Sindhri Iron Foundry (P) Ltd.* (1963) 68 CWN 118. His Lordship observed that "if the court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival Boards are holding meetings, that the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors there is no reason why the court should not make appropriate order to put an end to such matters.

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, his Lordship said:

"The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a Board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty-five ... There would be complete chaos and confusion ..." (*Ibid.*, p. 335).

"This ingenious remedy has not only permitted redressal of many abuses, but its mere availability has had a deterrent effect upon management." [George H. Hornstein: *The Future of Corporate Control*, (1950) 63 HLR 476].

It was held in the case of *Ajit Singh Ahuja v. Saphire (India) (P) Ltd.* [(2009) 1 Comp LJ 313 (CLB)] that in a case of oppression, a member has to specifically plead on five facts – (a) what is the alleged act of oppression; (b) who committed the act of oppression; (c) how it is oppressive; (d) whether it is in the affairs of the company; and (e) whether the company is party to the commission of the act of oppression.

Oppression must be of a Continuous Nature

"Oppression must be a continuous process. This is suggested by the words, 'are being conducted in a manner...' used in Section 397. Hence isolated acts of oppression or mismanagement will not give rise to an action under Section 397 of the Act. In *Shanti Pd. Jain's Case*, the court said:... "events have to be considered not in isolation but as a part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing up-to-date of petition."

However in *Tea Brokers P. Ltd. v. Hemendra Prosad Barooah* (1998) 5 Comp LJ 963 (Cal.) the Division Bench of Calcutta High Court observed that:

'This is undoubtedly, a right and privilege which a member enjoys in his capacity as a member of the company... such an act may be even a single act done on one particular occasion if the effect of such an act will be of a continuing nature and the member concerned is deprived of his rights and privilege for all time to come in future'.

In *Ramshankar Prasad v. Sindu Iron Foundry (P) Ltd.*, AIR 1966 Cal 512, it was held that a petition under Section 397, would be maintainable even if the oppression was of a short duration and of a singular conduct if its effects persisted indefinitely [followed in *Maharashtra Power Development Corporation. Ltd. v. Dabhol Power Co. Ltd.* (2003) 56 CLA 263 (Bom.)].

In *Bhagirath Agarwala v. Tara Properties P. Ltd.* (2003) 51 CLA 57 (Cal.), also the removal of a director and allotment of shares were set aside as they were done at a meeting which was covered without complying

with the requirements of Section 286 and also reflected an oppressive policy. The allotment was made only to one member without simultaneous offer to others on pro rata basis. A single act of issue of additional shares can have a continuous effect. It can constitute oppression. A relief can be had against it. There is no bar of limitation in such a case. [*Ashok Kumar Oswal v. Panchsher Textile Mfg. & Trading Co. Ltd.* (2002) 110 Com Cases 800 (CLB-PB)].

Past acts of oppression will not entitle a plaintiff to seek the remedy under Section 397. The purpose of this section is not so much to take up the past as to redeem the future. A catalogue of charges of the past alleged misdeeds will not attract the section [*Thakur Prem Singh v. Thakur Hotel (Simla) Co. (P) Ltd.*, AIR 1963 Punj. 63; *Raghunath Swarup Mathur v. Har Swarup Mathur*, (1970) 40 Com Cases 282 (All)].

REVIEW QUESTIONS



Choose the correct answer:

Which section of the Companies Act, 1956 provides that any member of a company can complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member?

- (a) Section 398
- (b) Section 388
- (c) Section 397
- (d) Section 399

Correct answer: (c)

Prejudicial to Public Interest

Relief under Section 397 will also be available if the affairs of the company are being conducted in a way prejudicial to public interest. 'Public interest' is a very broad term involving the welfare not only of the individual shareholders but also of the country according to the economic and social policies of the State. The concept of 'Social profitability' is very much akin to public interest.

Winding up Order under Just and Equitable Clause

The other requirement is that the facts justify the making of a winding up order under just and equitable clause. The principle is that if there is persistent violation of the regulations and statutes and an appeal to general body is not likely to put an end to the matters complained of by reason of the fact that those responsible for the violations control the affairs of the company, then it will be just and equitable to wind up the company, [*Ramjilal Baisiwala v. Baiton Cables Ltd.*].

In *Re. Bellador Silk Ltd.*, (supra.) however this requirement proved too harsh. One of the grounds on which the relief was denied to the petitioner was that the company being solvent, it was not just and equitable to wind it up. This decision has been criticised by some authors. According to them it is not necessary that the company should be insolvent. Reference in Section 210 of the English Companies Act, 1948 to the requirement to winding up order is purely hypothetical, [Palmer's Company Law, (1976) 618: 68 Cal W.N. 163].

Winding Up would Unfairly Prejudice the Petitioners

Though it is necessary that facts should justify winding up, instead of winding up an alternative relief is

provided if the facts are such that the winding up would unfairly prejudice the interest of the complaining members.

The basic principles given in section 443(2) and section 397 are the same, viz., to stave off the winding up of a company as far as possible. If the shareholders approach the CLB under this section, it has to form its own opinion that a case has been made out on which the company could be wound up on just and equitable ground, but is not desirable to wind up the company. So, also when the Company Judge in the winding up petition comes to the conclusion that an alternative remedy is available, and the petitioner are not acting in a reasonable manner, the winding up petition should be dismissed. [*Takshila Hospital Ltd. v Dr. Jagmohan Mathur*, (2002) 50 CLA 51 : (2002) 39 SCL 423 (Raj)].

Prevention of Mismanagement (Section 398)

Section 398 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest, [(Section 398 (1) (A))] or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner [(Section 398 (1) (b)]. If the court is so convinced, it may, with a view to bringing to an end or preventing the matter complained of or apprehended, make such order as it thinks fit [Section 398 (2)].

CASE LAW

A very clear illustration of mismanagement contemplated by the section is *Rajahmundry Electric Supply Corporation v. A. Nageswara Rao*, AIR 1956 SC 213.. In this case, a petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purpose, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and "a powerful local junta was ruling the roost", and that the shareholders outside the group of the chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The Court accordingly appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

A similar verdict was provided to a company by the Calcutta High Court in *Richardson and Cruddas Ltd. v. Haridas Mundra*, (1959) 29 Com Cases 547.

There should be present and continuing mismanagement. The charges of mismanagement in the past, even if proved, are not enough to establish an existing injury to the interest of the company or public interest [*R.S. Mathur v. H.S. Mathur*, (1970) 1 Comp LJ 35].

"Relief against mismanagement runs in favour of the company and not to any particular member or members'. (See Mathew J. Kust : Foreign Enterprise in India, 293 (1964). Secondly. "It is not necessary for the court to find a case for winding up in cases of mismanagement in order to grant relief. (*Ibid.*, p. 294). "Proof of prejudice to the public interest or to the company is enough. Thirdly, the section enables the court to take into consideration outside interest affected by corporate operation." Thus, the Calcutta High Court refused to order the winding up of a grossly mismanaged company and appointed a special officer to manage it because the company was engaged in special industries necessary for the implementation of the country's plans. [*Richardson & Cruddas Ltd. v. Haridas Mundra*, (*ibid*)].

It was held in the case of *Indowind Energy Ltd. v. ICICI Bank Ltd.* [2010] 153 Com Cases 394 (CLB) that non-declaration of dividend would not amount to oppression and mismanagement.

Persons Entitled to Apply

The number of members required to make application under Sections 397 and 398 (i.e., who must sign the application) is given in Section 399. It provides that where the company has a share capital, the application must be signed by at least 100 members of the company or by one-tenth of the total number of the members, whichever is less; or by any member or members holding not less than one-tenth of the issued share capital of the company. If the company has no share capital, the application has to be signed by at least one-fifth of the total number of its members. The Central Government may, however, allow any member or members to apply, if in its opinion, circumstances exist which make it just and equitable to do so. The contents of such an application should fulfil the requirements laid down in Rule 13 of the Companies (Central Government's) General Rules and Forms, 1956. The Central Government may demand security for costs as a safeguard against vexatious litigation.

Joint holders of any share or shares are counted as one member. To be entitled to make the application, the members must have paid all the calls and other sums due on their shares.

It was held in *Northern Projects Ltd. v. Blue Coast Hotels and Resorts Ltd.* [(2008) 88 SCL 74 (Bom.)], that in Section 399, the term 'issued share capital' includes both equity and preference share capital.

Once the consent has been given by the requisite number of members by signing the application, the application may be made by one or more of them on behalf and for the benefit of all of them. It has been held by the Supreme Court in *Rajahmundry Electric Supply Co. v. Nageshwara Rao*, AIR 1956 SC 213, that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application.

Obtaining of consent is a condition precedent to the making of the application and hence a consent obtained subsequent to the application is ineffective. *Makhan Lal Jain v. The Amrit Banaspati Co. Ltd.*, I.L.R. (1954) I All. 131.

In *L. Chandramurthy v. K.L. Kapsi* (2005) 48 SCL 294 CLB, a person who had disposed off his shares was not allowed to apply.

The Central Government or any person authorised by it in this behalf has also the power as per Section 401 to apply for relief under the section.

On the presentation of the petition for oppression and mismanagement, the Company Law Board may make such orders as it thinks fit under this section, If it is of the opinion that —

- (a) the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members.
- (b) to wind up the company would unfairly prejudice the members who have lodged a complaint.
- (c) but the Company Law Board would be prepared to make a winding up order on the ground that it is just and equitable that the company should be wound up.

Both the conditions mentioned at (a) and (b) above must be fulfilled before the Company Law Board can entertain any petition under Section 397 of the Act. The petitioner must not only allege that the winding up order is justified but also allege that an order for winding up should not be made as it will unfairly prejudice the petitioners and other members [In Re. *Bengal Lakshmi Cotton*, (1965) 35 Com Cases 187].

CASE LAW

The scope of this section was very succinctly enunciated by the Supreme Court in *Shanti Prasad Jain v. Kalinga Tubes Ltd.* where it observed that "It is not enough to show that there is just and equitable cause for winding up of the company though that must be shown as a preliminary to the application under Section 397. It must further be shown that the conduct of majority shareholders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as a part of consecutive story. There must be continuous acts on the part of the majority shareholders continuing to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some members. The conduct must be burdensome, harsh and wrongful. Mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless lack of confidence springs from oppression of minority by the majority in the management of the company's affairs and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary right as a shareholder."

"Mere unwise, inefficient or careless conduct of a director in the performance of his duties may not be ground for relief under this section". [*Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743 (S.C.)].

In *Rameshwar Prasad v. Sindri and Foundry Pvt. Ltd.*, AIR 1966 Cal. 512 the Calcutta High Court held that the majority shareholders who qualify under Section 399 can apply for relief under Section 397 and rejected the argument that the relief under Section 397 is available only to minority shareholders. However, the Delhi High Court in *Suresh Kumar Sanghi v. Supreme Motors Ltd. and Others* (1983), 54 Com Cases 235 held that the provisions of Section 397 would be applicable only in cases of an oppression by majority shareholders on the minority shareholders. According to the court, unless a shareholder or shareholders filing the petition were in the minority Section 397 cannot be invoked at all.

REVIEW QUESTIONS



Choose the correct answer:

What is the number of persons required to make an application under sections 397 and 398 of the Companies Act, 1956?

- (a) where the company has a share capital, 100 members
- (b) where the company has a share capital, one/tenth of the total number of members.
- (c) where the company has a share capital, 100 members or one/tenth of the total number of members, whichever is less.
- (d) none of the above.

Correct answer: (c)

CASE LAW

In the case of *Provakar Das Gupta v. Veteran Co. P. Ltd* [2010] 156 Com Cases 241(CLB), it was held that when the main purpose for establishing the company was for the welfare of ex-service men, the petitioners could not have sold their shares to an outsider—a non ex-service men. Till the transfer of shares was declared null and void, the petitioners could not participate in the affairs of the company even though their names continued to be in the register of members. Articles of association stipulate transfer of shares only to ex-military/ retired military personnel. Amendment of articles to induct heirs of existing directors as members and directors will constitute oppression and mismanagement.

4. POWERS OF THE COMPANY LAW BOARD (SECTION 402)

Powers of the Company Law Board under Section 397 and 398 are fairly wide, "In fact, the court may make any order for the regulation of the conduct of the company's affairs upon such terms and condition as may, in the opinion of the Court, be just and equitable in all the circumstance of the case" (AIR 1956 S.C. 213). Apparently the only limitation seems to be the over all objective of the sections and, therefore, the order must be directed to bring to an end to the matter complained of. However, an attempt is made under Section 402 to define the powers of the CLB. This section provides that without prejudice to the generality of the powers of the CLB, any order under Section 397 or 398 may provide for:

1. The regulation of the conduct of the company's affairs in future. Thus, for example, in *Richardson & Cruddas Ltd. v. Hardas Mundra*, (63 CWN 439; AIR 1959 Cal 695), the court appointed a special officer with an advisory board to the total exclusion of the shareholders of a company to function subject to the terms and condition laid down in the order.
2. The purchase of the shares or interests of any member of the company by other members or by the company. This relief was provided in *Mohan Lal v. The Punjab Co. Ltd.*, AIR 1961 Punj. 485.
3. In the case of purchase of its shares by the company, the consequent reduction of its share capital.
4. The termination, setting aside or modification of and agreement between the company and managing director, or any other director, and the manager.
5. The termination, setting aside or modification of any agreement with any person, provided due notice has been given to him and his consent obtained.
6. Setting aside of any fraudulent preferences made within three months before the date of the application.
7. Any other matter for which, in the opinion of the court, it is just and equitable that provision should be made. [See as an illustration, *Mrs. Gajarbai v. Patny Transport (P) Ltd.*, (1966) 2 Comp LJ 234, a decision of Andhra Pradesh High Court]. The facts were that one of the directors died leaving behind a will bequeathing the shares in the company to his second wife and sons who were already the shareholders of the company and the petitioner. The directors on account to their private dispute with the petitioners, acting, in a high-handed manner and unreasonably refused to transfer a part of the shares bequeathed under the Will while transferring some shares in favour of themselves as provided under the Will. They made certain improper transfers also. The petitioners applied under Sections 397 and 398 of the Companies Act for removal of one of the director from the Board, and for the appointment of committee of shareholders to manage the affairs of the company. But the court held that "the proper order to make, in the circumstances, is to direct the directors to transfer the shares to the petitioners in accordance with the terms of the Will".

If the Company Law Board orders any alteration of the memorandum or articles of the company, the company shall not be at liberty to introduce any provision inconsistent with the order [Section 404(1) and see also Sub-sections (2), (3) and (4)]. If the order sets aside or modifies any agreement with any management personnel, it will not give rise to any claim for damages or compensation for loss of office [Section 407 (1) (a)]. Further any managerial personnel whose appointment is so set aside shall not be capable of serving the company in any managerial capacity for the period of five years except with the leave of the Company Law Board [Section 407 (1) (b)]. The prohibition applies to any person who becomes his associate [Sub-section (1); See also Sub-section (3)]. Where the CLB, for the purposes of fulfilling the objects of Section 397, orders the company to purchase the shares of the outgoing shareholders, the other

provisions of the Act, like those of Section 77A, would not be attracted. The application of other sections may defeat the very purpose of the provisions of the Act relating to prevention of oppression and mismanagement. [*Gurmit Singh v. Polymer Papers Ltd.* (2003) 45 SCL 251 (CLB-ND)].

5. CONSEQUENCES OF TERMINATION OR MODIFICATION OF AGREEMENTS

Section 407(1)(b) of the Act states the consequences which follow upon the termination setting aside or modification of agreements between the company and its manager, managing director under Section 397 & 398. It provides that where an agreement has been terminated, set aside or modified by the order in respect of manager, managing or other directors, such person or persons cannot claim any compensation or damages against the company for the loss of office or in any other respect. Further, no manager, managing or other director whose agreement has been terminated, set aside or modified, shall for a period of 5 year from the date of the order of the CLB, without the leave of the CLB, be appointed or act as manager, managing or other director of the company. Before granting the leave Company Law Board must give an opportunity to the Central Government of being heard in the matter. If any person acts as manager, managing director or other director in contravention of this provision, he shall be punishable with imprisonment up to one year or fine up to ₹ 50,000 or with both.

An application seeking the leave of the Company Law Board under Section 407 shall be made to the Principal Bench of the CLB, with a fee of ₹ 2500, and accompanied by a copy of the notice of the intention to apply for leave given to the Central Government together the following documents:

1. Documentary and/or other evidence in support of the statement made in the petition, as are reasonably open to the petitioner(s);
2. Documentary evidence in proof of the eligibility and status of the petitioner(s) with the voting power held by each of them;
3. Where the petition is presented on behalf of members, the consent letters given by them.
4. Statement of particulars showing names, addresses, number of shares held and others moneys due on shares have been paid in respect of members who have given consent to the petition being presented on their behalf;
5. Where the petition is presented by any member or members authorised by the Central Government under Section 399(4), the order of the Central Government authorising such member or members to present the petition shall be similarly annexed to the petition.
6. Affidavit verifying the petition.
7. Bank draft evidencing payment of application fee.
8. Memorandum of appearance with copy of the Board resolution or the executed vakalatnama, as the case may be.

The petition herein shall also state that notice of the intention to apply for such leave has been given to Central Government and shall be accompanied by a copy of such notice.

The petitioner shall be required to serve a copy of the petition upon the concerned Registrar of Companies [Reg. 14(3)].

6. POWERS OF THE CENTRAL GOVERNMENT TO PREVENT OPPRESSION OR MISMANAGEMENT

1. The Act not only confers special powers upon the Company Law Board to prevent oppression or mismanagement, but also confers extraordinary powers upon the Central Government to attain the same end.

The Central Government may appoint such number of persons specified in writing to hold office as directors thereof as is necessary to effectively safeguard the interests of the company, its shareholders or the public interest, for such period, not exceeding 3 years on any one occasion as it may think fit, if the Company Law Board considers it necessary to make the appointment in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interest of the company or to public interest [Section 408(10)], where—

- (i) not less than 100 members of the company or of the members holding not less than 1/10th of the total voting power therein apply to the Company Law Board in the matter [Section 408(1)]; and
- (ii) on receipt of such application or on a reference made to it by the Central Government make such inquiry as it deems fit to make [Section 408(1)] and found necessary to such appointment.
- 2. But instead of passing such an order, the Company Law Board may direct the company to amend its articles to provide for a proportional representation (according to Section 265) for appointment of directors so that minority interests may be properly represented and make fresh appointments of directors in pursuance of the articles so amended, within such time as may be specified [Section 408(1)].
- 3. In case the CLB passes on order for amendment of a company's articles and to make fresh appointment of directors in accordance with it, it may direct that until new directors are appointed in pursuance of the Government's order such number of persons of the company specified by the Company Law Board shall hold office as additional directors of the company as are necessary to effectively safeguard the interests of the company, its shareholders or the public interest and on such directions, the Central Government shall appoint such additional directors [Section 408(2)].
- 4. Any directors appointed by the Central Government shall not be liable to retirement by rotation. For the purpose of reckoning two-thirds or any other proportion of the total number of directors of the company, any director(s) so appointed by the Central Government shall not be taken into account. The term of office of such directors will depend upon the order of the Central Government by which they are appointed [Section 408(3)].
- 5. A person appointed under Sub-section (1) to hold office as a director or a person directed under Sub-section (2) to hold office as an additional director, shall not be required to hold any qualification shares nor his period of office shall be liable to determination by retirement of directors by rotation; but any such director or additional director may be removed by the Central Government from his office at any time and another person may be appointed by the Government in his place to hold office as director or as, the case may be, an additional director [Section 408(4)].
- 6. No change in the Board of directors made after a person is appointed or directed to hold office as a director or additional director under Section 408 shall, so long as such director or additional director holds office, have effect unless confirmed by the Company Law Board [Section 408(5)].
- 7. Notwithstanding anything contained in this Act or in any other law, where any person is appointed by Central Government to hold office as director or additional director of a company in pursuance of Sub-section (1) or Sub-section (2) of Section 408, the Central Government may issue such directions to the company as it may consider necessary or appropriate in regard to its affairs. Such directions may include directions to remove an auditor already appointed and to appoint another auditor in his place or to alter the articles of the company and upon such directions being given, the appointment, removal or alteration as the case may be, shall be deemed to have come into effect as if the provisions of this Act in this behalf have been complied with without requiring any further act or thing to be done [Section 408(6)].

8. The Central Government may require the persons appointed as directors or additional directors in pursuance of Sub-section (1) or Sub-section (2) to report to the Government from time to time with regard to the affairs of the company [Section 408(7)].

Sub-sections (6) and (7) were added to Section 408 by the Amendment Act, 1974. The weakness of the section before this amendment was that the appointment of one or two directors was not effective enough to check mismanagement. The merit of the new provisions added is that it gives a power of direct action to interfere and control the management of the company by controlling the Board of directors itself, by appointing such number of directors as may be required for the purpose. The power to call the reports [Sub-section (7)], and the power to give directions [Sub-section (6)], will play a vital role in disciplining the company's management.

9. *Union of India v. Satyam Computers Services Ltd. & Ors.* [(2009) 1Comp LJ 308(CLB)] The Respondent Company indulged in grave financial mismanagement practices due to which its Chairman resigned. The Central Government applied to the CLB for the removal of the Board of directors and to appoint its directors to manage the respondent company.

It was held that the petitioner has sufficient grounds to invoke the provisions of section 388B/397/398 and 408 of the Companies Act, 1956. The written admission of the second respondent, who is the chairman of the company, establishes beyond any shadow of doubt that there have been financial impropriety and jugglery of financial statements, with the view to mislead the stakeholders, employees and the public in general. It appears that a serious fraud has been perpetrated on the society as a whole. The manner in which the affairs of the company have been conducted has shaken the confidence of the public in the company as is evident from the fall in the share price of the company on 7.1.2009 from ₹ 188 to 38.40. As indicated above, the company is the fourth largest IT Company in India. It has clients in over 60 countries and also has over 53,000 employees and has nearly 3 lakh shareholders. Their interests along with the interests of the company have to be protected. The public interest at large is also at stake.

The need of the hour is to be to create confidence in the minds of all those connected with the company in any capacity and also to assure that regulatory/judicial mechanism in India is alive and active to take immediate and positive steps in case of needs. The present state of affairs of the company is such, that there could not be a better case, wherein, this Board, in exercise of its powers under sections 388C/403 of the Act, is obligated under the law to regulate the affairs of the company on an urgent basis.

Therefore, in the interests of the members, employees, customers of the company and also in the larger public interest, the interim relief sought should be granted *ex parte*. Accordingly, it is directed/ordered, *inter alia*, as follows (i) the present board of directors stands suspended with immediate effect. None of the present directors shall represent himself to be a director of the company and shall also not exercise any powers as a director (ii) On the authority of this order, in the name and on behalf of the Board, the Central Government shall immediately constitute a fresh board of the company with not more than 10 persons of eminence as directors. The Central Government may also designate one of them as the chairman of the board. This board shall be entitled to exercise and discharge all powers vested in the board by the articles and the Act. The said constitution shall be notwithstanding anything contrary contained in the articles, the Act, listing agreement or any other law/regulations relating to the constitution of the board of a listed company. The said board will continue till further orders. (iii) The newly constituted board shall meet within seven days of its constitution and take necessary immediate action to put the company back on the road.(iv) It shall submit periodical reports to the Central Government, with a copy to this Board on the state of affairs of the company. (v) The petitioner is permitted to file additional affidavits that may become necessary after further investigations/enquiries into the affairs of the company. (vi) The petitioner will serve a copy of the petition along with a copy of this order on all the respondents immediately, who shall file their replies to the petition by 20.2.2009.

7. POWER TO PREVENT CHANGES IN THE BOARD

Section 409 of the Companies Act, 1956 provides as under :

1. Manager, managing director or any other director of a Company is empowered to complain to the Company Law Board that as a result of change which has taken place or is likely to take place in the ownership of any shares held in the company, a change in the Board of directors is likely to take place which (if allowed) would affect prejudicially the affairs of the company [Section 409(1)]. A change in the Board of directors would mean appointment or removal of a director, replacement of the Board either partly or in full. No change in the designation or powers of the Board can be considered to be a change within the meaning of Section 409.
2. The Company Law Board may make such enquiry as it deems fit on the complaint made to it [Section 409(1)].
3. The Company Law Board after such enquiry if satisfied that it is just and proper so to do, by order, direct that no resolution passed or that may be passed or no action taken or that may be taken to effect a change in the Board of directors after the date of the complaint shall have effect unless confirmed by the Company Law Board. Any such order shall have effect notwithstanding anything contained contrary in the memorandum or articles of the company or any agreement made or resolution passed in general meeting or/by the Board of directors [Section 409(1)].
4. The Company Law Board has the power when any such complaint is received by it to make interim order before making or completing the necessary inquiry [Section 409(2)].
5. The powers conferred by Section 409 cannot be exercised in the case of a private company unless it is a subsidiary of public company [Section 409(3)].

LESSON ROUND-UP

- The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.
- Under the Companies Act the powers have been divided between two segments; one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their power through Annual General Meetings/Extra-ordinary General Meetings.
- The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority.
- Since the majority of the members are in an advantageous position to run the company according to their command, the minority shareholders are often oppressed. The company law provide for adequate protection for the minority shareholders when their rights are trampled by the majority.
- The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company.
- The supremacy of the majority, however, does not prevail in all situations. There are certain acts which the majority of shareholders cannot approve or affirm. In such cases, any shareholder may sue to enforce obligations owed to the company. He brings the action as representative of the corporate interest.
- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief.

- Relief under the Act will also be available if the affairs of the company are being conducted in a manner prejudicial to public interest. 'Public interest' is a very broad term involving the welfare not only of the individual shareholders but also of the country according to the economic and social policies of the State.
- If there is persistent violation of the regulations and statutes and an appeal to general body is not likely to put an end to the matters complained of by reason of the fact that those responsible for the violations control the affairs of the company, then it will be just and equitable to wind up the company.
- If the court is so convinced that the affairs of a company are being conducted in a manner prejudicial to the interest of the company or public interest, or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner, it may with a view to bring an end or preventing the matter complained of or apprehended, make such order as it thinks fit.
- Section 399 provides that where the company has a share capital, the application must be signed by at least 100 members of the company or by one-tenth of the total number of the members, whichever is less; or by any member or members holding not less than one-tenth of the issued share capital of the company. If the company has no share capital, the application has to be signed by at least one-fifth of the total number of its members.
- Company Law Board and Central Government have been empowered under the Act to prevent oppression and mismanagement.

GLOSSARY

Democracy

Democracy means the rule of people, by people and for people.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)

1. "A company is a democratic institution in which the majority have a right to control the company." Do you support this statement? Give your comments in the rule laid down in *Foss v. Harbottle*.
2. Explain clearly the meaning of 'majority rule' as applied in managing a company registered under the Companies Act 1956. Are there any exceptions to this rule? If so, explain in the light of the statutory law and case law.
3. "The rule in *Foss v. Harbottle* presently has lost its importance because of adequate statutory provisions made in the Companies Act, 1956". Discuss the adequacy of these provisions.
4. The articles of a company provided for the taking of a poll at a general meeting of the company if so demanded by five shareholders. At a general meeting the Chairman, in breach of the articles, declined to take a poll. One of the shareholders brought an action on behalf of himself and other shareholders against the directors and company, seeking a declaration that decisions taken at the meeting were invalid and seeking an injunction to restrain their implementation. Are the shareholders competent to file the suit?
5. "Majority will have its way but minority must be allowed to have its say." Discuss the above proposition with reference to prevention of oppression and mismanagement?
6. Enumerate the powers of the Company Law Board to prevent oppression and mismanagement. What are the powers of the Central Government to prevent oppression and mismanagement?
7. "Section 397 and 398 are intended to avoid winding up, if possible, and keep the company going, while at the same time saving the minority shareholders from oppression and mismanagement". Explain.

Lesson 27

Merger, De-Merger, Amalgamation, Compromise and Arrangements – An Overview

LESSON OUTLINE

An over view of Provisions of the Companies Act, 2013 relating to

- Compromise/arrangements
- Mergers/Demergers

LEARNING OBJECTIVES

While implementing the strategic decision of merger/amalgamation, the transferor/transferee company has to comply with a number of regulations viz., the Companies Act, 2013 and rules made there under, Income Tax Act, 1961, Listing Agreement, The Indian Stamp Act 1899, The Competition Act, 2002 etc. It involves conducting of various meeting including board/general meetings, creditors' meeting, valuation and calculation of swap ratio, obtaining of various approvals from regulators like Stock Exchanges, National Company Law Tribunal(NCLT), Competition Commission of India etc., drafting of documents such as preparation of scheme, notices/explanatory statements, filing of various documents including e-forms with ROC, filing of scheme of amalgamation with NCLT etc.,

After reading this lesson you will be able to understand the broad regulatory framework with respect to compromise/arrangement, mergers/demergers

It may be noted that Section 230-240 of the Companies Act and the Rules under Chapter XV of the Companies Act 2013 are yet to be notified and the National Company Law Tribunal and National Company Law Appellate Tribunal are to be constituted.

REGULATORY FRAMEWORK FOR MERGER/AMALGAMATION

The Regulatory Framework of Mergers and Amalgamations (M&A) covers

1. The Companies Act, 2013¹ (Provisions regarding M & A yet to be enforced)
2. Rules Made under Chapter XV of the Companies Act 2013² (Rules yet to be notified)
3. Provisions of Companies Act, 1956 on M & A (still in force)
4. Income Tax Act, 1961
5. Listing Agreement
6. The Indian Stamp Act, 1899
7. Competition Act, 2002

1. COMPANIES ACT, 2013

Chapter XV of Companies Act, 2013 comprising Section 230 to 240 contains provisions on 'Compromises, Arrangements and Amalgamations'. The scheme of Chapter XV goes as follows.

1. Section 230-231 deals with compromise or arrangements.
2. Section 232 deals with mergers and amalgamation including demergers.
3. Section 233 deals with amalgamation of small companies
4. Section 234 deals with amalgamation with foreign company
5. Section 235 deals acquisition of shares of dissenting shareholders.
6. Section 236 deals with purchase of minority shareholding.
7. Section 237 deals with power of central government to provide for amalgamation of companies in public interest.
8. Section 238 deals with registration of offer of schemes involving transfer of shares.
9. Section 239 deals with preservation of books and papers of amalgamated companies.
10. Section 240 deals with liability of officers in respect of offences committed prior to merger, amalgamation etc.,

2. Rules made under Chapter XV of the companies Act 2013(to be notified).

The scope of rules made under Chapter XV of the Companies Act 2013 includes detailed procedural aspects relating to substantive law.

Companies Act, 1956

Chapter V of Companies Act, 1956 comprising Section 390 to 396A contains provisions on 'Arbitration, Compromises, Arrangements and Reconstructions'. There are however, no provision on Arbitration Since Section 389 which dealt with Arbitration was deleted. The scheme of Chapter V goes as follows.

1. Section 390 contains interpretation of certain expressions used in Section 391 and 393.

1 Sections Chapter XV(Section 230-240 are yet to be notified)

2 Rules yet to be notified

2. Section 391 is relating to the power of the company to compromise or to make arrangement with its creditors and members.
3. Section 393 deals with regard to information as to compromises and arrangements with creditors and members.
4. Section 394 deals with facilitation of reconstruction and amalgamation of companies.
5. Section 394A deals with a notice to be given to the Central Government in respect of applications under Section 391 and 394.
6. Section 395 deals with provisions regarding the power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority shareholders.
7. Section 396 contains provisions as to the power of the central government to provide for amalgamation of companies in national interest.
8. Section 396 A deals with preservation of books and papers of amalgamated companies.

2. Companies Court Rules, 1959

Rules 67-87 contains provisions dealing with the procedure for carrying out a scheme of compromise or arrangement including amalgamation or reconstruction.

3. Under the Income Tax Act, 1961

The Income Tax Act, 1961 covers aspects such as tax reliefs to amalgamating/amalgamated companies, carry forward of losses, exemptions from capital gains tax etc. For example, when a scheme of merger or demerger involves the merger of a loss making company or a hiving off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, *inter alia*, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferor Company.

4. Under the Listing Agreement

Under Clause 24(f) of the Listing Agreement, where the scheme of merger or demerger involves a listed company, it is necessary to send a copy of the scheme to the stock exchanges where the shares of the said company are listed to obtain their No Objection Certificate (NOC). Generally stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the takeover code or the SEBI (ICDR) Regulations, Stock Exchanges accord their approval. Where the shares are listed on BSE or NSE, other Stock Exchanges wait for the approval by BSE or NSE before granting their approval.

5. Under the Indian Stamp Act

It is necessary to refer to the Stamp Act to check the stamp duty payable on transfer of undertaking through a merger or demerger.

6. Competition Act, 2002

The provisions of Competition Act and the Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 are to be complied with.

PROVISIONS OF COMPANIES ACT 1956

Scope of Section 391

Section 391(1) of the Companies Act, 1956 provides that where a compromise or arrangement is proposed

between company and its creditors or any class of them or between company and its members or any class of them, the Court may on the application of the company or any creditor or member of the company or liquidator (where company is being wound up), order a meeting of creditors or class of creditors or members or class of members, as the case may be, to be called, held and conducted in such manner as it directs. From the above provision of law, it is clear that there could be a compromise or arrangement between a company on the one side and its creditors or any class of them on the other side. There could be an arrangement between a company and its members or any class of them. In such a scheme of compromise or arrangement, the creditors or members could be the interested parties. In the case of a company in winding up, the liquidator becomes the party entitled to present the scheme to the court. All or any one of the interested parties have to make an application to the court praying for sanctioning the scheme of compromise or arrangement.

Pertinently, it has been held in several cases that Section 391 is a 'complete code' or 'single window clearance system', and that the Court has been given wide powers under this section, to frame a scheme for the revival of a company. Being a complete code, the Court can, under this 'section', sanction a scheme containing all the alterations required in the structure of the company for the purpose of carrying out of the scheme.

Section 391 contemplates a compromise or arrangement between a company and its creditors or any class of them, or its members or any class of them, and provides machinery whereby such a compromise or arrangement may be binding on dissentient persons by an order of the Court. [*Oceanic Steam Navigation Co. In re. (1939) 9 Com Cases 229 (Ch.D.)*].

When an application is made, the Court will naturally consider the merits of the scheme. The Court will also see whether all interested parties or whether all parties whose rights are likely to be affected have been given the notice about the scheme. In other words, Court gives an opportunity to all persons who are concerned or interested in the scheme. The Court may order a meeting of the creditors and / or the members. While ordering the convening of a meeting, the Court has the power to direct the manner in which the meeting should be conducted and how the proceedings and the result of the meeting should be reported. The Court has the discretion to sanction the scheme. You may note the use of the word 'may' in Sub-section (1) of Section 391 of the Act. It clearly implies that the Court has the discretion to make or not to make the order. As already stated, even before convening a meeting, the Court should pay attention to the fairness of the proposed scheme because it would be no use putting before the meeting a scheme, which is not fair. The Court may also refuse a meeting to be called where the proposals contained therein are illegal, or in violation of provisions of the Act or incapable of modification. [*Travancore National & Quilon Bank, In Re. (1939) 9 Com Cases 14 (Mad.)*]. Thus, the Court does not have to compulsorily call for a meeting, but in its discretion, dismiss the application at that stage itself [*Sakamari Metals & Alloys Limited, In Re. (1981) 51 Com Cases 266 (Bom.)*].

The Court is duty bound to ascertain the bona fides of the scheme and whether the scheme is *prima facie* feasible. The Court will not act merely as a rubber stamp while sanctioning a scheme. The Court must consider the application on merits. [*N.A.P. Alagiri Raja & Company v. N. Guruswamy (1989) 65 Com Cases 758 (Mad.)*]. The Court should examine the nuts and bolts of the scheme and should not hesitate to reject the scheme or ask for additional material or even point to creditors, members, etc. of pitfalls in the scheme and the Court's role under Section 391(1) is equally useful, vital and pragmatic as under Section 391(2) [*Sakamari Metals & Alloy Limited In Re. (1981) 51 Com Cases 266 (Bom.)*]. Where a large number of creditors opposed the scheme, it was obvious that there was no possibility of its being implemented [*Krishnakumar Mills Co. Ltd. In Re. (1975) 45 Com Cases 248 (Guj.)*].

CASE LAW

It was held in the case of *Mekaster Valves and Engineering Services P. Ltd.*, In re. [(2009) 149 Com Cases 593 (Guj)] that when the court sanctions a scheme of arrangement or compromise, the scheme is sanctioned as a whole with all its clauses and proposals. The certified copy of the order sanctioning the scheme filed with the Registrar of Companies shall be treated as intimation to the Registrar of Companies and he shall take note of all the changes proposed and sanctioned by the court. Since all the changes were proposed to be effected as an integral part of the scheme, the approval granted by the shareholders at the meeting to the scheme as a whole amounted to approval granted to all such incidental proposals and no separate procedure was required to be followed as envisaged by sections 17, 31, 94, 97, 81(1A), 100 and 149(2A), respectively. Therefore, there was no need to comply with the provisions of the Act. The scheme of amalgamation being in the interest of the companies and their members and creditors, the scheme was to be sanctioned.

SANCTIONED ARRANGEMENT BINDING ON ALL CONCERNED PARTIES

According to sub-section (2) of Section 391, if a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the court, be binding on all the creditors, or all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of company which is being wound up, on the liquidator and contributories of the company.

Proviso to Section 391(2) provides for disclosure of material facts relating to company to the Court.

NEED FOR REPORTS FROM REGISTRAR OF COMPANIES

In a scheme of compromise or arrangement, the Court is bound to seek a report of the Registrar of Companies representing the Ministry of Corporate Affairs in order to ensure that the affairs of the company have not been conducted in a prejudicial manner. The Registrar of Companies makes a report to the Regional Director in the Ministry of Corporate Affairs. On receipt of the report of the Registrar of Companies, the Regional Director submits his report to the Court through the standing counsel of the Central Government in the form of an affidavit. Thus the Court receives the report of the government and only after considering the same, passes necessary orders sanctioning or rejecting the scheme.

WHEN COURTS DO NOT SANCTION A SCHEME?

If a compromise or arrangement is not bona fide but intended to cover misdeeds of delinquent directors, the Court shall not sanction the scheme [*Pioneer Dyeing House Limited v. Dr. Shanker Vishnu Marathe* (1967) 2 Comp LJ 16].

If the object of the scheme is to prevent investigation or there is failure in the management of affairs of the company or disregard of law or withholding of material information from the meeting or the scheme is against public policy, the Court will not sanction the scheme [*J.S. Davar v. Dr. S.V. Marathe*, AIR 1967 Bom. 456 (DB)].

If it can be shown that the petition is made mala fide and motivated primarily to defeat the claims of certain creditors who had obtained decrees against the company, there was inordinate delay in making the application for sanctioning the scheme and certain information was withheld from the Company Court, the petition for sanctioning the scheme though approved by the creditors and shareholders was rejected [*Richa Jain v. Registrar of Companies* (1990) 69 Com Cases 248 (Raj.)].

Salient aspects emerge in every proposal containing a scheme of compromise or arrangement:

- Any scheme of compromise or arrangement that falls within the provisions of Sections 391 to 393 of the Act should receive sanction from the Court in order to become effective and binding.
- The scheme of compromise or arrangement should be prepared as a written document.
- It should be presented to the Court.
- Court may direct the convening of meetings of creditors or a class of them and/or Court may direct the convening of meetings of members or a class of them.
- Court gives opportunity to all concerned.
- Under Section 391(1) of the Act, the Court gives directions with regard to conducting of meetings.
- The Court also fixes the time and place of such meeting, and appoint a chairman of the meeting.
- The Court fixes the quorum and lays down the procedure to be followed at the meeting, including voting by proxy; determines the value of creditors or members and the persons to whom notice is to be given.
- The Court also gives directions to the chairman to report to the Court the result of the meeting within a given period.

In *Webneuron Services Ltd., In Re.* [(2009) 149 Com Cases 61(Del)], the transferor company sought approval to a scheme of amalgamation with the transferee company. Employee of Transferor Company opposed the petition on the ground of non payment of dues of ₹ 4,48,040. Objection of the employee was overruled and the scheme was sanctioned. The reason given was that the transferor company had, in accordance, with the direction of the court, deposited an amount of ₹ 4,48,040 with the Registrar General of the court and in case the ex employee was found entitled to the amount, he could get it with interest. The terms and conditions of service of the employees of the transferor company were not affected and there was no legal impediment in sanctioning the proposed scheme of amalgamation. The scheme was to be sanctioned and the transferor company was to be wound up without formal winding up.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

If a compromise or arrangement is not *bona fide* but intended to cover misdeeds of delinquent directors, the Court can sanction the scheme.

- True
- False

Correct Answer: False

If a compromise or arrangement is not bona fide but intended to cover misdeeds of delinquent directors, the Court shall not sanction the scheme.

EXPLANATORY STATEMENT TO THE NOTICE OF MEETING

Apart from the directions of the Court, the provisions of Section 393 of the Act, regarding furnishing of

adequate information about the scheme to creditors and members, should also be complied with. Accordingly, with every notice calling the meeting, sent to the creditor or member, a statement setting forth, the terms of compromise or arrangement specifically stating any material interests of director(s) or, managing director(s) or manager of the company in whatsoever capacity, in the scheme and the effect of their interest as in contradiction to the interests of other persons, should be included.

Also, where a notice calling the meeting is given by advertisement, there shall be included either the statement as aforesaid or notification of the place where and the manner in which, the creditors or members entitled to attend the meeting may obtain the copies of such statement. In case, the compromise or arrangement affects the rights of debenture holders, the statement shall accordingly give like information in such respect. Every such copy should be made available to the members or creditors entitled to attend the meeting, in the manner specified and free of charge.

If default is made in complying with the above provisions regarding the notice and the statement, every officer (including liquidator of the company, if any, and every trustee of debenture-holders) in default and the company shall be punishable with fine, which may extend to ₹ 50,000. But if it can be shown that the default in sending the aforesaid notice and the statement was due to refusal of any such person, who is required under law to supply the necessary particulars as to his material interest, the company and its officers shall not be so punishable.

Every officer (director, managing director or manager and every trustee of debenture-holders) of the company, is required to give notice to the company for such matters relating to himself as may be necessary for the purpose of the compromise or arrangement, and if he fails to do so, he shall be punishable with fine which may extend to ₹ 5,000.

At the meeting the scheme is to be passed with the support of majority in number and three-fourths in value of those present and voting. The creditors or members who are present at the meeting but remain neutral or abstain from voting, will not be counted in ascertaining the majority in number or value [*Hindustan General Electric Corporation, In Re.*, AIR 1959, (Cal.) 679].

The Chairman appointed by Court presides over the meeting and has to file his report within 7 days of the conclusion of the meeting where the scheme was considered and voted upon by the creditors or members. Subsequently, the petitioner makes the application for confirmation of the scheme within 7 days of filing of the report of the chairman.

The Court, while sanctioning the scheme, must be satisfied that there is full and fair disclosure of information by the petitioner about the state of affairs of the company and its latest financial position. The Court should also be satisfied that statutory majority are acting bona fide and the compromise or arrangement is such that as it may be reasonably approved. [*Dorman Long & Co. Limited* (1933) All ER Rep. 460]. Therefore the Court would like to be satisfied basically on three points: Firstly that the provisions of the statute have been complied with. Secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class, they purport to represent and; thirdly that the arrangement is such, as a man of business, would reasonably approve [*Anglo Continental Supply Co., Re.* (1922) 2 Ch. 723]. The scheme, if sanctioned by the Court, with or without modifications, if any, to make it operational, is binding on all the creditors including government, creditors and liquidator, contributories, all the members or classes thereof, as the case may be, and also on the company. It takes effect not from the date of sanction of the Court, but from the date it was arrived at.

Sub-section (3) of Section 391 provides that the order of the Court becomes effective only after a certified copy thereof is filed with the Registrar of Companies.

Sub-section (4) of Section 391 provides that a copy of every such order of the Court has to be attached to every copy of the Memorandum of Association of the Company.

According to Sub-section (5) of Section 391 if default is made in complying with Sub-section (4), the company, and every officer of the company who is in default, shall be punishable with fine.

As per Sub-Section (6) of Section 391 the Court may, at any time after an application has been made, stay the commencement or continuation of any suit or proceedings against the company on such terms as it may think fit, until the application is finally disposed of.

Sub-section (7) of Section 391 provides that an appeal from the order of the Court can be made to the higher Court so empowered.

7. POWERS OF THE COURT TO SUPERVISE THE IMPLEMENTATION OF THE SCHEME

Section 392 of the Companies Act, 1956 confers the powers on the High Court sanctioning a compromise or arrangement in respect of a company, to supervise the carrying out of a compromise or arrangement and give any directions or making modifications in the scheme, as it considers necessary, either at the time of sanctioning it or any time thereafter. Under this Section, the Court cannot issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct. [*Mysore Electro Chemical Works Ltd. v. ITO*, (1982) 52 Com Cases 32 (Ker.)]. The Court has powers to give directions even to third parties to the compromise or arrangement provided such direction is necessary for the proper working of compromise or arrangement.

REVIEW QUESTIONS



State whether the following statements are “True” or “False”

1. The Chairman appointed by the Court to preside over the meeting has to file his/her report within seven days of the conclusion of the meeting where the scheme was considered and voted upon by the creditors or members.
2. The Court can also issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct.

Correct Answer: 1. True 2. False

Under Section 392 of the Companies Act, 1956, the Court cannot issue directions which do not relate either to the sanctioned scheme itself or its working in relation to the company which the scheme seeks to reconstruct.

8. POWERS OF THE COURT TO SANCTION MODIFICATION OF THE TERMS OF A SCHEME

As regards the modification of a scheme, application thereof can be made by any person interested. 'Any person interested' should not be confined to creditor or liquidator of the company whereby any person who has obtained a transfer of shares in the company but has not yet been registered as a member is also to be included therein [*K.K. Gupta v. K.P. Jain* (1979) 49 Com Cases 342: AIR 1979 SC 734]. In *T. Mathew v.*

Saroj Poddar (1996) 22 CLA 200 at 216 (Bom.) the following main points emerged:

- (a) The scheme can be modified by the Court either at the time of or after its sanction.
- (b) Such modification can include the substitution of sponsor of the scheme.
- (c) Modification of scheme or substitution of sponsor should be necessary for proper, efficient and smooth working of the scheme.
- (d) Modification can be made at the instance of any person who is interested in the affairs of the company and the court can also introduce modification *suo motu*.
- (e) The Court should examine the bona fides of the person applying to be substituted as a sponsor, his capability and his interest in the company.

POWERS OF THE COURT TO ORDER A WINDING UP WHILE CONSIDERING A SCHEME

If the Court is satisfied that a compromise or arrangement sanctioned under Section 391 cannot be carried out satisfactorily with or without modifications, it may vide Section 392(2) of the Act, either on its own motion or on the application of any person interested in the affairs of the company, make an order for winding up which shall be deemed to be the same as under Section 433 of the Act.

POWERS OF THE COURT TO MAKE CONSEQUENTIAL ORDERS

Where an application is made to the Court under Section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as mentioned therein, and the Court is satisfied that the scheme relates to the reconstruction or amalgamation of any two or more companies, it will make consequential orders as provided in Section 394 of the Act.

According to section 394, where an application is made to the court under section 391 and it is shown to the court that the compromise or arrangement has been proposed for the purpose of a scheme of reconstruction of any company or amalgamation of two or more companies and that under the scheme the whole or any part of the undertaking, property or liabilities of any company is to be transferred to another company, the court may make provisions for all or any of the following matters:

- (i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- (ii) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person;
- (iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- (iv) the dissolution, without winding up, of any transferor company;
- (v) the provision to be made for any person who, within such time and in such manner as the directs, dissent from the compromise or arrangement; and
- (vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out;

However, the Court shall not sanction any compromise or arrangement for the amalgamation of a company, which is being wound up, with any other company unless the Court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in manner prejudicial to the interests of its members or to public interests. Similarly, the court will not make an order for dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.

Notice to be given to Central Government for applications under sections 391 and 394.—

As per section 394A of the Companies Act, 1956, the Court shall give notice of every application made to it under section 391 or 394 to the Central Government, and shall take into consideration the representations, if any, made to it by that Government before passing any order under any of these sections.

Power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority (Section 395)

Section 395 lays down as follows:

Where the transferee company has offered to acquire the shares or any class of shares of the transferor company, the scheme or contract embodying such offer has to be approved by the shareholders concerned within four months. If the approval is given by the holders of not less than 9/10th value of shares, the shares already held by the transferee company or its nominee or subsidiary are excluded the transferee company may, at any time within two months of the expiry of the said four months, give a notice to the dissenting shareholders that it desires to acquire their shares. The transferee company is entitled and bound to acquire the shares of dissenting shareholders on the same terms on which the shares of approving shareholders were approved unless on the application of the dissenting shareholders within one month of such notice, the court orders otherwise.

3. If the transferee company already holds in the transferor company shares of the class whose transfer is involved, to a value more than 1/10th of the total value of all shares of that class in that company, then the above provision will not apply and the transferee company cannot acquire the shares of the dissenting members. However, it is entitled to still acquire the share if:

- (a) it offers the same terms to all the shareholders of the same class, and
- (b) the shareholders who approve of the scheme, besides holding not less than 9/10ths in value of the shares other than those already held by the transferee company itself or through nominees, are also not less than 3/4ths in number of the holders of those shares.

Special Power of Central Government to Order Amalgamation

Section 396 of Companies Act, 1956 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate.

Ministry of Corporate Affairs vide its General Circular No. 16/2011 F.No. 51/16/2011/CL-III dated the 20th April, 2011, simplified procedure for amalgamation of Government Companies U/s 396 of the Companies Act, 1956.

The Ministry of Corporate Affairs have been dealing with the amalgamation of Government Companies in the

Public Interest under section 396 of the Companies Act, 1956 by following the procedures prescribed under Companies (Court) Rules, 1959 which are applicable to amalgamation under Sections 391-394 of the Companies Act, 1956. Without prejudice to the generality of Section 396, it has now been decided that, in appropriate cases, simpler procedures shall be adopted for the amalgamation of Government Companies under section 396 of the Companies Act, 1956 as given below:-

- (1)(a) Every Central Government Company which is applying to the Central Government for amalgamation with any other Government Company or Companies required to obtain approval of the Cabinet i.e. Union Council of Ministers to the effect that the proposed amalgamation is in the 'public interest'.
- (b) In the case of State government companies, the approval of the State Council of Ministers would be required.
- (c) Where both central and state government companies are involved, approval of both State Cabinet(s) and Central Cabinet shall be necessary.
- (2) (i) A Government Company may, by a resolution passed at its general meeting decide to amalgamate with any other Government Company, which agrees to such transfer by a resolution passed at its general meeting;
- (ii) Any two or more Government Companies may, by a resolution passed at any general meetings of its Members, decide to amalgamate and with a new Government Company.
- (3) Every resolution of a Government Company under this section shall be passed at its general meeting by members holding 100% of the voting power and such resolution shall contain all particulars of the assets and liabilities of amalgamating government companies.
- (4) Before passing a resolution under this section, the Government Company shall give notice thereof of not less than 30 days in writing together with a copy of the proposed resolution to all the Members and creditors.
- (5) A resolution passed by a Government Company under this section shall not take effect until (i) the assent of all creditors has been obtained, or (ii) the assent of 90% of the creditors by value has been received and the company certifies that there is no objection from any other creditor.
- (6) The resolutions passed by the transferor and transferee companies along with written confirmation of the Cabinet decision then be submitted to the Central Government which shall, if it is satisfied that all the requirements of Section 396 have been fulfilled, order by notification in the Gazette that the said amalgamation shall take effect.
- (7) The order of the Central Government shall provide:-
 - (a) for the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company
 - (b) that the amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.
 - (c) for such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out

(8) The Cabinet decision referred to in para (1) above may precede or follow the passing of the resolution referred to in para (2).

(9) When an order has been passed by the Central Government under this section, it shall be a sufficient conveyance to vest the assets and liabilities in the transferee.

(10) Where one government company is amalgamated with another government company, under these provisions, the registration of the first-mentioned Company i.e. transferor company, shall stand cancelled and that Company shall be deemed to have been dissolved and shall cease to exist forthwith as a corporate body.

(11) Where two or more Government Companies are amalgamated into a new Government Company in accordance with these provisions and the Government Company so formed is duly registered by the Registrar, the registration of each of the amalgamating companies shall stand cancelled forthwith on such registration and each of the Companies shall thereupon cease to exist as a corporate body.

(12) The amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations, and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.

(13) The Registrar shall strike off the names of every Government Company deemed to have been dissolved under sub-sections (10) to (11).

(14) Nothing in this Circular shall prevent government companies from applying for amalgamation before the Central Government under Sections 391-394 of the Companies Act.

Section 396 of Companies Act, 1956 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate

PROVISIONS OF THE COMPANIES ACT 2013 (Yet to be notified)

COMPROMISE OR ARRANGEMENT WITH MEMBERS OR CREDITORS

Tribunal to order meeting of members/creditors etc.

Section 230(1) states that when a compromise or arrangement is proposed—

- (a) between a company and its creditors or any class of them; or
- (b) between a company and its members or any class of them,

the Tribunal may, on the application of the (i) company or (ii) of any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

For the purposes of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods.

Affidavit by the applicant to disclose certain material facts

Section 230 (2) states that the company or any other person, by whom an application is made under sub-

section (1), shall disclose to the Tribunal by affidavit—

- (a) all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;
- (b) reduction of share capital of the company, if any, included in the compromise or arrangement;
- (c) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent. of the secured creditors in value, including—
 - (i) a creditor's responsibility statement in the prescribed form;
 - (ii) safeguards for the protection of other secured and unsecured creditors;
 - (iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;
 - (iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and
 - (v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

Notice of the meeting

Section 230(3) states that when a meeting is proposed to be called in pursuance of an order of the Tribunal under sub-section (1), a notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by

- a statement disclosing the details of the compromise or arrangement,
- a copy of the valuation report, if any, and
- explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and
- the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
- such other matters as may be prescribed:

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed:

When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

Notice to provide for voting by themselves or through proxy or through postal ballot

Subsection (4) of section 230 states that a notice under sub-section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice:

Who can object to the scheme?

Any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent. of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

Notice to be sent to the regulators seeking their representations

Section 230(5) states that a notice under sub-section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

Approval and sanction of the scheme

Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company.

Order of the tribunal sanctioning the scheme to provide for the following matters

(7) An order made by the Tribunal under sub-section (6) shall provide for all or any of the following matters, namely:—

- (a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;
- (b) the protection of any class of creditors;
- (c) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;
- (d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;
- (e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

Accounting treatment proposed in the scheme to be in conformity with accounting standards

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Order of tribunal to be filed with the Registrar

Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

Tribunal may dispense with calling of meeting of creditors

Section 230(9) states that the Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

Compromise in respect of buy back is to be in compliance with section 68

As per Section 230(10), no compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

Compromise includes takeover

Section 230(11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

Do provisions of section 66 apply with respect to reduction of capital effected in pursuance of order of tribunal under section 230?

Provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

Power of the tribunal to enforce compromise or arrangement

As per section 231(1) when the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

- (a) shall have power to supervise the implementation of the compromise or arrangement; and
- (b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

Sub-section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding up the company and such an order shall be deemed to be an order made under section 273.

MERGER AND AMALGAMATION OF COMPANIES

Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies

Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal—

- (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the

- amalgamation of any two or more companies; and
- (b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies,

the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply mutatis mutandis.

Circulation of documents for members/creditors meeting

Section 232(2) states that when an order has been made by the Tribunal under sub-section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:—

- (a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
- (b) confirmation that a copy of the draft scheme has been filed with the Registrar;
- (c) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;
- (d) the report of the expert with regard to valuation, if any;
- (e) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

Sanctioning of scheme by tribunal

Section 232(3) states that the Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

- (a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;
- (b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

No transferee company can hold shares in its own name or under any trust

A transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished;

- (c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer;
- (d) dissolution, without winding-up, of any transferor company;

- (e) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;
- (f) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;
- (g) the transfer of the employees of the transferor company to the transferee company;
- (h) when the transferor company is a listed company and the transferee company is an unlisted company,—
 - (A) the transferee company shall remain an unlisted company until it becomes a listed company;
 - (B) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal:

The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

 - (i) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and
 - (j) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out:

Auditor's certificate as to conformity with accounting standard

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Transfer of property or liabilities

Sub-section (4) states that an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect.

Certified copy of the order to be filed with the registrar

Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

Effective date of the scheme

Section 232(6) states that the scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

Annual statement certified by CA/CS/CWA to be filed with registrar every year until the completion of the scheme

Section 232 (7) states that every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

Punishment

Section 232(8) states that if a transferor company or a transferee company contravenes the provisions of this section, the transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Explanation under Section 232

- (i) in a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company;
- (ii) references to merging companies are in relation to a merger by absorption, to the transferor and transferee companies, and, in relation to a merger by formation of a new company, to the transferor companies;
- (iii) a scheme involves a division, where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company; and
- (iv) property includes assets, rights and interests of every description and liabilities include debts and obligations of every description.

MERGER AND AMALGAMATION OF CERTAIN COMPANIES

Section 233 prescribes simplified procedure for Merger or amalgamation of

- two or more small companies or
- between a holding company and its wholly-owned subsidiary company or
- such other class or classes of companies as may be prescribed;

Merger of small companies/holding and subsidiary companies

Accordingly sub-section (1) of Section 233 states that notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:—

- (a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;
- (b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent. of the total number of shares;
- (c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and
- (d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

Transferee company to file a copy of scheme approved

Section 233(2) states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

Central Government to issue confirmation order, where there are no objections or suggestions from registrar or official liquidator

Section 233(3) states that on the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

Objections if any by the registrar or official liquidator to be communicated to the central government

Section 233(4) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

Application by Central Government to the Tribunal

Section 233(5) states that if the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

Tribunal's Action to Central Government's application

Section 233(6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

If the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

Registrar having jurisdiction over transferee company has to be communicated

Section 233(7) states that a copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

Effect of registration of the scheme

Section (8) states that the registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding-up.

Section 233 (9) states that the registration of the scheme shall have the following effects, namely:—

- (a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;
- (b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;
- (c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and
- (d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished

Section 233 (10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

Transferee Company to file an application with Registrar along with the scheme registered

Section 233(11) The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

CROSS BORDER MERGERS

Merger or amalgamation of a Company with a foreign company

Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

For the purposes of sub-section (2), the expression “foreign company” means any company or body corporate incorporated outside India whether having a place of business in India or not.

Section 234. (1) states that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

POWER OF THE CENTRAL GOVERNMENT TO PROVIDE FOR AMALGAMATION OF COMPANIES IN PUBLIC INTEREST

Power of Central Government to provide for amalgamation of Companies

Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

Continuation of legal proceedings

Section 237 (2) states that the order under sub-section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

Interest or rights of members, creditors, debenture holders not to be affected.

As per Section 237(3), every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

Appeal to tribunal

As per Section 237 (4) Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

Conditions for order under Section 237

As per Section 237 (5) No order shall be made under this section unless—

- (a) a copy of the proposed order has been sent in draft to each of the companies concerned;
- (b) the time for preferring an appeal under sub-section (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and

- (c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

Copies of order to be laid before each house of parliament

As per Section 237 (6) the copies of every order made under this section shall, as soon as may be after it has been made, be laid before each House of Parliament.

Registration of offer of schemes involving transfer of shares

Section 238(1) states that in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235,—

- (a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed;
- (b) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available; and
- (c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered: Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

Section 238(2) states that an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under sub-section (1).

Section 238(3) states that the director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

Preservation of books and papers of amalgamated company

As per section 239, the books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

Liability of officers in respect of offences committed prior to amalgamation

As per Section 240, notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

LESSON ROUND-UP

- Section 230(1) states that when a compromise or arrangement is proposed—
 - (a) between a company and its creditors or any class of them; or
 - (b) between a company and its members or any class of them,
- the Tribunal may, on the application of the (i) company or (ii) of any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.
- Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company.
- Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.
- Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal—
 - (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and
 - (b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies,
- the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply mutatis mutandis.
- Section 233 prescribes simplified procedure for Merger or amalgamation of
 - two or more small companies or
 - between a holding company and its wholly-owned subsidiary company or
 - such other class or classes of companies as may be prescribed
- Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.
- Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Describe the provisions relating to cross border mergers in Companies Act 2013.
 2. What are the requirements relating to notice required under Section 230 of the Companies Act 2013?
 3. Companies Act simplified the mergers between smaller companies. Do you agree?

Lesson 28

Producer Companies

LESSON OUTLINE

- Concept of producer companies
- Objects of producer company
- Formation and registration of producer company
- Membership and voting rights of members.
- Benefits to members
- Memorandum of Association, Articles of Association and their content.
- Conversion of inter-state co-operative society into Producer Company.
- Appointment of directors, vacation of office, liability of directors, their committee.
- Powers and functions of the board, meetings of the board and quorum.
- Committee of Board
- Chief Executive and his functions.
- Secretary of Producer Company.
- Annual general meetings.
- Share capital, transferability of shares and surrender, issue of bonus shares.
- Amalgamation, merger or division to form new Producer Companies.
- Disputes and striking off name.

LEARNING OBJECTIVES

There are different forms of business organizations. The company form of business organization is one of them. A producer company is one of the said company form of business organization. These types of companies are working like co-operative societies. Mainly these types of companies are registered in rural areas by the producers. These companies are incorporated to develop the rural economies and bridge the gap between industry and agriculture, rural and urban area and industry and labour etc. These companies are basically for the promotion of rural economies.

After reading this lesson you will be able to understand the concept of Producer Companies introduced by the Companies (Amendment) Act, 2002. The provisions not only provide an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. You will also understand the provisions which enable the conversion of an existing co-operative society into a company as well as the incorporation of a Producer Company and the provisions relating to membership, management, meetings, share capital etc. of Producer Companies.

Proviso to 465(1) states that provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies:

1. GENESIS

The Companies (Amendment) Act, 2002 vide Notification No. S.O. 135(E) dated 5.02.02 has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies. Rural producers have been at a potential disadvantage given their generally limited assets, resources, education and access to advanced technology. In the present scenario, there is an emerging need of changing the terms of trade between rural and urban, labour and industry, finance and commerce. Therefore, if cooperative enterprises are to continue to serve rural producers, they require an alternative to the institutional form presently available under law. The Companies (Amendment) Act, 2002 is a step in this direction.

The newly inserted provision, by virtue of Companies (Amendment) Act, 2002 not only provides an opportunity to the co-operative sector to corporatise itself but also opens up new avenues for them. The conversion to producer companies will enable them to invite greater investments and modernize themselves. They can take advantage of the provisions to reinvent themselves, and function more efficiently. Accordingly, it is specified that a 'producer' shall mean any person engaged in any activity connected with or relatable to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.

The Amendment Act also includes the insertion of the provisions which enables the conversion of an existing co-operative society into a company as well as the incorporation of a Producer Company. This part contains specific provisions relating to incorporation, management, meetings, share capital etc. of Producer Companies.

COMPANIES ACT 2013 AND PRODUCER COMPANIES

Proviso to 465(1) states that provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies: Accordingly Part IX of companies Act 1956 would continue for producer companies.

2. OBJECTS OF PRODUCER COMPANY

A Producer company means a body corporate, having objects or activities specified in Section 581B and registered as Producer Company. Hence, the objectives for which Producer Companies may be formed are laid down in Section 581B. These include inter alia, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/ consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.

However, in terms of Section 581B of the Companies Act, 1956, the objects of the Producer Company shall relate to all or any of the following matters, namely:

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import of goods or services for their benefit:

Provided that the Producer company may carry on any of the activities specified in this clause either

- by itself or through other institution;
- (b) processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its Members;
 - (c) manufacture, sale or supply of machinery, equipment or consumables mainly to its Members;
 - (d) providing education on the mutual assistance principles to its Members and others;
 - (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its Members;
 - (f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce;
 - (g) insurance of producers or their primary produce;
 - (h) promoting techniques of mutuality and mutual assistance;
 - (i) welfare measures or facilities for the benefit of Members as may be decided by the Board;
 - (j) any other activity, ancillary or incidental to any of the activities referred to in Clauses (a) to (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner;
 - (k) financing of procurement, processing, marketing or other activities specified in Clauses (a) to (j) which include extending of credit facilities or any other financial services to its Members.

Every Producer Company shall deal primarily with the produce of its active members for carrying out any of its specified objects. This means there is an obligation on the producer company to deal primarily with the active members in conducting its activities. The expression 'active member' has been defined in Clause (a) of Section 581A to mean a member who fulfils the quantum and period of patronage of the producer company as may be required by the articles of the producer company. The patronage means the use of services offered by the Producer Company to its members by participation in its business activities.

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

There is an obligation on the Producer Company to deal primarily with the produce of its active members in carrying out its specified objects.

- True
- False

Correct answer: True

3. FORMATION OF PRODUCER COMPANY AND ITS REGISTRATION

Section 581C of the Act provides that, any ten or more individuals, each of them being a producer or two or more producer institutions or a combination of ten or more individuals and producer institutions, desirous of

forming a producer company may form an incorporated company as such having its objects, specified in Section 581B as producer company under this Act after complying with the requirements and the provisions of the Act in respect of registration. ‘Producer institution’ means a Producer Company or any other institution having only producer or producers or Producer Company or Producer Companies as its member whether incorporated or not, having any of the objects referred to in Section 581B and which agrees to make use of the services of the Producer Company or Producer Companies as provided in its articles.

The Registrar on being satisfied that all requirements relating to registration and incidental matters have been complied with, shall register the memorandum, articles and other documents and issue a certificate of incorporation within 30 days of the receipt of the documents for registration. On registration, the Producer Company shall be deemed to be a private company limited by shares without any limit on the number of members.

The direct costs associated with the promotion and registration of the company may be reimbursed by the Producer Company.

4. MEMBERSHIP AND VOTING RIGHTS OF MEMBERS OF PRODUCER COMPANY

Section 581D of the Act provides that unless the membership of the Producer Company consists of a Producer institution only, every member shall have a single vote irrespective of the number of shares held. In case, where the membership consists solely of Producer Institutions, the voting rights of such Producer institutions shall be determined on their previous year's participation in the business of the company. However, during the first year of its regulation, the voting rights in a Producer Company shall be determined on the basis of shareholding by producer institutions.

Where the membership of Producer Company consists of a combination of individuals and Producer Institutions, every member shall exercise a single vote. The Articles may however, authorize the Producer Company to restrict the voting rights to active members only.

No person, who has any business interest which conflicts with the business of Producer Company, shall become a member of that Producer Company and if subsequently a member acquires any business interest which is in conflict with the business of the Producer Company, he shall cease to be a member.

5. BENEFITS TO MEMBERS

Section 581E states that, initially every member shall receive only such value of the produce or products pooled and supplied as is determined by the Board of Producer Company and the withheld price may be disbursed later in cash or in kind or by allotment of equity shares. Every such member shall be entitled to receive a limited return and may be allotted bonus shares. ‘Withheld price’ for this purpose means part of the price due and payable for goods supplied by any member to the Producer Company, and as withheld by the Producer Company for payment on a subsequent date.

Patronage bonus may be disbursed proportionately, if any, surplus remains after making provision for limited return and reserves. Patronage bonus refers to the payment by Producer Company out of its surplus income to the members in proportion to their respective patronage.

The approval of Board of directors is necessary for disbursing ‘withheld price’ whereas for disbursing the ‘patronage bonus’, either in cash or by way of allotment of equity shares or both, the approval of members at the general meeting is required.

6. MEMORANDUM OF ASSOCIATION, ARTICLES OF ASSOCIATION

The Memorandum of Association and the Articles of Association of the Producer Company, duly signed by the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.

The Memorandum and Articles shall contain the disclosures as provided under the provisions of Sections 581F and 581G respectively and are as under:

Contents of Memorandum of Producer Company

In terms of the provisions of Section 581F, the Memorandum of Association of every Producer Company shall state the following:

- (a) the name of the company with "Producer Company Limited" as the last words of the name of such Company;
- (b) the State in which the registered office of the Producer Company is to situate;
- (c) the main objects of the Producer Company shall be one or more of the objects specified in Section 581B;
- (d) the names and addresses of the persons who have subscribed to the memorandum;
- (e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount;
- (f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with Sub-section (2) of Section 581J;
- (g) that the liability of its members is limited;
- (h) opposite to the subscriber's name the number of shares each subscriber takes:
Provided that no subscriber shall take less than one share;
- (i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

Contents of Articles of Association of Producer Company

As per Section 581G, the contents of the Articles of a Producer Company shall contain Mutual Assistance Principles and other provisions, which are as under:

Mutual Assistance Principles

The articles shall contain the following mutual assistance principles, namely:

- (a) the membership shall be voluntary and available to all eligible persons who, can participate or avail of the facilities or services of the Producer Company, and are willing to accept the duties of membership;
- (b) each Member shall, save as otherwise provided in Part IX of the Act, have only a single vote irrespective of the shareholding;
- (c) the Producer Company shall be administered by a Board consisting of persons elected or appointed as directors in the manner consistent with the provisions of this Part and the Board shall be accountable to the Members;

- (d) save as provided in this Part, there shall be limited return on share capital;
- (e) the surplus arising out of the operations of the Producer Company shall be distributed in an equitable manner by:
 - (i) providing for the development of the business of the Producer Company;
 - (ii) providing for common facilities; and
 - (iii) distributing amongst the Members, as may be admissible in proportion to their respective participation in the business;
- (f) provision shall be made for the education of Members, employees and others, on the principles of mutuality and techniques of mutual assistance;
- (g) the Producer Company shall actively co-operate with other Producer Companies (and other organisations following similar principles) at local, national or international level so as to best serve the interest of their Members and the communities it purports to serve.

Other Provisions or Contents of Articles of Producer Company

The Articles shall also contain the following provisions, namely:

- (a) the qualifications for membership, the conditions for continuance or cancellation of membership and the terms, conditions and procedure for transfer of shares;
- (b) the manner of ascertaining the patronage and voting right based on patronage;
- (c) subject to the provisions contained in Sub-section (1) of Section 581N, the manner of constitution of the Board, its powers and duties, the minimum and maximum number of directors, manner of election and appointment of directors and retirement by rotation, qualifications for being elected or continuance as such and the terms of office of the said directors, their powers and duties, conditions for election or co-option of directors, method of removal of directors and the filling up of vacancies on the Board, and the manner and the terms of appointment of the Chief Executive;
- (d) the election of the Chairman, term of office of directors and the Chairman, manner of voting at the general or special meetings of Members, procedure for voting by directors at meetings of the Board, powers of the Chairman and the circumstances under which the Chairman may exercise a casting vote;
- (e) the circumstances under which, and the manner in which, the withheld price is to be determined and distributed;
- (f) the manner of disbursement of patronage bonus in cash or by issue of equity shares, or both;
- (g) the contribution to be shared and related matters referred to in Section 581Z(I)(2);
- (h) the matters relating to issue of bonus shares out of general reserves as set out in Section 581ZJ;
- (i) the basis and manner of allotment of equity shares of the Producer Company in lieu of the whole or part of the sale proceeds of produce or products supplied by the Members;
- (j) the amount of reserves, sources from which funds may be raised, limitation on raising of funds, restriction on the use of such funds and the extent of debt that may be contracted and the conditions thereof;
- (k) the credit, loans or advances which may be granted to a Member and the conditions for the grant of

the same;

- (l) the right of any Member to obtain information relating to general business of the company;
- (m) the basis and manner of distribution and disposal of funds available after meeting liabilities in the event of dissolution or liquidation of the Producer Company;
- (n) the authorisation for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith;
- (o) laying of the memorandum and articles of the Producer Company before a special general meeting to be held within ninety days of its registration;
- (p) any other provision, which the Members may, by special resolution recommend to be included in articles.

Amendment to Memorandum and Articles

Amendment in the provisions/clauses of the Memorandum can be done by way of passing a Special Resolution as per Section 581H, whereas, the amendment in the Articles is required to be proposed by not less than two-third of the elected directors or by not less than one-third of the members and adopted by passing a Special Resolution in the general meeting under Section 581-I.

A copy of the amended Memorandum or Articles along with a duly certified copy of Special Resolution thereof are to be filed with the Registrar of Companies within thirty days from the date of its adoption at the general meeting.

7. OPTION TO INTER-STATE CO-OPERATIVE SOCIETIES TO BECOME PRODUCER COMPANIES

An 'Inter-State Co-operative Society' means a Multi-State Co-operative Society as defined in Section 3(p) of Multi-State Co-operative Societies Act, 2002 and includes any co-operative society registered under any other law in force and which has after its formation, extended any of its objects to more than one State.

Section 581J provides that any Inter-State Co-operative Society whose objects are not confined to one state may submit an application together with the prescribed documents to the Registrar for registration as Producer Company. The Registrar on being satisfied, that all the requirements relating to registration have been complied with, shall within 30 days of receipt of the application, issue a certificate of incorporation and the words "Producer Company Limited" shall form part of its name to explain its identity.

Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith following enclosures and documents:

1. a copy of the Special Resolution passed with 2/3rd majority of the members;
2. a statement showing names, addresses and occupation of the directors and the chief executive;
3. a list of the members;
4. a statement indicating that the Inter-State Cooperative Society is engaged in any one or more of the objects specified in Section 581-B;
5. a declaration by two or more directors certifying that the particulars given as per Para (1) to (4) above are correct.

Upon registration as a producer company, the ROCs who registers the company shall immediately intimate the Registrar with whom the Inter-State Cooperative Society was earlier registered, for appropriate deletion

of the society from its register.

The 'Inter-State Co-operative Society' shall, upon registration stand transformed into a Producer Company, and shall be governed by the provisions of Part IX-A of the Companies Act, 1956.

8. VESTING OF UNDERTAKING IN PRODUCER COMPANY

Section 581L provides that all properties, assets, movable or immovable, and all rights, debts, liabilities, interests, privileges and obligations of the Inter-State Co-operative Society shall vest in the Producer Company with effect from the transformation/registration date.

Similarly all sums of money due to Inter-State Co-operative Society immediately before the transformation date shall be deemed to be due to the Producer Company. Every organisation managed by the erstwhile co-operative society, shall henceforth, be managed by the so incorporated Producer Company.

Every organisation getting financial, managerial or technical assistance from the Inter-State Co-operative Society before the 'transformation date', may continue to get such assistance by the Producer Company.

Any pending suit, arbitration, appeal or other legal proceeding, of whatever nature, by or against, the Inter-State Co-operative Society on transformation date may be continued, prosecuted and enforced by or against the Producer Company.

9. CONCESSION, ETC. TO BE DEEMED TO HAVE BEEN GRANTED TO PRODUCER COMPANY

All fiscal and other concessions, licences, benefits, privileges and exemptions granted to the Inter-State Co-operative Society in connection with its affairs and business of the Inter-State Cooperative Society under any law for the time being in force shall be deemed to have been granted from transformation date to the Producer Company. [Section 581M]

10. PROVISIONS IN RESPECT OF OFFICERS AND OTHER EMPLOYEES OF INTER-STATE CO-OPERATIVE SOCIETY

As per Section 581N all directors in the Inter-State Co-operative Society before its incorporation as Producer Company, shall continue to be in office for a period of one year from the date of transformation.

Every other officer or employee of such a society (other than a director, chairman or managing director) shall continue to hold office in the so formed Producer Company for the same tenure, at the same remuneration, terms and conditions as he would have held in the Inter-State Co-operative Society.

Any officer or employee of the earlier society opting not to remain in the employment of the newly formed Producer Company, shall be deemed to have resigned.

Officers and employees who have been so transferred from their services shall not be provided any compensation. Similarly no compensation shall be provided to any director, chairman or managing director of the society on account of premature termination of their contract with the society.

Retired officers and employees of the co-operative society shall continue to receive the same benefits, rights or privileges from the Producer Company.

11. NUMBER OF DIRECTORS

Section 581-O provides that, every Producer Company shall have minimum five and not more than fifteen

directors. Provided that in the case of an Inter-State Co-operative Society as a Producer Company, such company may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

12. APPOINTMENT OF DIRECTORS

The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors consisting of not less than five, who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of Section 581P(2). However, such designation shall remain effective for a period of 90 days only.

The election of directors shall be conducted within a period of ninety days of registration of Producer Company. However, in the case of an Inter-State Co-operative Society, which has been registered as a Producer Company, election of directors should be conducted within a period of three hundred and sixty-five days.

A director shall hold office as such for not less than one year but not exceeding five years and every director who retires shall be eligible for re-appointment. The tenure of such directors shall not exceed such period as may be specified in the Articles.

13. VACATION OF OFFICE BY DIRECTORS

The office of director of a Producer Company shall become vacant under the following circumstances according to Section 581Q of the Act:

- (a) if he is convicted by a court of any offence involving moral turpitude and sentenced in respect thereto with imprisonment for not less than six months;
- (b) if the Producer Company, in which he is a director, has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for ninety days;
- (c) if he has made a default in repayment of any advances or loans taken from the Producer Company in which he is a director;
- (d) if the Producer Company, in which he is a director:
 - (i) has not filed the annual accounts and annual return for any continuous three financial years commencing on or after the 1st day of April, 2002; or
 - (ii) has failed to, repay its deposit or withheld price or patronage bonus or interest thereon on due date, or pay dividend and such failure continues for one year or more;
- (e) if default is made in holding election for the office of director, in the Producer company in which he is a director, in accordance with the provisions of the Companies Act and its Articles;
- (f) if the annual general meeting or extraordinary general meeting of the Producer Company, in which he is a director, is not called in accordance with the provisions of the Act except due to natural calamity or such other reasons.

The above provisions of vacation of the office of a director, shall also, apply to the director of that Producer Institution, which is a member of such Producer Company.

14. POWERS AND FUNCTIONS OF BOARD

The Board of directors of a Producer Company shall exercise all such powers and do all such acts and things, as a Producer Company is authorized so to do. [Section 581R(1)]

However, in terms of the provisions of Section 581R(2), the Board of Directors may exercise the following powers without prejudice to the generality of the foregoing powers:

- (a) determination of the dividend payable;
- (b) determination of the quantum of withheld price and recommend patronage to be approved at general meeting;
- (c) admission of new Members;
- (d) pursue and formulate the organisational policy, objectives, establish specific long-term and annual objectives, and approve corporate strategies and financial plans;
- (e) appointment of a Chief Executive and such other officers of the Producer Company, as may be specified in the Articles;
- (f) exercise superintendence, direction and control over Chief Executive and other officers appointed by it;
- (g) cause proper books of account to be maintained; prepare annual accounts to be placed before the annual general meeting with the auditor's report and the replies on qualifications, if any, made by the auditors;
- (h) acquisition or disposal of property of the Producer Company in its ordinary course of business;
- (i) investment of the funds of the Producer Company in the ordinary course of its business;
- (j) sanction any loan or advance, in connection with the business activities of the Producer Company to any Member, not being a director or his relative;
- (k) take such other measures or do such other acts as may be required in the discharge of its functions or exercise of its powers.

All the above powers can be exercised only by means of a resolution passed by the Board at its meeting on behalf of the Producer Company.

15. MATTERS TO BE TRANSACTED AT THE GENERAL MEETING

Section 581S states that the following powers shall be exercised by the Board of directors on behalf of the company only by means of passing of resolutions at the annual general meeting of the company:

- (a) approval of budget and adoption of annual accounts;
- (b) approval of patronage bonus;
- (c) issue of bonus shares;
- (d) declaration of limited return and decision on the distribution of patronage;
- (e) specify the conditions and limits of loans that may be given by the Board to any director; and
- (f) approval of any transaction of the nature as is to be reserved in the Articles for approval by the Members.

16. LIABILITY OF DIRECTORS

Section 581T, provides that anything done by the directors, whether by way of voting on a resolution or approving by any other means, anything, in contravention of the provisions of this Act or any other law for the time being in force, or its Articles, shall make them jointly and severally liable towards the Producer Company to make good the loss or damage suffered by such company.

Where as a result of the above, such director has made any profit, the Producer Company shall have the right to recover an amount equal to said profits from such director.

The liability so imposed shall be in addition to and not in derogation of a liability imposed under this Act or any other law for the time being in force.

17. COMMITTEE OF DIRECTORS

Section 581U states that the Board may constitute such number of committees as it may deem fit for the purposes of assisting the Board in efficient discharge of its functions. However, the Board of directors shall not delegate any of its powers or assign the powers of the Chief Executive, to any committee of directors.

The committee of the Board may, with the approval of the Board, co-opt such number of persons, as it deems fit, as the members of the committee. Provided that the Chief Executive appointed under Section 581W or a director of Producer Committee shall be a member of such committee. [Section 581U(2)]

Every such committee shall function under general superintendence, direction and control of the Board as may be specified. Further the fees and allowances to be paid to the members of the committee and the tenure of the committee shall be such as may be determined by the Board. The minutes of every Committee meeting shall be placed before the next Board meeting.

18. MEETINGS OF THE BOARD AND QUORUM

As per Section 581V the Board meeting of a Producer Company shall be held at least once in every three months and at least four such meetings shall be held in every year. The Chief Executive shall give notice to every director for the time being in India, and at his usual address in India to every other director at least seven days prior to the date of meeting. However, a Board meeting may also be called at a shorter notice after recording reasons thereof in writing.

The quorum for the meeting shall be one-third of the total strength of directors, subject to a minimum of three.

Unless otherwise provided in the Articles, such sitting fees and allowances may be paid to the directors attending the meetings, as decided by the members.

19. CHIEF EXECUTIVE AND HIS FUNCTIONS

As per Section 581W, a full time Chief Executive shall be appointed by the Board by whatever name called who, shall not be a member of the company. He shall be the ex-officio director, and shall not retire by rotation. The qualifications, experience and the terms and conditions shall be such as may be determined by the Board. The chief executive, who shall be entrusted with substantial powers of the management, shall manage the affairs of the Producer Company but subject to the superintendence, direction and control of the Board and be accountable to the Board for the performance of the Producer Company.

The various functions that may be discharged by a chief executive may *inter alia* include managing the day to day affairs of the company, maintaining proper books of accounts, furnishing members with periodic information, assisting the Board with respect to legal and regulatory matters making appointments and discharge of such other functions as may be delegated by the Board.

20. SECRETARY OF PRODUCER COMPANY

Section 581X of the Act provides that every Producer Company having an average annual turnover exceeding five crore rupees in each of three consecutive financial years shall appoint a member of the Institute of Company Secretaries of India as a whole-time Secretary of the company.

If a Producer Company fails to appoint Company Secretary, the company and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues. However, in any proceedings against a person in respect of an offence for failure to appoint a Company Secretary, it shall be a defence to prove that all reasonable efforts were taken to comply with the provisions or that the financial position of the company was such that it was beyond its capacity to appoint a whole time secretary.

21. QUORUM OF THE GENERAL MEETING

Section 581Y of the Act provides that unless Articles of Association require a larger number, one-fourth of the total membership shall constitute the quorum at a general meeting.

22. VOTING RIGHTS

Section 581Z states that except as provided in Section 581D(1) (regarding voting rights of individual members and Producer Institutions), and 581D(3) (regarding voting rights to active members), every member of the Producer Company shall have one vote irrespective of the number of shares held by him. In the case of equality of votes, the Chairman or the person presiding over the meeting shall have a casting vote, except in the matter of election of the Chairman.

23. ANNUAL GENERAL MEETINGS [SECTION 581ZA]

Every Producer Company shall hold its first Annual General Meeting (AGM) within a period of ninety days from the date of its incorporation.

Not more than fifteen months shall elapse between the date of one AGM of the Producer Company and that of the next AGM. The Registrar may, for any special reason, permit the extension of time for holding of an AGM (not being the first AGM) by a period not exceeding three months. Notice in writing indicating date, time and place of the meeting shall be given at least fourteen days before the meeting and shall also be accompanied by the following documents which shall be sent to every member and auditor of the company:

- (a) agenda of the meeting;
- (b) minutes of the previous annual general meeting or extraordinary general meeting;
- (c) names and qualifications of candidates for election of directors;
- (d) audited balance sheet, profit and loss account and Board's report of the company in respect of specified disclosures and its subsidiaries, if any;
- (e) draft resolution for appointment of auditors;
- (f) draft resolution for proposed amendment, if any, in memorandum or articles.

The Annual General Meeting shall be held during business hours, on a day not being a public holiday at the registered office of the company or at any other place within the city, town or village where the registered office of the company is situated.

Unless the Articles provide for a larger number, the quorum of the general meeting shall be one-fourth of the total number of members.

Within sixty days from the date of the annual general meeting, the company is required to file the proceedings of the meeting, the audited balance sheet, the profit and loss account and the Director's report together with an annual return along with the filing fees with the Registrar.

On the requisition made in writing and duly signed by not less than one-third of the members, the Board of directors shall call an Extraordinary General Meeting (EGM) in accordance with the provisions of Section 169 and Section 186 of this Act.

Where a Producer Company is formed by Producer Institutions then such Institutions shall be represented in the general body through the Chairman or the Chief Executive thereof who shall be competent to act on its behalf, except in case of default under Section 581Q(1).

REVIEW QUESTIONS



Choose the correct answer

Within how many days from the date of its incorporation should a Producer Company hold its first Annual General Meeting ?

- (a) Sixty
- (b) Eighty
- (c) Ninety
- (d) Thirty

Correct answer: (c)

24. SHARE CAPITAL

As per Section 581ZB of the Act, a Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company.

However, in terms of Section 581ZC, the Producers who are active members may, if so provided in the articles, have special rights and the Producer Company may issue appropriate instruments to them in respect of such special rights.

Transferability of shares and attendant rights

A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board under Section 581ZD. Special rights for this purpose means any rights relating to supply of additional produce by the active member or any other rights relating to his produce conferred on him by the Board.

Within three months from the date of his becoming a member, such person shall nominate his nominee, to whom the shares shall vest in the event of his death.

Surrender of shares

If the Board of a Producer Company is satisfied that any member has ceased to be a primary member, or he has failed to retain his qualifications, necessary to enable him to remain the member of the Producer Company, then Board may direct him to surrender his shares to the company together with Special Rights, if any, attached therewith, at the value determined by the Board. Alternatively, the Board may direct the issuance of a notice to such member. [Section 581ZD(5)]

25. BOOKS OF ACCOUNT

Every producer company shall keep at its registered office proper books of account with respect to matters specified under Section 581ZE of the Act. The balance sheet and profit and loss account of the Producer Company shall be prepared in accordance with Section 211.

The matters specified under Section 581ZD are as under:

1. Sums of money received and expended.
2. Sales and Purchase of goods.
3. Instruments of liability executed by or on behalf of the company.
4. Assets and liabilities.
5. Utilisation of materials or labour or other items of cost.

26. INTERNAL AUDIT

As per Section 581ZF of the Act, every Producer Company shall have internal audit of its accounts at such intervals in such manner as may be specified in its Articles, by a chartered accountant.

27. DONATIONS OR SUBSCRIPTION BY PRODUCER COMPANY

Section 581ZH provides that a Producer Company, by passing a special resolution, may make donation for promoting social and economic welfare and mutual assistance principles in a financial year to the extent of three percent of the net profit of the company in the preceding financial year. However, a Producer Company is strictly prohibited from making donation for political purposes.

28. GENERAL AND OTHER RESERVES

In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by Section 581ZI.

The Department of Company Affairs (Now Ministry of Corporate Affairs) has issued Producer Companies (General Reserve) Rules, 2003 vide F.No. 1/1/2003-CL.V dated 7.8.2003, which is applicable to the companies formed and registered under Section 581C of the Companies Act, 1956.

These Rules define a “co-operative society” to mean a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State.

As per the Rules, a Producer Company shall make investments from and out of its general reserves in the following manner, maintained by it in terms of the provisions of Section 581ZI of the Act:

- (a) in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or Cooperative Societies or scheduled bank, or
- (b) in a cooperative bank, State Cooperative Bank, Cooperative land development bank or Central cooperative bank, or
- (c) with any other scheduled bank, or
- (d) in any of the securities specified in Section 20 of the Indian Trust Act, 1882, or
- (e) in the shares or securities of any other multi-state cooperative society or any cooperative society, or
- (f) in the shares, securities or assets of a public financial institutions specified under Section 4A of the Companies Act, 1956.

The then Ministry of Company Affairs has vide Notification No. GSR 146(E) dated 9.03.2006 amended the Procedure Companies (General Reserves) Rules, 2003. As per the amended rules investments may be made in any one or in combination of the above.

29. ISSUE OF BONUS SHARES

A Producer company may, after

- the recommendation of the Board, and
- passing of a resolution in General Meeting,

issue bonus shares to its members in proportion to the shares held by them, on the date of the issuance of such shares, by capitalising the amounts from its general reserves. [Section 581ZJ].

30. LOAN, ETC. TO MEMBERS [SECTION 581ZK]

The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members. However, any loan or advance to any director or his relative shall be granted only after the approval of members by a resolution.

31. INVESTMENT IN OTHER COMPANIES, FORMATION OF SUBSIDIARIES ETC. [SECTION 581ZL]

The Producer Company may invest its general reserves in approved securities, fixed deposit, units, bonds issued by the government or a cooperative or scheduled bank or in such other mode as may be prescribed. It may, for the promotion of its objectives also acquire shares of other Producer Companies. However, special resolution is required to be passed for acquisition of shares of any other Producer Company or entering into agreement for the formation of subsidiaries or joint venture.

Investment in shares of any other company other than Producer Company cannot exceed thirty per cent of the aggregate of its paid-up capital and free reserves, except where a special resolution has been passed and the prior approval of the Central Government has been obtained. However, such investments should be consistent with the objects of the Producer Company. For disposal of any of its investments, special resolution shall be passed by the board. A register containing particulars of all investments as prescribed shall be kept in the registered office and shall be open to the members of the company for inspection and taking extracts therefrom.

32. AMALGAMATION, MERGER OR DIVISION, ETC., TO FORM NEW PRODUCER COMPANIES

Section 581ZN provides comprehensive provisions for the schemes of amalgamation, merger or division etc. of Producer Company.

A Producer Company may, by a resolution passed at its general meeting:

- (a) transfer its assets and liabilities, wholly or partly, to any other Producer Company, for any of the objectives specified in Section 581B if other Producer Company so agrees by passing a resolution at its general meeting;
- (b) divide itself into two or more Producer Companies;

Also, two or more Producer Companies may, by a resolution passed at any general or special meetings of its members, decide to:

- (a) amalgamate and form a new Producer Company; or
- (b) merge one Producer Company with another Producer Company.

The resolutions referred to above shall be passed by not less than two-thirds of its members present and voting. However, prior to such resolution a copy of proposed resolution shall be forwarded to all the members and creditors for their consent.

Section 581ZN(5) makes provisions to satisfy the claims of dissenting members and creditors of such amalgamating Producer Companies.

33. DISPUTES

As per Section 581ZO, any dispute relating to the formation, management or business of a Producer Company shall be settled by conciliation or by arbitration as provided under the Arbitration and Conciliation Act, 1996.

34. STRIKING OFF NAME OF PRODUCER COMPANY

Section 581ZP states that the Registrar can after making an inquiry strike off the name of a company where the company:

- (i) has failed to commence its business within one year of its registration;
- (ii) ceases to transact business;
- (iii) is no longer carrying on its objectives;
- (iv) is not following the mutual assistance principles.

The Registrar shall, before passing the order issue a show cause notice to the company with a copy to the directors and give a reasonable opportunity of being heard. Any member of the Producer Company aggrieved by an order may appeal to CLB within sixty days of passing an order.

35. RE-CONVERSION OF PRODUCER COMPANY TO INTER-STATE CO-OPERATIVE SOCIETY

Any Producer Company may make an application, after a resolution has been passed in the general meeting by not less than two-third of its members present and voting or on request by its creditors representing three-fourth of its value of creditors, to the High Court for its re-conversion to Inter-State Co-operative Society, and follow the procedure as laid down in Section 581ZS of the Act.

LESSON ROUND-UP

- Proviso to 465(1) states that provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies:
- The Companies (Amendment) Act, 2002 has inserted Part IX-A to the Companies Act, 1956 and introduced the concept of Producer Companies.
- A 'producer' shall mean any person engaged in any activity connected with or relatable to any primary produce. The amendment also seeks to provide a comprehensive meaning to primary produce which shall encompass produce of farmers, arising from agriculture (including animal husbandry, horticulture, etc.) produce of persons engaged in handloom, handicraft, any product resulting from any of the above activities or from an ancillary activity and any activity which is intended to increase the production or quality of anything referred above.
- Objectives for which Producer Companies may be formed include inter alia, production, marketing, export of primary produce of members, processing, packaging of produce of its members; manufacture, sale of machinery etc. mainly to its members, generation and distribution of power, insurance of producers/primary produce, rendering technical/consultancy services, promoting mutual assistance, welfare measures and any other activity for the benefit of members.
- The Act provides that, any ten or more individuals, each of them being a producer or two or more producer

institutions or a combination of ten or more individuals and producer institutions, desirous of forming a producer company may form an incorporated company, as such having its objects specified under this Act after complying with the requirements and the provisions of the Act in respect of registration.

- Unless the membership of the Producer Company consists of a Producer institution only, every member shall have a single vote irrespective of the number of shares held. Further, every such member shall be entitled to receive a limited return and may be allotted bonus shares.
- The Memorandum of Association and Articles of Association of the Producer Company, containing the disclosures as required under the Act and duly signed by the subscribers are required to be presented to the Registrar of the state where the Company's registered office is proposed to be set up.
- Any Inter-State Cooperative Society willing to register itself as a Producer Company shall submit an application to ROC alongwith enclosures and documents as required under the Act.
- The Act gives provisions regarding concessions deemed to have been granted to Producer Company and in respect of officers and other employees.
- The subscribers of the Memorandum and Articles may designate or nominate therein, the Board of directors who shall govern the affairs of Producer Company until directors are elected in accordance with the provisions of the Act. Minimum and maximum number of directors has been given under the Act as also their powers and the circumstances under which the office of director of a Producer Company shall become vacant. Provisions for meeting of the board and quorum are also given therein.
- The Board may constitute such number of committees as it may deem fit for the purpose of assisting the Board in efficient discharge of its functions.
- A full time Chief Executive shall be appointed by the Board by whatever name called who shall not be a member of the company.
- Every Producer Company having an average annual turnover exceeding ₹ Five crores in three consecutive financial years shall appoint a whole-time Secretary of the company. The Whole time Secretary should be member of the Institute of Company Secretaries of India.
- Provisions for conducting an Annual General Meeting along with notice contents have also been provided under the Companies Act.
- A Producer Company's share capital shall consist of equity shares only and the shares held by members shall be in proportion to the patronage of that company. A member of the Producer Company may, transfer whole or part of his shares along with any special rights, to an active member at par value only but after obtaining the previous approval of the Board. The board may direct a member to surrender his shares to the company if he ceases to be a primary member or fails to retain his qualifications essential for being a member.
- Every Producer Company shall keep proper books of account with respect to matters specified in the Act and shall have internal audit of its account as may be specified in its Articles, by a Chartered Accountant.
- In addition to other reserves, the Producer Company shall maintain general reserve in every financial year as stipulated by the Companies Act. A Producer Company may issue bonus shares to its members by capitalizing the amount from its general reserves. It may also invest in other companies or in formation of subsidiaries in accordance with the Act.
- The Board may, subject to provisions made in the Articles of the company, provide financial assistance to the members.
- The Act provides comprehensive provisions for the schemes of amalgamation, merger or division etc. of Producer Company.
- Any dispute relating to the formation, management or business of a Producer Company shall be settled by conciliation or by arbitration. Further, the Registrar can after making an inquiry strike off the name of a company

under the circumstances given in the Act.

- Any Producer Company may make an application to the High Court for its re-conversion to Inter-State Co-operative Society, following the procedure laid down in the Act.

GLOSSARY

Withheld Price	It means part of the price due and payable for goods supplied by any member to the Producer Company, and as withheld by the Producer Company for payment on a subsequent date.
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SELF-TEST QUESTIONS

1. The objectives of Producer Company must satisfy the requirements laid down in Section 581B of the Companies Act, 1956. Discuss.
 2. Discuss the membership and voting rights of member of Producer Company.
 3. State the contents of Memorandum of Association of Producer Company.
 4. What powers can be exercised by directors of Producer Company?
 5. State the matters to be transacted at the general meeting of the Producer Company.

Lesson 29

Limited Liability Partnerships

LESSON OUTLINE

- Introduction
- Salient Features
- The important terms as per the Limited Liability Partnership Act, 2008
- The important requirements for formation of a Limited Liability Partnership
- Partners and Designated Partners
- Roles and responsibilities of Designated Partners
- Limited Liability Partnership (LLP) Agreement.
- LLP for the professionals
- Statement of Account ad Solvency
- Audit of Limited Liability Partnership
- Filing of Annual Return
- Foreign Limited Liability Partnership
- Electronic filing of documents
- Investigation of the affairs of LLP
- Winding up of LLP.

LEARNING OBJECTIVES

In order to cope with and conform to the rapid changes taking place in the industry and business, a form of business organization combining the vital aspects of a partnership firm and the advantages of a limited liability company was essential. This need gave birth to the new form of organization called "**Limited Liability Partnership**", which is more popularly known as LLP.

LLP is an alternative business vehicle that gives the benefits of limited liability company and the flexibility of a partnership firm. Since, LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure'; LLP is many a times termed as a **hybrid** of a company and a partnership. The LLP is a separate legal entity which can continue its existence irrespective of changes in its partners.

After reading this lesson you will be able to understand the features of LLP, important requirements for formation, role and responsibility of designated partner and rules regarding winding up of LLP and the difference between LLP and other forms of business.

1. INTRODUCTION

Limited Liability Partnership (LLP) is an incorporated partnership formed and registered under the Limited Liability Partnership Act 2008 with limited liability and perpetual succession. The Act came into force, for most part, on 31st March 2009 followed by its Rules on 1st April 2009 and the registration of the first LLP on 2nd April 2009.

The arrival of the much-desired and long-awaited LLP Act was result of efforts of several expert committees which recommended its introduction starting with the Bhatt Committee of 1972, Naik Committee of 1992, Abid Hussain Committee of 1997, Gupta Committee of 2001, Naresh Chandra Committee of 2003 and the JJ Irani Committee of 2005.

LLP is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its partners the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement.

The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be a suitable vehicle for small and medium enterprises and for investment by venture capitalists.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Indian Partnership Act 1932 shall be applicable to LLPs.

- True
- False

Correct Answer: False

2. SALIENT FEATURES

The salient features of the Limited Liability Partnership are as follows:—

- (i) The LLP is a body corporate and a legal entity separate from its partners. Any two or more persons, associated for carrying on a lawful business with a view to profit, may by subscribing their names to an incorporation document and filing the same with the Registrar, form a Limited Liability Partnership. The LLP has a perpetual succession;
- (ii) The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the proposed legislation. There would be flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the proposed legislation;
- (iii) A LLP is a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be tangible or intangible in nature or both tangible and intangible in nature. No partner would be liable on account of the independent or un-authorized acts of other partners or their misconduct;

- (iv) Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India.
- (v) A LLP shall maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government;
- (vi) The Central Government has power to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose;
- (vii) The Indian Partnership Act, 1932 shall not be applicable to LLPs. A partnership firm, a private company and an unlisted public company may convert themselves to LLP in accordance with provisions of the proposed legislation;
- (viii) The Central Government has made rules for carrying out the provisions of the LLP Act.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Central Government does not have any powers whatsoever to investigate the affairs of an LLP.

- True
- False

Correct Answer: False

The Central Government shall have powers to investigate the affairs of an LLP, if required, by appointment of competent inspector for the purpose.

3. DISTINCTION BETWEEN LLP AND PARTNERSHIP

The principle points of difference between a company and a partnership are as follows:

1. LLP is a separate legal entity and therefore, can be sued or it can sue others without involving the partners. A partnership firm is not distinct from the several persons who compose it.
2. The partners of a LLP would have limited liability i.e. they would not be liable beyond the money contributed by them. Whereas, partners of a firm would have unlimited liability.
3. The retirement or death of a partner would not dissolve the LLP. On the other hand, the death or retirement of a partner would dissolve the partnership firm.
4. In a partnership, the property of the firm is the property of the individuals comprising it. In a LLP, it belongs to the LLP and not to the individuals comprising it.
5. Whereas a partnership can be formed either orally or by a deed of agreement whether registered or not, LLP is formed by an incorporation document and an LLP agreement, thus, giving it a legality.
6. Whereas a registered or unregistered partnership cannot have more than 20 partners, LLP can have more than that number since no upper limit has been laid down by the Act.
7. A LLP has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the LLP, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

8. Whereas an individual partner would not be able to conduct business transaction with the partnership firm of which he is a partner, a partner of LLP in his separate capacity as a legal person can do business with the LLP since the LLP is a separate legal entity by itself.

4. DISTINCTION BETWEEN LLP AND COMPANY

1. In case of LLP, the need for classifying the object clauses into main, ancillary and other objects as well as framing the Share Capital clause in the memorandum for incorporating a company is reduced into a simple procedure of filling of the prescribed information in the Incorporation document and statement in Form No. 2.
2. In case of LLP, a 'limited liability partnership agreement' (LLPA) is prepared which is a variant of the 'articles of association' of a company.
3. Whereas the memorandum of a company is required to name the state in which it is required to be incorporated, there is no such obligation in the case of LLP. Consequently, the detail procedure involved in changing the registered office from the state of incorporation to another state is not required to be followed in case of a LLP.
4. In the LLP Act, there is no such stipulation for meeting of partners either periodically or compulsory at the year end as stipulated for directors and shareholders meetings in the Companies Act.
5. There is no separation between management of the company and the ownership as is observed in a company since all the partners, unlike all the directors, can take part in the day to day affairs of the LLP.
6. In case of a company no individual director can conduct the business of the company but in an LLP, each partner has the authority to do so unless expressly prohibited by the partnership terms.
7. Whereas, the Companies Act contemplates regulating the remuneration payable to directors, there are no corresponding provisions in the LLP Act for remuneration payable to designated partners. The same could be as per the LLP Agreement.
8. In the case of LLP, unlike in the case of companies, there are no restrictions on the borrowing powers.
9. The LLP can choose to maintain the accounts on cash basis/accrual basis whereas under the Companies Act, accrual method is compulsory.
10. Audit of a company is compulsory. Conversely, the audit of LLP is not compulsory if the capital contributed does not exceed ₹ 25 lakh or if the turnover does not exceed ₹ 40 lakhs.
11. Cost audit as contemplated in Section 233B of the Companies Act, 1956 has not been prescribed for LLPs.
12. The appointment of Company Secretaries as required under Section 383A of the Companies Act, 1956 is not provided in the LLP Act. However, the annual return of a LLP in form 11 is to be certified as 'true and correct' by a Company Secretary in practice.

5. COMPARISON OF LLP WITH PRIVATE LIMITED COMPANY

A comparison of a LLP with a Private Limited Company reveals that such companies have:

- Limited Liability: Similar to LLP.
- Internal flexibility: The Company Law requires a formal board structure and decision making at validly constituted meetings, passing of resolutions and maintenance of minutes of meetings.

- Privacy: Similar to LLP.
- Requirement of a LLP agreement: The Memorandum and Articles of Association are the default standard provisions doing away with the need for a separate agreement similar to a LLP agreement.
- Legal uncertainty: Private Limited companies have long been in existence and being tried and tested vehicles of business entities, there is no legal uncertainty which is not true in case of a LLP.

The LLP structure seems most suited for partnership concerns set up by professionals such as company secretaries in practice and others, by offering them the benefits of limited liability on one hand and the flexibility in internal management that is akin to partnerships on the other. Venture capitalists might also be attracted to the LLP structure owing to the ability of the partners to participate in management without the risk of losing limited liability, the absence of capital maintenance rules and the likely advantageous tax position. The laws of U.S.A., U.K., Singapore and Australia permit formation of LLPs.

6. INCORPORATION OF LIMITED LIABILITY PARTNERSHIP

According to section 11 (1) of the Limited Liability Partnership Act, 2008, for a limited liability partnership to be incorporated—

- (a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;
 - (b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the registrar of the state in which the registered office of the limited liability partnership is to be situated; and
 - (c) a statement in the prescribed form shall be filed along with the incorporation document, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the limited liability partnership and by any one who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.
2. The incorporation document shall— .
- (a) be in form 2 as per rule 11.
 - (b) state the name of the limited liability partnership;
 - (c) state the proposed business of the limited liability partnership;
 - (d) state the address of the registered office of the limited liability partnership;
 - (e) state the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
 - (f) state the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
 - (g) contain such other information concerning the proposed limited liability partnership as may be prescribed.
3. If a person makes a statement under clause (c) of Sub-Section (1) which he—
- (a) knows to be false; or
 - (b) does not believe to be true,

shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

Subject to prior compliance with the requirements of section 11(1) of the Act, section 12(1) mandates the Registrar to register the incorporation document and issue a certificate of incorporation within 14 days. The certificate of incorporation shall be conclusive evidence that the limited liability partnership is incorporated by the name specified in the incorporation document.

Registered Office of LLP

Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received. [(Section 13(1)]

Rule 17 (1) of the Limited Liability Partnership Rules, 2009 provides that the limited liability partnership may change its registered office from one place to another by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide for such procedure, consent of all partners shall be required for changing the place of registered office of limited liability partnership to another place:

Provided that where the change in place of registered office is from one state to another state, the limited liability partnership having secured creditors shall also obtain consent of such secured creditors.

Name of LLP

According to section 15(1), every limited liability partnership shall have either the words "limited liability partnership" or the acronym "LLP" as the last words of its name. Section 15 (2) prohibits registration of a LLP with a name that is either undesirable in the opinion of the Central Government or that is identical with or that which too nearly resembles to the name of any existing partnership firm or a LLP or a body corporate or a trade mark registered or pending registration under the Trade Marks Act, 1999.

Rule 18 (1) of the LLP Rules, 2009 provides that the name of the limited liability partnership shall not be one prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950. Further, Rule 20 (1) provides that the limited liability partnership may change its name by following the procedure as laid down in the limited liability partnership agreement. Where the limited liability partnership agreement does not provide such procedure, consent of all partners shall be required for changing the name of the limited liability partnership.

7. LLP AGREEMENT

No provision has been made for directors or a board structure on the lines of Company Law. The LLP agreement determines the mutual rights and duties of the partners and their rights and duties in relation to limited liability partnership. This LLP agreement is required to be filed with the Registrar.

It has been provided under Section 23 – Save as otherwise provided by this Act, the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.

Limited liability partnership agreement should be filed with the Registrar within 30 days of incorporation in form 3. A person becomes a Partner by virtue of LLP agreement. This means that the LLP agreement is a must and it serves as a basic document and, to a certain extent, takes the place of MOA and AOA applicable in the case of a company registered under the Companies Act, 1956. Any change in the LLP agreement is

also required to be notified to the Registrar of Companies. The importance of the said document lies in the fact that it is a public document and it is open to public inspection being on the records of the Registrar.

In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the limited liability partnership and the partners shall be determined by the provisions relating to that matter as are set out in the First Schedule.

8. PARTNERS AND DESIGNATED PARTNERS

Any person can be a 'partner' in the limited liability partnership in accordance with the LLP agreement. Every LLP shall have atleast two designated partners who are individuals and at least one of them shall be a resident in India.

Section 5 provides that any individual or body corporate may be a partner in limited liability partnership. However, an individual shall not be capable of becoming a partner of a limited liability partnership, if—

- (a) He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- (b) he is an undischarged insolvent; or
- (c) he has applied to be adjudicated as an insolvent and his application is pending.

Section 7 provides that every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India. Provided that in case of a limited liability partnership in which all the partners are body corporates, at least two partners shall nominate their respective individuals who are to act as "designated partners" and one of the nominees shall be a resident of India.

Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (PIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply mutatis mutandis for the said purpose.

The Central Government, vide Notification No. GSR 506(E) dated 5th July, 2011, notified Limited Liability Partnership (amendment) Rules, 2011 whereby it has integrated the Director's Identification Number (DIN) issued under Companies Act, 1956 with Designated Partnership Identification Number (DPIN) issued under Limited Liability Partnership (LLP) Act, 2008 with effect from 9.7.2011.

Pursuant to aforesaid notification with effect from 9.7.2011, no fresh DPIN will be issued. Any person, who desires to become a designated partner in a Limited Liability Partnership, has to obtain DIN by filing e-form DIN-1. If a person has been allotted DIN, the said DIN shall also be used as DPIN for all purposes under Limited Liability Partnership Act, 2008. If a person has been allotted DPIN, the said DPIN will also be used as DIN for all the purposes under Companies Act, 1956. If a person has been allotted both DIN and DPIN, his DPIN will stand cancelled and his DIN will be used as DIN as well as DPIN for all purposes under Limited Liability Partnership Act, 2008 and Companies Act, 1956. Every designated partner, shall intimate his consent to become a designated partner to the limited liability partnership and DPIN, in Form 9 and the LLP shall intimate such DPIN to Registrar in Form 4.

Disqualification of a designated partner

If he –

- (a) Has at any time within the preceding five years been adjudged insolvent; or

- (b) Suspends, or has at any time within the preceding five years suspended payment to his creditors and has not at any time within the preceding five years made, a composition with them;
- (c) has been convicted by a Court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months; or
- (d) has been convicted by a Court for an offence involving section 30 of the Act.

(Section 30 deals with punishment for carrying out acts by the LLP or its partners with intent to defraud its creditors or for a fraudulent purpose).

Responsibilities of Designated Partner - Where the LLP has contravened the provisions of LLP Act

Moreover, it would be seen from what has been stated above that as per the Act the designated partner would be liable to all penalties imposed on the LLP for the contravention of the provisions of the Act and as such the designated partner would be required to pay all the monetary fines imposed on the LLP. There is no provision in the Act providing for the reimbursement of such monetary penalties to him by the LLP. Further in the following instances apart from the LLP, the designated partner would also be imposed monetary penalties under the Act:-

- For non-compliance with the directions of the Central Government for change of name under Section 17 of the Act,
- For non-maintenance of books of accounts, non-filing of accounts, duly audited where such an audit is mandatory under Section 34 of the Act,
- For non-filing of the annual return of the LLP with the Registrar under Section 35 of the Act.

REVIEW QUESTIONS



Choose the correct answer

What is the minimum limit for appointment of designated partners in a limited liability partnership?

- (a) Maximum two designated partners
- (b) At least two designated partners
- (c) Any number of designated partners
- (d) None of the above

Correct answer: (b)

9. PARTNERS' OBLIGATIONS

All partners, not just the designated partners, are agents of the LLP, but not of other partners. As such, all partners owe the duties of an agent to the LLP. The LLP shall not be bound by anything done by a partner in dealing with a person if that partner has no authority to act for LLP in doing a particular act and the person with whom he is dealing also knows that the partner has no authority for such act and to provide that an obligation of LLP, whether arising out of contract or otherwise will solely be the obligation of LLP. It is also provided that liabilities of LLP are to be met from the property of LLP. Further the LLP shall be liable for a wrongful act or omission by a partner in the course of the business of the LLP or with its authority. The obligation of a LLP shall not affect the personal liability of a partner for his own wrongful act or omission but a partner shall not be personally liable for wrongful act or omission of any other partner. No partner is

personally liable directly or indirectly for an obligation of LLP solely by reason of his being a partner of the LLP.

10. ADVANTAGES & DISADVANTAGES OF LLP

The advantages of a LLP include:

- Separate legal entity: A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- Perpetual Succession: A limited liability partnership shall have perpetual succession. In other words, partners may come and partners may go but a LLP will go on till the winding up of its affairs.
- Limited Liability: reduced risk to personal wealth from creditors' claims.
- Internal flexibility: allows for participation in management and maintenance of ethos of partnership.

The disadvantages include:

- *Lack of privacy*: Disclosure of financial information required under Section 34.
- *Requirement of a LLP agreement*: A LLP agreement is a necessity so as to avoid the application of default provisions (First Schedule) and to provide for matters not covered in the default provisions.
- *Legal uncertainty*: This being a newly introduced concept in the corporate world, it is yet to prove itself as a commercial entity.

11. LLP FOR THE PROFESSIONALS

LLPs are eminently suited to the professionals like Company Secretaries and others. They will get the benefit of limited liability and insulate them from third party claims against professional negligence or deficiency. A cross section of the professionals may come together under the banner of LLP to carry on the professional work in their respective field of specialisation, with the respective statutes according sanction for such a dispensation. Such an arrangement will bring the professionals closer and this will benefit the corporate and other clients, as they may be able to get solutions to their problems under one roof. This will also create a strong organisation of professionals and acts as a bulwark against keen competition expected to happen from the professionals abroad, with the opening of legal field under the WTO dispensation.

12. VALUATION OF CAPITAL CONTRIBUTION

As per Rule 23(1) of the LLP Rules, 2009, the contribution of each partner shall be accounted for and disclosed in the accounts of the LLP along with nature of contribution and amount. Further, Rule 23 (2) provides that the contribution of a partner consisting of tangible, movable or immovable or intangible property or other benefits brought or contribution by way of an agreement or contract for services shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government.

13. MAINTENANCE OF BOOKS AND ACCOUNT (RULE 24 OF LLP RULES)

(1) Every limited liability partnership shall keep books of accounts which are sufficient to show and explain the limited liability partnership's transactions and are such as to —

- (a) disclose with reasonable accuracy, at any time, the financial position of the limited liability partnership at that time; and
- (b) enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act. [Rule 24(1)]

(2) The books of account shall contain—

- (a) particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;
- (b) a record of the assets and liabilities of the limited liability partnership;
- (c) statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and
- (d) any other particulars which the partners may decide. [Rule 24(2)]

(3) The books of account which a limited liability partnership is required to keep shall be preserved for eight years from the date on which they are made. [Rule 24(3)]

(4) Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. [Rule 24(4)]

(5) A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners. [Rule 24(6)]

14. AUDIT OF LIMITED LIABILITY PARTNERSHIP ACCOUNTS (RULE 24 OF LLP RULES)

The accounts of every limited liability partnership shall be audited in accordance with these rules:

A limited liability partnership whose turnover does not exceed, in any financial year, forty lakh rupees or whose contribution does not exceed twenty-five lakh rupees is not required to get its accounts audited.

The Accounts of LLP should be audited as per LLP Rules, 2009. Where the partners of LLP do not decide for audit of the accounts of the LLP, such LLP shall include in the Statement of Account and Solvency a statement by the partners to the effect that the partners acknowledge their responsibilities for complying with the requirements of the Act and the Rules with respect to preparation of books of account and a certificate in the form specified in Form 8. [Rule 24(8)]. The audit of LLP may be done by a Chartered Accountant in Practice only.

An auditor or auditors of a limited liability partnership shall be appointed for each financial year of the LLP for auditing its accounts. [Rule 24(10)]

15. FILING OF ANNUAL RETURN (RULE 25 OF LLP RULES)

As per Section 35(1), every limited liability partnership shall file an annual return with the Registrar in Form 11. The annual return of an LLP having turnover upto Rs. five crore rupees during the corresponding financial year or contribution upto Rs. fifty lakh rupees shall be accompanied with a certificate from a designated partner, other than the signatory to the annual return, to the effect that annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in practice to the effect that he has verified the particulars from the books and records of the limited liability partnership and found them to be true and correct.

REVIEW QUESTIONS**State whether the following statement is “True” or “False”**

A partner shall not be personally liable for the wrongful act or omission of any other partner of the Limited Liability Partnership.

- True
- False

Correct answer: True

16. ELECTRONIC FILING OF DOCUMENTS

Rule 36(1) of LLP Rules provides that every form or application or document or declaration required to be filed or delivered under the Act and rules made there under, shall be filed in computer readable electronic form, in portable document format (pdf) to the Registrar through the portal maintained by the Ministry of Corporate Affairs(MCA) on its website www.mca.gov.in or through any other website approved by the Central Government and authenticated by a partner or designated partner of the limited liability partnership for such purpose by the use of a valid digital signature. Earlier MCA had launched a separate portal www.llp.gov.in for filling of form/application etc. Now the same is integrated with MCA portal.

Integrating e-Governance project for Limited Liability Partnership (LLP) under the platform of MCA21

The Ministry of Corporate Affairs, has achieved a new milestone by integrating e- Governance project for Limited Liability Partnership (LLP) under the platform of MCA21. With effect from 11-06-2012 all LLP forms, except Forms to be filed by Foreign LLP is being processed and approved by respective Registrar of Companies (ROCs) of concerned state. The forms to be filed by foreign LLPs shall be processed and approved by the ROC, Delhi & Haryana.

17. INVESTIGATION OF THE AFFAIRS OF LIMITED LIABILITY PARTNERSHIP (SECTION 43)

As per Section 43 the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.

- (a) if not less than one-fifth of the total number of partners of the limited liability partnership make an application along with supporting evidence and security amount as may be prescribed; or
- (b) if the limited liability partnership makes an application that the affairs of the limited liability partnership ought to be investigated; or
- (c) if, in the opinion of the Central Government, there are circumstances suggesting—
 - (i) that the business of the limited liability partnership is being or has been conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the limited liability partnership was formed for any fraudulent or unlawful purpose; or
 - (ii) that the affairs of the limited liability partnership are not being conducted in accordance with the provisions of this Act; or

- (iii) that, on receipt of a report of the Registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the limited liability partnership ought to be investigated.

18. FOREIGN LIMITED LIABILITY PARTNERSHIP

As per rule 34(1) of the LLP Rules, a foreign limited liability partnership shall, within thirty days of establishing a place of business in India, file with the Registrar in Form 27 —

- (a) a copy of the certificate of incorporation or registration and other instrument(s) constituting or defining the constitution of the limited liability partnership;
- (b) the full address of the registered or principal office of the limited liability partnership in the country of its incorporation;
- (c) the full address of the office of the limited liability partnership in India which is to be deemed as its principal place of business in India; and
- (d) list of partners and designated partners, if any, and the names and addresses of two or more persons resident in India, authorized to accept on behalf of the limited liability partnership, service of process and any notices or other documents required to be served on the limited liability partnership.

20. WINDING UP OF LIMITED LIABILITY PARTNERSHIP

The winding up of a limited liability partnership may be either voluntary or by the Tribunal. Limited liability partnership, so wound up may be dissolved.(Section 63)

Circumstances in which limited liability partnership may be wound up by Tribunal (Section 64)

A limited liability partnership may be wound up by the Tribunal—

- (a) if the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;
- (b) if, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two;
- (c) if the limited liability partnership is unable to pay its debts;
- (d) if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;
- (e) if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or
- (f) if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

Limited Liability Partnership (Winding up and Dissolution) Rules, 2012

The Limited Liability Partnership (Winding up and Dissolution) Rules, 2012 prescribes the details provisions relating to winding up. Any LLP may be wound-up voluntarily if the LLP passes a resolution to wind up the LLP with approval of at least three-fourths of the total number of its partners. Provided that where the LLP has creditors, whether secured or unsecured, the winding up shall not take place unless approval of such

creditors takes place. A copy of the resolution shall be filed with the Registrar within thirty days of passing of such resolution in Form No. 1. For details, please visit www.mca.gov.in/LLP.

21. FOREIGN DIRECT INVESTMENT (FDI) IN LIMITED LIABILITY PARTNERSHIPS (LLPs)

FDI is allowed in LLPs. The department of Industrial Policy and Promotion vide its press note dated May 20 2011, amending Consolidated FDI Policy allows LLPs to have FDI.

Salient Features

- FDI in LLPs is allowed, through the government route only for LLPs operating in sectors/activities where 100% FDI is allowed through automatic route. There are no FDI linked performance related conditions(Such as 'Non-Banking Finance Companies' or 'Development of townships, housing, built-up infrastructure and Construction-development projects' etc)
- FDI in LLP is not allowed at all even through government route in those sectors where 100% FDI is not allowed under automatic route.
- LLPs with FDI is not eligible to make any downstream investments.
- An Indian Company, having FDI is permitted to make downstream investment in an LLP only if both the company as well as LLP are operating in sectors where 100% FDI is allowed through the automatic route and there are no FDI linked performance related conditions.
- LLP with FDI is not allowed to operate in agricultural/plantation activity, print media or real estate business.
- LLPs cannot avail External Commercial Borrowings.
- Foreign Capital participation in the capital structure of LLPs is allowed only by way of cash consideration, received by inward remittance, through normal banking channels or by debit to NRE/FCNR account of the person concerned, maintained with an authorized dealer/authorized bank.
- Investment in LLPs by Foreign Institutional Investors (FIIs) and Foreign Venture Capital Investors (FVCIs) is not permitted.
- Conversion of a company with FDI, into an LLP, is allowed only if the conditions stipulated for LLP regarding FDI are complied with.
- For LLPs with FDI, the designated partner "resident in India", as defined under the 'Explanation' to Section 7(1) of the LLP Act, 2008, would also have to satisfy the definition of "person resident in India", as prescribed under Section 2(v)(i) of the Foreign Exchange Management Act, 1999.
- In case the LLP with FDI has a body corporate that is a designated partner or nominates an individual to act as a designated partner in accordance with the provisions of Section 7 of the LLP Act, 2008, such a body corporate should only be a company registered in India under the Companies Act, 1956 and not any other body, such as an LLP or a trust.

LESSON ROUND-UP

- Any two or more persons associated for carrying on a lawful business with a view to earn profit may form a limited liability partnership by subscribing their names to an incorporation document and registration with the registrar of companies.
- Salient features of the Limited Liability Partnership
- Body corporate with a separate legal entity.

- Mutual rights and duties of partners of an Limited Liability Partnership inter se and those of the Limited Liability Partnership and its partners shall be governed by an agreement between the partners.
- Limited liability of the partners.
- Every Limited Liability Partnership shall have atleast two partners.
- The Indian Partnership Act, 1932 shall not be applicable to LLPs.
- Every Limited Liability Partnership shall have at least two designated partners who are individuals and atleast one of them shall be a resident of India.
- The mutual rights and duties of the partners of limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.
- Every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of six months of the financial year to which the Statement of Account and Solvency relates. A limited liability partnership's Statement of Account and Solvency shall be signed on behalf of the limited liability partnership by its designated partners.
- A limited liability partnership whose turnover exceed forty lakh rupees, in any financial year or whose contribution exceed twenty-five lakh rupees shall be required to get its accounts audited.
- Every limited liability partnership shall file an annual return with the Registrar in Form 11.
- The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.
- The winding up of a limited liability partnership may be either voluntary or by the Tribunal.

GLOSSARY

LLPA	Limited Liability Partnership Agreement
DPIN	Designated Partner Identification Number

SELF-TEST QUESTIONS

1. What do you mean by Limited Liability Partnership. State the salient features of Limited Liability Partnerships.
2. Who is a designated partner? Give the relevant provisions of the LLP Act 2008 with regard to designated partners.
3. Write short notes on:
 - (i) LLP Agreement (ii) LLP for the professionals.
4. State the circumstances in which LLP may be wound up by the Tribunal.

Lesson 30

Application of Company Law to Different Sectors

LESSON OUTLINE

- Introduction
- Application of company law to Different Sectors
- Exemptions provided under the Act
 - Acceptance of Deposits
 - Inter-corporate loans
 - Financial statements
 - Borrowings

LEARNING OBJECTIVES

Companies Act 2013 is applicable on other forms of businesses such as Banking Sector, Insurance Sector, Companies engaged in supply of electricity etc., which are also governed by special Act of parliament, as far as there is no inconsistency.

While, Section 1(4) of the Companies Act deals with the provisions relating to application of Company law to different sectors, the certain aspects relating to financial statement, loans and investments, acceptance of deposits etc., are not applicable to some sectors as they are regulated by the principle legislations governing them.

After reading this lesson you will be able to understand the applicability of companies act 2013 to different sectors and the exemptions provided there under.

INTRODUCTION

Companies Act 2013 is applicable to other sectors such as Banking companies, insurance companies, electricity companies etc. However, the act excludes these companies from its purview for some sections which are governed under the special acts under which these companies are formed.

APPLICATION OF COMPANIES ACT TO INSURANCE, BANKING, ELECTRICITY SUPPLY AND OTHER COMPANIES GOVERNED BY SPECIAL ACTS

Section 1(4) of the Companies Act 2013 states that the provisions of this Act shall apply to—

- (a) companies incorporated under this Act or under any previous company law;
- (b) insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;
- (c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;
- (d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;
- (e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and
- (f) such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification.

EXCEPTIONS PROVIDED UNDER COMPANIES ACT 2013 TO SPECIFIC SECTORS.

The following are the important sections that excludes certain sectors from the applicability of that particular section in Companies Act 2013.

1. Section 67(3)- Financial assistance for purchase of shares

Section 67 (2) states that no public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

Section 67 (3) states that nothing in Section 67 (2) shall apply to the lending of money by a banking company in the ordinary course of its business;

2. Proviso to Section 73(1)- Prohibition to Accept deposits

Section 73. (1) states that On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter.

Proviso to Section 73(1) states that nothing in this sub-section shall apply to a banking company and nonbanking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

3. Proviso to Section 129(1)- Financial Statement

Section 129 (1) states that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

The proviso to Section 129(1) states that nothing contained in this 129(1) shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company. Further the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—

- (a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
- (b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
- (c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
- (d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Proviso to Section 179(3) - Powers of the Board to borrow

Section 179(3) states that the Board of Directors of a company shall exercise certain powers specified in the section on behalf of the company by means of resolutions passed at meetings of the Board. The borrowing powers of the Board is covered under Section 179(3)(d)

The proviso to Section 179(3) states that the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section.

Explanation to Section 179(3) states that nothing in clause (d) shall apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.

Proviso to Section 180(1)- Special resolution for Borrowing

Section 180. (1) states that the Board of Directors of a company shall exercise the certain powers only with the consent of the company by a special resolution

Borrowing money, where the money to be borrowed, together with the money already borrowed by the company in excess of aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business, requires special resolution under section 180(1)(c).

Proviso to Section 180(1) states that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

Section 186- Intercorporate Loan

Section 186 prescribes limits upto which a company shall give any loan/guarantee/provide security in connection with a loan to any other body corporate. This section also mandates certain disclosures, maintenance of registers etc.,

Section 186 (11) states that nothing contained in Section 186, except sub-section (1), shall apply—

(a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;

Section 186(1) states that without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

Section 189 – Register of Contracts

Section 189 (1) states that every company shall keep one or more registers giving separately the particulars of all contracts or arrangements to which sub-section (2) of section 184 (Contract in which director is interested)or section 188(Related Party transactions) applies, in such manner and containing such particulars as may be prescribed and after entering the particulars, such register or registers shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.

Section 189(5) (b) states that nothing contained in sub-section (1) shall apply to any contract or arrangement by a banking company for the collection of bills in the ordinary course of its business.

LESSON ROUND-UP

Section 1(4) states that companies act is applicable to Banking, Insurance other sectors.

There are exceptions provided under Companies Act 2013 especially to banking sector with respect to

- Financial statements
- Borrowings
- Loans and investments
- Acceptance of deposits etc.,

SELF-TEST QUESTIONS

1. What are the applicability of companies act to different sectors?
3. Briefly explain the applicability of companies act to banking companies with respect to borrowings..
4. Discuss the applicability of provisions of Companies Act, 2013 on Banking companies

Lesson 31

Offences, Penalties and their Compounding

LESSON OUTLINE

- Introduction
- Officers in default
- Adjudication of penalties
- Compounding of Offences
- Punishment for fraud
- Appointment of company prosecutors
- Punishment for false statements
- List of offences covered under Section 447 (punishment for fraud)
- List of compoundable offences
- By Tribunal
- By Regional Director
- By Special Courts

LEARNING OBJECTIVES

The Companies Act 2013 provides effective penalty mechanism, considering the gravity of offence, time bound actions, speedy trials etc., Some innovative measures such as establishment of special courts for speedy trials, punishment for fraud, enhanced penalties etc. Besides, the penalty mechanism provided under 1956 act has been strengthened with respect to appointment of company prosecutors, compounding of offences etc. The act states that notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code. Section 212 deals with investigation into the affairs of the company by Serious Fraud Investigation Office.

After reading this lessons you will be able to understand the broad view of regulatory mechanism with respect to offences, penalties etc including provisions relating to special courts, adjudication of penalties, punishment for fraud etc., This lessons also lists out various offences and penalties under different heads such as compoundable vs non compoundable, various offences that attract penalties for fraud etc.

REGULATORY FRAMEWORK – OFFENCES, PENALTIES AND COMPOUNDING – COMPANIES ACT 2013

The Companies Act 2013 provides for stricter enforcement of penalties in time bound manner by establishing necessary mechanism for enforcement of penalties such as establishment of special court, appointment of adjudicating officers, imposition of penalties for various offences including fraud depends on the gravity of an offence, hefty penalties, wider definition of officer in default etc., Further the act bifurcates offences into compoundable and non-compoundable offences. Further based on the quantity of penalty the compoundable offences are compounded either by the Tribunal or the regional Director as the case may be.

Broad regulatory framework of Companies Act 2013 covering the aspects such as offences, penalties, prosecution, remedies etc.,

Section 2(6) –officer in default

* Section 435-438 – Special Courts

Section 439 – Offences to be non-cognizable

*Section 441 – Compounding of certain offences

Section 443- Appointment of Company Prosecutors

Section 447- Punishment for fraud

Section 448-Punishment for false statements

Section 449- Punishment for false evidence

Section 450- Punishment where no specific penalty or punishment is provided

Section 451- Punishment in case of repeated default

Section 452- Punishment for wrongful withholding of property

Section 453 – Punishment for improper use of the words ‘Limited’ or Private Limited’

Section 454- Adjudication of penalties

OFFENCES UNDER COMPANIES ACT 2013

Who is an Officer who are In Default [Section 2(60)]

As per Section 2(60) “officer who is in default”, for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:—

- (i) whole-time director;
- (ii) key managerial personnel;
- (iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
- (iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records,

* Not yet enforced.

authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

- (v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;
- (vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;
- (vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer

ESTABLISHMENT OF SPECIAL COURT (SECTIONS 435 TO 440)

The Central Government may for the purpose of providing speedy trial of offences under this Act, by notification establish or designate Special Courts. The Special Court may exercise the same power which a Magistrate having may exercise under Section 167 of the Code of Criminal Procedure, 1973 in relation to an accused person who has been forwarded to him. When a person accused of or suspected of the commission of an offence under the Act is forwarded, a Judicial Magistrate may authorise the detention of that person for fifteen days or an Executive Magistrate for seven days. When the Magistrate consider that the detention of the person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction.

A Special Court may upon perusal of the police report of the facts constituting an offence under this Act or upon a complaint, take cognizance of the offence without the accused being committed to it for trial. When trying an offence under this Act, a Special Court may also try an offence under the Code of Criminal Procedure, 1973 in a same trial. The Special Court may try in a summary way any offence under this Act which is punishable with imprisonment for a term not exceeding three years. In case of summary trial, a sentence of imprisonment for a term exceeding one year shall not be passed. Where the Special Court think it is undesirable to try the case summarily, the Special Court shall record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear in regular trial.

All offence under the Companies Act shall be triable only by the Special Court for the area in which the registered office of the company in relation to which the offence is committed. The provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court. The Special Court shall be deemed to be a Court of Session and the person conducting a prosecution before a Special Court be deemed to be a Public Prosecutor.

OFFENCES TO BE NON-COGNIZABLE (SECTION 439):

All offenses are non-cognizable except offenses referred to SFIO

Every offence under this Act except the offences referred to in sub – section (6) of Section 212(Section 212 deals with investigation of offences by SFIO, which is discussed elsewhere in this lesson) shall be deemed to be non – cognizable within the meaning of the said code.

When court can take cognizance of any offence?

No court shall take cognizance of any offence under this Act except on the complaint of –

- (a) the Registrar in writing,

- (b) a shareholder of the company,
- (c) a person authorised by the Central Government.

The court may take cognizance of offences relating to issue and transfer of securities and non – payment of dividend on complaint in writing by a person authorised by the Securities and Exchange Board of India. When the complainant is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offence shall not be necessary. The court may require personal attendance of these complainants at the trial.

COMPOUNDING OF OFFENCES(Section 441)

Any offence punishable (whether committed by a company or any officer thereof) with fine only and where the maximum amount of fine which may be imposed for such offence does not exceed five lakh rupees, may, be compounded by the Regional Director;

Any offence punishable under this Act (whether committed by a company or any officer thereof) with fine only and where the maximum amount of fine which may be imposed for such offence exceeds five lakh rupees, may, be compounded by the Tribunal;

The offences which are punishable with Fine or Imprisonment; fine or Imprisonment or with both may be compoundable with the permission of Special Court.

Any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

Offences may be compounded by

- Regional Director
- National Company Law Tribunal
- Special court

Compoundable offences: Where the complainant agrees to enter into compromise and drop the charges against accused i.e., the offences which are eligible to compromise are compoundable. The offences are not of serious nature.

List of offences as may be compounded by Special Courts/ Regional Director or National Company Law Tribunal is placed at Annexure 1

APPOINTMENT OF COMPANY PROSECUTORS (SECTION 443-SECTION 445)

The Central Government may appoint generally or for any specified class of cases in any local area, one or more persons as Company Prosecutors for the conduct of prosecution arising out of this Act and persons so appointed shall have all the powers and privileges conferred by the Code on Public prosecutors appointed under section 24 o f the Code of Criminal procedure, 1973.The Central Government may, in any case arising out of the new Act, direct any Company Prosecutor or authorise any other person to present an appeal from an order, other than High Court, and the appeal presented by such Prosecutor or other person shall be deemed to have been validly presented to the appellate court. The provisions of section 250 of the Code of Criminal Procedure 1973, shall apply, mutatis mutandis, to compensation for accusation without reasonable cause before the Special Court or the Court of Sessions. The court imposing any fine may direct that the whole or any part thereof shall be applied in or towards payment of costs o f the proceedings or in or towards payment of reward to the person on whose intimation the proceedings were instituted.

PUNISHMENT FOR FRAUD (SECTION 447)

Explanation to Section 447 defines the term 'Fraud' as –

- (i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;
- (ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;
- (iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

Fraud is punishable with imprisonment for a term of not less than six months but it may extend to ten years. The liability towards fine is not less than the amount involved in the fraud but it may extend to three times the amount. Where the fraud involves public interest ,the imprisonment shall not be less than three years. This is without prejudice to the repayment of any debt involved in fraud.

List of offences attracted under Section 447 are placed at Annexure II

PUNISHMENT FOR FALSE STATEMENT (SECTION 448)

Any person making a statement which is false in any material particulars knowing it to be false or omission to make material fact knowing it to be material, in relation to any return, report, certificate, financial statement, prospectus statement or other document required by the provisions of this Act or the rules made there-under, the punishment for the same is as applicable for fraud under Section 447.

PUNISHMENT FOR FALSE EVIDENCE (SECTION 449)

If any person intentionally gives false evidence upon any examination on oath or solemn affirmation authorised under this Act or in any affidavit, deposition or solemn affirmation in or about the winding up of any company, he shall be punishable with imprisonment for a term which shall not be less than three years but it may extend to seven years and with fine which may extend to rupees ten lakh.

PUNISHMENT WHERE NO SPECIFIC PENALTY OR PUNISHMENT IS PROVIDED (SECTION 450)

If a company or any officer of the company or any other person contravenes any of the provisions of proposed Act or the rules there-under or any condition, limitation, or restriction subject to which any approval is given or granted for which no penalty or punishment is provided elsewhere, then the company and every officer thereof who is in default or such other person is punishable with fine extending it to rupees ten thousand and where the contravention is a continuing offence, with a further fine extending it to rupees one thousand for every day during which the contravention continues.

PUNISHMENT IN CASE OF REPEATED DEFAULT (SECTION 451)

In the case of repeated default committed for the second or subsequent occasions within a period of three years, then the company and every officer thereof who is in default is punishable with twice the amount of fine for such offence, in addition to any imprisonment for the same.

PUNISHMENT FOR WRONGFULLY WITHHOLDING OF PROPERTY (SECTION 452)

If any officer or employee of a company wrongfully obtains possession of any property including cash or

having such property wrongfully withholding it or knowingly applies it for the purpose other than expressed or directed in the articles and authorised by this Act, then he shall, on the complaint of the company or any member or creditor or contributory thereof, be punishable with fine of not less than rupees one lakh but it may extend to rupees five lakh. The court trying an offence may also order restoration of property and in default thereof, the person is punishable with imprisonment for a period of two years.

PUNISHMENT FOR IMPROPER USE OF THE WORD “LIMITED” OR “PRIVATE LIMITED”(SECTION 453)

If any person carries on trade or business under the name or title of which the word “limited” or the words “private limited” or any construction or imitation thereof, unless duly incorporated with limited liability or as a private company with limited liability, as the case may be, is punishable with fine of not less than rupees five hundred but it may extend to rupees two thousand for every day during which that name or title has been used.

ADJUDICATION OF PENALTIES (SECTION 454)

The Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of this Act in the manner as may be prescribed. The Central Government shall while appointing adjudicating officers, specify their jurisdiction in the order.

The adjudicating officer may, by an order impose the penalty on the company and the officer who is in default stating any non-compliance or default under the relevant provision of the Act.

The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to such company and the officer who is in default.

Any person aggrieved by an order made by the adjudicating officer may prefer an appeal in Form No. ADJ to the Regional Director having jurisdiction in the matter. Every appeal shall be filed within sixty days from the date on which the copy of the order made by the adjudicating officer is received by the aggrieved person and shall be in such form, manner and be accompanied by such fees as may be prescribed.

The Regional Director may, after giving the parties to the appeal an opportunity of being heard, pass such order as he thinks fit, confirming, modifying or setting aside the order appealed against.

When the company does not pay the penalty imposed by the adjudicating officer or the Regional Director within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twentyfive thousand rupees but which may extend to five lakh rupees. When an officer of a company who is in default does not pay the penalty within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

Companies (Adjudication of Penalties) Rules, 2014

- Before adjudging penalty, the adjudicating officer shall issue a written
- A written notice to the company and to every officer of the company who is in default, to show cause, within such period as may be specified in the notice (not being less than fifteen days and more than forty five days from the date of service thereon), why the inquiry should not be held against him. Every notice issued under this sub-rule, shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company

and officer in default, as the case may be:

- While adjudging quantum of penalty, the adjudicating officer shall
 - have due regard to the following factors, namely:-
- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
 - (b) the amount of loss caused to an investor or group of investors or creditors as a result of the default;
 - (c) the repetitive nature of the default.

Every appeal against the order of the adjudicating officer shall be filed in writing with the Regional Director having jurisdiction in the matter within a period of sixty days from the date of receipt of the order of adjudicating officer by the aggrieved party, in Form **ADJ** setting forth the grounds of appeal and shall be accompanied by a certified copy of the order against which the appeal is sought.

The detailed procedural aspects are prescribed in Companies (Adjudication of Penalties) Rules 2014.

All sums realised by way of penalties under the Act shall be credited to the Consolidated Fund of India.

Annexure I

List of offences Compoundable in nature (powers vested with Regional Director)

Section	Nature of offence	Fine
11(2)	Committing default in complying with the requirements relating to commencement of business.	Fine upto ₹5,000 on company. Fine upto ₹1,000 for each day of default (for officer in default)
16(3)	Committing default in complying with the directions issued under sub-section (1) relating to rectification of name of company	Fine upto ₹1,000 for each day of default on company. Fine not less than ₹5,000 but may be extended to ₹1 lakh (for officer in default).
26(9)	Contravention of provisions relating to issue of a prospectus	Fine from ₹50,000 to 3 lakh on company.
53(3)	Violation of provisions relating to issue of shares at discount	Fine not less than ₹1 Lakh but may be extended to ₹5 lakh on company
56(6)	Failure to comply with the provision relating transfer and transmission of securities under sub-section (1) to (5)	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company. Fine not less than ₹10,000 but may be extended to ₹1 lakh (for officer in default).
59(5)	Committing default in complying with the order of Tribunal relating to rectification of register of members	Fine not less than ₹1 lakh but may be extended to ₹ 5 lakh on company.

64(2)	Failure to file a notice related to alteration, increase or redemption of share capital along with the altered memorandum with the Registrar	Fine upto ₹1,000 for each day of default continues, or five lakh rupees, whichever is less.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Fine not less than Rs. 1 lakh but may be extended to ₹25 lakh on company. [If more than 5 lakh then compoundable by the Tribunal]
68(11)	If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board relating to buy back of securities	Fine not less than ₹1 lakh but may be extended to ₹3 lakh on company.
86	Contravention of any provision of Chapter VI relating to Registration of Charges	Fine not less than ₹1 lakh but may be extended to ₹10 lakh on company.
88(5)	Failure to maintain register of members or debenture-holders or other security holders as prescribed	Fine not less than ₹50,000 but may be extended to ₹3 lakh and further fine up to ₹1,000/- for each day of default in case failure continues.
89(5)	Failure to file declaration not holding beneficial interest in any share	Fine upto ₹50,000 and further fine up to ₹1,000/- for each day of default in case failure continues.
89(7)	Failure to file return relating to beneficial interest in any share before the expiry of the time specified under the first proviso to sub-section (1) of section 403	Fine not less than ₹500 but may be extended to ₹1,000 on company & every officer who is in default and further fine up to ₹1,000/- for each day of default in case failure continues.
92(6)	If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder	Fine which shall not be less than ₹50,000 but may be extended to ₹5 lakh.
*99	Default in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal	Fine upto ₹1 lakh on company & every officer who is in default and further fine up to ₹5,000/- for each day of default in case failure continues.
102(5)	Default in complying with the provisions of this section relating to statement to be annexed to notice	Fine upto ₹50,000 or 5 times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.
105(3)	If default is made in complying with sub-section	Fine upto ₹5,000 on every officer who is in

* Not yet enforced

	(2) relating to proxies	default.
105(5)	If invitations to appoint a person as proxy or one of a number of persons specified in the invitations are issued	Every officer of the company who knowingly issue or willfully authorizes or permits their issue shall be punishable with Fine upto ₹1 lakh
*121(3)	Failure to file Report on annual General meeting.	Fine not less than ₹1 lakh but may be extended to ₹ 5 lakh on company. Fine not less than ₹25,000 but may be extended to ₹1 lakh (for officer in default)
124(7)	Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124	Fine not be less than ₹1 lakh but may be extended to ₹5 lakh or with both (for every officer in default) and for company from ₹5 lakh to ₹25 lakh
137(3)	Failure to file financial statements with the Registrar	Fine up to ₹1,000/- for each day of default, but maximum up to ₹10 lakh and from ₹1 lakh to 5 lakh (for officers in default).
140(3)	Non-compliance by auditor of sub-section (2) relating to filing of resignation information	Fine not less than ₹50,000 but may be extended to ₹5 lakh on auditor/audit firm.
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company and ₹ 10,000 to 1 lakh for officer in default.
157(2)	Failure to furnish DIN to Registrar	Fine not less than ₹25,000 but may be extended to ₹1 lakh on company and every officer in default.
165(6)	Acting as a director of more than 20 companies	Fine not less than ₹5,000 but may be extended to ₹25,000 for each day of default
166(7)	Default in complying with the provisions of this section relating to directors duties	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on directors
172	Contravention of the provisions of Chapter XI relating to appointment and qualifications of directors	Fine not less than ₹50,000 but may be extended to ₹5 lakh
178(8)	Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination, Remuneration and Stakeholders Relationship Committee	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company For officers ₹25,000 to ₹ 1 lakh.
188(5)(i)	Related party transaction in case of other	Fine not less than ₹25,000 but may be

* Not yet enforced.

188(5)(ii)	company and listed company	extended to ₹5 lakh
186(13)	Contravention of the provisions of this section relating to loans and investment	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company for officer in default ₹25,000 to ₹1 lakh
187(4)	Contravention of the provisions of this section relating to investment of company held in its name	Fine not less than ₹25,000 but may be extended to ₹25 lakh on company. For officer ₹ 25,000 to ₹ 1 lakh.
191(5)	Contravention of the provisions of this section relating to payment to director for loss of office in connection with transfer of property	Fine not less than ₹25,000 but may be extended to ₹1 lakh on such director
197(15)	Contravention of the provisions of this section relating to managerial remuneration in case of absence or inadequacy of profits.	Fine not less than ₹1 lakh but may be extended to ₹5 lakh
203(5)	Contravention of the provisions of this section relating to appointment of Key Managerial personnel	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on company Fine up to ₹50,000 on Director or key managerial person who is in default and further fine up to ₹1000 for each day of default in case the contravention continues.
204(4)	Contravention of the provisions of this section relating to Secretarial Audit for bigger companies.	Fine not less than ₹1 lakh but may be extended to ₹5 lakh on the company, every officer of the company and company secretary in practice.
206(7)	Failure to furnish any information during inspection or inquiry	Fine up to ₹1 lakh and further fine up to ₹500 for each day of default on the company and every officer of the company.
*221(2)	Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1)	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and on officer ₹ 50,000 to ₹ 5 lakh
*222(2)	securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and ₹25,000 to ₹1 lakh on officer
*232(8)	Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation	Fine not less than ₹1 lakh but may be extended to Rs. 25 lakh on company and ₹1 lakh to ₹ 3 lakh on officer

* Not yet enforced.

*238(3)	Failure to register the offer of Schemes involving transfer of shares.	Fine not less than ₹25,000 but may be extended to ₹5 lakh on director who issue such circular
*242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company and ₹25,000 to 1 lakh on officers
*247(3) <i>Proviso</i>	Contravention of the provisions of this section by the valuer	Fine not less than ₹1 lakh but may be extended to ₹5 lakh
*249(2)	Filing of application in restricted cases for removal of name	Fine upto ₹1 lakh
*302(4)	Committing default by official liquidator in forwarding a copy of the order of dissolution of company by tribunal within the period specified in sub-section (3)	Fine upto ₹5,000 for each day of default (on company liquidator)
*306(5)	Default in calling the meeting of the creditors; to prepare a statement of the position of the company's affairs alongwith a list of creditors, estimated amount of claim and filing the resolution with Registrar	Fine not less than ₹50,000 but may be extended to ₹ 2 lakh
*307(2)	Default in publication of resolution to wind up voluntarily	Fine upto ₹5,000 for each day of default on company and every officer of the company
*312(2)	Failure to give notice of appointment of Company Liquidator to Registrar	Fine upto ₹500 for each day of default on company and every officer who is in default
*314(5)	Failure to prepare quarterly statement of accounts by company liquidator in voluntary winding up and file with Registrar under sub-section (5)	Fine upto ₹5,000 for each day of default (on Company liquidator)
*318(8)	Failure to complying with the provisions of this section relating to final meeting and dissolution of company	Fine upto ₹1 lakh (on Company liquidator)
*342(6)	Failure or neglect to give assistance required under sub-section (5)	Fine not less than ₹25,000 but may be extended to ₹1 lakh
*344(2)	Failure to give statement that the company is in liquidation	Fine not less than ₹50,000 but may be extended to ₹3 lakh
*348(6)	Contravention of the provisions of information as to pending liquidation	Fine upto ₹ 5,000 for each day of default (for Company liquidator)

* Not yet enforced

*356(2)	Failure to file certified copy of the order of Tribunal relating to dissolution of company void with the Registrar	Fine upto ₹10,000 for each day of default (for Company liquidator or the person on whose application the order was passed)
392	Contravention of the provisions of Chapter XXII by a foreign company	Fine not less than ₹1 lakh but may be extended to ₹3 lakh and further fine up to ₹50,000 for each day of default and ₹25,000 to 5 lakh on officers
405(4)	Failure to furnish information or statistics etc. by the companies required by the Central Government	Fine upto ₹ 25,000 on company and 25,000 to 3 lakh on officers
450	No specific penalty or punishment is provided in the Act	Fine up to ₹10,000 and further fine up to ₹1,000 for each day of default in case of contravention continues
451	Repeated default within 3 years	Twice the amount of fine for such offence in addition to any imprisonment provided for that offence
452(1)	Punishment for wrongful withholding of property	Fine not less than ₹1 lakh but may be extend to ₹5 Lakh on officer or employee of the company
453	Improper use of the words "limited" and "private limited"	Fine not less than ₹500 but may be extended to ₹2,000 for each day of default
454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company
464(3)	Being a member of a company formed exceeding certain numbers	Fine upto ₹1 lakh and liabilities incurred in such business
469(3)	Contravention of the Rules framed by Central Government	Fine upto ₹5,000 and further fine up to ₹500 for each day of default in case of contravention continues

List of offences compoundable in nature (powers vested with the Tribunal)

Section	Nature of offence	Fine
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects etc.	Fine not less than ₹10 lakh but may be extended to ₹1 crore on company.
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock	Fine not less than ₹5 lakh but may be extended to ₹50 lakh on company.

* Not yet enforced.

	exchanges	
46(5)	Fraudulently issuing of duplicate share certificates by a company	Fine not less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may be extended to 10 times or ₹10 crores whichever is higher on company.
*66(11)	Failure to publish the order of confirmation of the reduction of share capital by the Tribunal	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Fine not less than ₹1 lakh but may be extended to ₹25 lakh on company. [If less than 5 lakh then compoundable by the RD]
74(3)	If a company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal	Fine not less than ₹1 crore but may be extended to ₹10 crore on company.
117(2)	Failure to file with the Registrar the copy of notice or agreement within stipulated time	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company. Fine not less than ₹1 lakh but may be extended to ₹5 lakh (for officer in default including liquidator).
124(7)	Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company.
143(15)	Failure of auditor to intimate to Central Government regarding fraud against the company by officers or employees	Fine not less than ₹1 lakh but may be extended to ₹25 lakh.
185(2)	Contravention of the provisions of sub-section 1 relating to loans, guarantee or security	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company or on other officers in default
*245(7)	Committing default in complying with the order of Tribunal under this section	Fine not less than ₹5 lakh but may be extended to ₹25 lakh on company
*314(8)	Default in complying with the provisions of	Fine upto ₹10 lakh on company liquidator

* Not yet enforced

	this section except sub-section (5)	
*316(2)	Failure to send quarterly report on winding up and call meeting by company liquidator	Fine upto ₹10 lakh on company liquidator

List of offences compoundable in nature (powers vested with Special Court)

Section	Nature of offence	Fine / Imprisonment
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects etc.	Imprisonment upto three years or fine not less than ₹25,000 but may be extended to ₹25 lakh, or with both (for officer in default)
26(9)	Contravention of provisions relating to issue of a prospectus	Imprisonment upto three years or fine not less than ₹50,000 but may be extended to ₹3 lakh or with both (every person who is knowingly a party to the issue of such prospectus)
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock exchanges	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹3 lakh or with both (for officer in default).
*48(5)	Committing default in complying with the provisions regarding to variation of shareholders' rights	Fine not less than ₹25,000 but may be extended to ₹5 lakh on company. Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹5 lakh or with both (for officer in default).
53(3)	Violation of provisions relating to issue of shares at discount	Imprisonment upto six months or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both (for officer in default).
59(5)	Committing default in complying with the order of Tribunal relating to rectification of register of members	Imprisonment upto one year or fine not less than ₹1 lakh but may be extended to ₹3 lakh or with both (for officer in default).
68(11)	If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board relating to buy back of securities	Imprisonment upto three years or fine not less than ₹1 lakh but may be extended to ₹3 lakh or with both (for officer in default).
71(11)	Committing default in complying with the order of Tribunal relating to redemption of debentures	Imprisonment upto three years or fine not less than ₹2 lakh but may be extended to ₹5 lakh or with both (for officer in default).
74(3)	If a company fails to repay the deposit or part	Imprisonment upto seven years or fine not

* Not yet enforced

	thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal	less than ₹25 lakh but may be extended to ₹2 crore or with both (for officer in default).
86	Contravention of any provision of Chapter VI relating to Registration of Charges	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both (for officer in default).
92(5)	Failure to file annual return before the expiry of the period specified under section 403 with additional fee	Fine not less than ₹50,000 but may be extended to ₹5 lakh on company. Imprisonment upto six months or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for officer in default).
128(6)	Failure to keep proper books of account	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for MD, WTD, CFO etc.)
129(7)	Failure to keep proper financial statement	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for every director)
134(8)	Default in complying with the provisions regarding financial statement and Board's report	Imprisonment upto three years or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for every director)
137(3)	Failure to file financial statements with the Registrar	Fine up to ₹1,000/- for each day of default, but maximum up to ₹10 lakh. Imprisonment upto six months or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both (for every director)
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	Imprisonment upto one year or fine not be less than ₹10,000 but may be extended to ₹1 lakh or with both (for officer in default)
159	Contravention of the provisions of section 152, 155 and 156	Imprisonment upto six months or fine up to ₹50,000 and further fine up to ₹500/- for each day of default in case of contravention continues
167(2)	Functioning as a director after vacation of office	Imprisonment upto one year or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both
178(8)	Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination, Remuneration and Stakeholders Relationship Committee	Imprisonment upto one year or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both (for officer in default)

184(4)	Failure to disclose of director's interest and Participation in Board meeting by interested director	Imprisonment upto one year or fine not less than ₹50,000 but may be extended to ₹1 lakh or with both
185(2)	Contravention of the provisions of sub-section 1 relating to loans, guarantee or security	Imprisonment upto six months or fine not less than ₹5 lakh but may be extended to ₹25 lakh or with both
187(4)	Contravention of the provisions of this section relating to investment of company held in its name	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both
188(5)(i)	Contravention of this section relating to Related party transaction in case of listed company	Imprisonment upto one year or fine not less than ₹25,000 but may be extended to ₹5 lakh or with both
194(2)	Forward dealing in securities of the company by Key Managerial personnel or director	Imprisonment upto two years or fine not less than ₹1 lakh but may be extended to ₹5 lakh or with both (for every director or Key Managerial Personnel)
195(2)	Contravention of this section (195) relating to Insider trading of securities by Key Managerial personnel or director	Imprisonment upto five years or fine not less than ₹5 lakh but may be extended to ₹25 crore or three times the profit made on insider trading whichever is higher or with both
*221(2)	Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1)	Imprisonment upto three years or fine not less than ₹50,000 but may be extended to ₹5 lakh or with both (for officer in default)
*222(2)	securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	Imprisonment upto six months or fine not less than ₹ 25,000 but may be extended to ₹5 lakh or with both (for officer in default)
*232(8)	Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation	Imprisonment upto one year or fine not less than ₹1 lakh but may be extended to ₹3 lakh or with both (for officer in default)
*242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both (for officer in default)
*243(2)	Acting as managing or other director or manager, whose agreement has been	Imprisonment upto six months or fine up to ₹5 lakh or with both

* Not yet enforced

	terminated or set aside	
*274(4)	Failure to file statement of affairs	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹5 lakh or with both
*284(2)	Failure to extend full cooperation to the company liquidator	Imprisonment upto six months or fine up to ₹50,000 or with both
*305(4)	Without reasonable grounds giving declaration of solvency in case of proposal to wind up voluntarily	Imprisonment not less than three years but may be extended to five years or fine not less than ₹50,000 but may be extended to ₹3 lakh or with both
*306(5)	Default in calling the meeting of the creditors; to prepare a statement of the position of the company's affairs alongwith a list of creditors, estimated amount of claim and filing the resolution with Registrar	Imprisonment upto six months or fine not less than ₹50,000 but may be extended to ₹2 lakh or with both (for directors)
*347(4)	contravention of any rule framed or an order made under sub-section (3)	Imprisonment upto six months or fine upto ₹50,000 or with both
*348(7)	Wilful default by company liquidator	Imprisonment upto six months or fine upto ₹1 lakh or with both
392	Contravention of the provisions of Chapter XXII by a foreign company	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹5 lakh or with both (for officer in default)
405(4)	Failure to furnish information or statistics etc. by the companies required by the Central Government	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹3 lakh or with both (for officer in default)
*441(5)	Failure to comply with the order made by Tribunal or Regional Director in relation to Compounding of offences	Imprisonment upto six months or fine upto ₹1 lakh or with both
454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	Imprisonment upto six months or fine not less than ₹25,000 but may be extended to ₹1 lakh or with both (for officer in default)

List of offences non-compoundable in nature

Section	Nature of offence	Imprisonment and Fine
46(5)	Fraudulently issuing of duplicate share certificates by a company	Fine not less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may be extended to 10 times or ₹10 crores whichever is

* Not yet enforced

		higher on company. Imprisonment not less than six months but may be extended to 10 years and fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud (for officer in default).
56(7)	If the depository or depository participant with an intention to defraud a person, has transferred the shares.	Imprisonment not less than six months but may be extended to 10 years and fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud (for officer in default).
57	Deceitfully personating as an owner of any shares or interest in a company	Imprisonment minimum of one year but may be extended to three years and with fine not less than ₹1 lakh but may be extended to 5 lakh
58(6)	Contravention of an order of the Tribunal regarding the refusal of registration and appeal against refusal.	Imprisonment not less than one year but may be extended to three years and with fine not less than ₹1 lakh but may be extended to ₹5 lakh
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Imprisonment upto three years and fine not less than ₹1 lakh but may be extended to ₹25 lakh (for officer in default).
118(12)	Tampering with the minutes of the proceedings of meeting	Imprisonment upto two years and fine not less than ₹25,000 but may be extended to ₹1 lakh.
127 Proviso	Failure to distribute dividend within thirty days	Imprisonment upto two years and fine not less than ₹1,000 for each day of failure (for every director) and 18% interest liability on company
*140(5)	Final order of Tribunal in relation to fraudulent behavior of auditor	Barred to be appointed as auditor for 5 years and Imprisonment not less than six months but may be extended to 10 years and fine not less than the amount involved in fraud but may be extended to 3 times the amount involved in fraud
147(2) Proviso	Failure of auditor to comply with the provisions of sections 139, 143, 144 and 145 If knowingly contravenes	Imprisonment upto 1 year and fine not less than ₹1 lakh but may be extended to ₹25 lakh
182(4)	Political contribution made in contravention of this section	Imprisonment upto six months and fine upto five times of the amount contributed (for officer in default)

* Not yet enforced

186(13)	Contravention of the provisions of this section relating to loans and investment	Imprisonment upto two years and fine not less than ₹25,000 but may be extended to ₹1 lakh
207(4)	Disobeys the direction issued by the Registrar or inspector under this section	Imprisonment upto one year and fine not less than ₹25,000 but may be extended to ₹5 lakh and deemed to have vacate office and shall disqualified from holding any office in any company
217(6)	Disobeys the direction issued by the Registrar or inspector under this section in relation to investigation	Imprisonment upto one year and fine not less than ₹25,000 but may be extended to ₹1 lakh and deemed to have vacate office and shall disqualified from holding any office in any company
217(8)	Failure to provide information, books or papers etc. to inspector during investigation	Imprisonment upto six months and fine not less than ₹5,000 but may be extended to ₹1 lakh and further fine up to ₹2,000 for each day of default
*245(7)	Committing default in complying with the order of Tribunal under this section	Imprisonment upto three years and fine not less than ₹25,000 but may be extended to ₹1 lakh (for officer in default)
*247(3) <i>Proviso</i>	Contravention of the provisions of this section by the valuer If the contravention is with the intentions to fraud	Imprisonment upto one year and fine not less than ₹1 lakh but may be extended to ₹5 lakh
*267	Contravention of the provisions of this chapter, Tribunal, Appellate Tribunal or temper the records	Imprisonment up to seven years and fine upto ₹10 lakh
*336(1)	Offences by officers of companies in liquidation	Imprisonment not less than three years but may be extended to five years and fine not less than ₹1 lakh but may be extended to ₹3 lakh
*336(2)	Offences by officers of companies in liquidation covered under sub-Section (vii) of Section (d) of sub-section (1)	Imprisonment not less than three years but may be extended to five years and fine not less than ₹3 lakh but may be extended to ₹5 lakh
*337	Frauds by officers	Imprisonment not less than one year but may be extended to three years and fine not less than ₹1 lakh but may be extended to ₹3 lakh
*338(1)	Failure to keep proper books of account before winding up	Imprisonment not less than one year but may be extended to three years and fine not less than ₹1 lakh but may be

* Not yet enforced

		extended to ₹3 lakh
447 <i>Proviso</i>	Punishment for fraud If the fraud involves public interest	Imprisonment not less than six months but may be extended to 10 years and fine not less than the amount involved in fraud but may be extended to 3 times the amount involved in fraud Imprisonment not less than 3 years
449	Intentionally gives false evidence	Imprisonment not less than three years but may be extended to seven years and fine upto ₹10 lakh
452 (2)	Wrongful withholding of property	To deliver up or refund any such property or cash wrongfully obtained; the benefits that have been derived, imprisonment for a term which may extend to two years.

Annexure II

The following table contains the acts for which the punishment for fraud under Section 447 is provided in the Act:

S.No.	Section No.	Item/Particulars
	7(5) & (6)	Incorporation of company (5) Furnishing any false or incorrect particulars of any information or suppression any material information, in any of the documents filed with the Registrar in relation to registration of a company by any person, of which he is aware, the person shall be liable under Section 447. (6) After the incorporation of a company, if it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, promoters, first directors of the company and the persons making declaration for incorporation shall be liable for action under Section 447.
	8(11)	Formation of companies with charitable objects, etc When it is proved that the affairs of the companies formed with charitable objects, were conducted fraudulently, every officer in default shall be liable.
	34	Criminal liability for mis-statements in prospectus Where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under Section 447. <i>Shall not apply if he proves that such statement or omission</i>

		<i>was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.</i>
	36	<p>Punishment for fraudulently inducing persons to invest money</p> <p>The person shall be liable, who knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into,—</p> <ul style="list-style-type: none"> (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or (b) any agreement, the purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or (c) any agreement for, or with a view to obtaining credit facilities from bank or financial institution;
	38(1)	<p>Punishment for personation for acquisition, etc., of securities</p> <p>The person shall be liable, if he</p> <ul style="list-style-type: none"> (a) makes or abets the making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; (b) makes or abets the making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; (c) induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name.
	46 (5)	<p>Certificate of shares</p> <p>(5) If a company with intent to defraud issues a duplicate certificate of shares, every officer of the company who is in default shall be liable under Section 447.</p>
	56 (7)	<p>Transfer and transmission of securities</p> <p>(7) Where any depositor or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447.</p>
	*66 (10)	Reduction of share capital

* Not yet enforced

		<p>(10) If any officer of the company—</p> <ul style="list-style-type: none"> (a) knowingly conceals the name of any creditor entitled to object to the reduction; (b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or (c) abets or is privy to any such concealment or misrepresentation as aforesaid. <p>he shall be liable.</p>
	*75 (1)	<p>Damages for fraud</p> <p>Where company fails to repay deposit or any interest thereon within the time specified & it is proved that the deposits had been accepted with intent to defraud depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the liability under Section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.</p>
	140 (5)	<p>Removal, resignation of auditor and giving of Special notice</p> <p>(5) Tribunal either <i>suo motu</i> or on an application made by Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.</p> <p>If application is made by Central Government & Tribunal is satisfied that any change of auditor is required, it shall within 15 days of receipt of such application, make an order that he shall not function as an auditor & Central Government may appoint another auditor in his place.</p> <p>Auditor against whom final order has been passed by Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of the order and auditor shall also be liable under Section 447.</p>
	206 (4)	<p>Power to call for information, inspect books and conduct inquiries</p> <p>(4) If ROC is satisfied on the basis of information available or furnished or on a representation made by any person that</p>

* Not yet enforced

		<p>business of company is carried on for a fraudulent/unlawful purpose/not in compliance with the provisions of this Act/if grievances of investors are not being addressed, he may, call on the company to furnish in writing any information or explanation on matters specified within such time as he may specify & carry out such inquiry as he deems fit after providing a reasonable opportunity of being heard:</p> <p>Where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud as per Section 447.</p>
	*213 (proviso)	<p>Investigation into company's affairs in other cases</p> <p>If after investigation it is proved that—</p> <p>(i) the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or</p> <p>(ii) any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud,</p> <p>then, every officer in default of company and persons concerned in the formation of company or the management of its affairs shall be punishable for fraud.</p>
	229	<p>Penalty for furnishing False statement, mutilation, destruction of documents</p> <p>Where a person who is required to provide an explanation or make a statement during inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation,—</p> <p>(a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company/body corporate;</p> <p>(b) makes, or is a party to the making of, a false entry in any document concerning the company/ body corporate; or</p> <p>(c) provides an explanation which is false or which he knows to be false,</p> <p>he shall be punishable for fraud.</p>

* Not yet enforced

	*251 (1)	Fraudulent application for removal of name Where it is found that an application by a company under sub-Section (2) of Section 248 has been made with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the persons in charge of the management of the company shall— (a) be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and (b) be punishable for fraud in the manner as provided in Section 447.
	266 (1)(proviso)	Power of Tribunal to Assess damages Against delinquent directors, etc Such direction by the Tribunal shall be without prejudice to any other legal action that may be taken against the person including any punishment for fraud in the manner as provided in Section 447.
	339 (3)	Liability for fraudulent conduct of business (3) Where any business of a company is carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose, every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be liable for action under Section 447.
	448	Punishment for false statement If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of this Act or rules thereunder, any person makes a statement,— (a) which is false in any material particulars, knowing it to be false; or (b) which omits any material fact, knowing it to be material, he shall be liable under Section 447.

LESSON ROUND-UP

- Companies Act provides punishment for offences in the form of imprisonment and/or fine in the various sections of the Act.
- All offences under Companies Act shall be triable by special court for the area in which the registered office of the company in relation to which the offence is committed.
- Section 212(6) deals with investigation into the affairs by serious fraud investigation office.

* Not yet enforced

- Section 2(60) of the Act defines the term 'officer in default'.
 - Under Section 441 of the Act, the offences, the penalty for which is fine only may be compounded by the Central Government.

SELF-TEST QUESTIONS

1. Explain the term 'Officer in default'? state the types of punishment prescribed under the Act?
 2. What do you mean by 'Compounding of offences'?
 3. Write a short notes on the following:-
 - (a) Punishment for fraud.
 - (b) Establishment of special court
 - (c) Non-cognizable offence

Lesson 32

Winding up-Concept and Modes

LESSON OUTLINE

- Introduction
- Meaning of winding up
- Modes of winding up
- Winding up by Tribunal
- Voluntary winding up

LEARNING OBJECTIVES

Corporate Collapse implies business failure of the company, which may occur due to inadequate capital, fraudulent business practices, management inexperience and incompetence, failure to respond to change, recession, obsolescence, excessive gearing etc.

In the words of Prof. L.C.B. Gower, Winding-up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. A liquidator is appointed and he takes control of the company, collects its debts and finally distributes any surplus among the members in accordance with their rights. The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law.

The Companies Act, 2013 provides for effective time bound winding up process. It also provides for aspects such as new grounds of winding up by NCLT, report of company liquidator, more powers to company liquidator, valuation of assets by registered valuer, professional assistance, concurrence of creditors for voluntary winding up, simplification of provisions by providing exclusive right to creditors to appoint the committee of inspection., remedy for fraudulent preference and so on. ,

After reading this study you will be able to understand the provisions of Companies Act 2013(Section 271-365) regarding the Concepts and modes of winding up. The Provisions of Companies Act, 2013 regarding winding up is not yet notified and the provisions of Companies Act 1956 continue to be in force.

INTRODUCTION

Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

Winding-up is the process by which management of a company's affairs is taken out of its directors' hands, its assets are realized by a liquidator and its debts are realized and liabilities are discharged out of proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will, therefore, be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.

The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law. However, the purpose must not be exploited for the benefit or advantage of any class or person entitled to submit petition for winding up of a company. It may be noted that on winding up, the company does not cease to exist as such except when it is dissolved. The administrative machinery of the company gets changed as the administration is transferred in the hands of the liquidator. Even after commencement of the winding-up, the property and assets of the company belong to the company until dissolution takes place. On dissolution the company ceases to exist as a separate entity and becomes incapable of keeping property, suing or being sued. Thus in between the winding up and dissolution, the legal status of the company continues and it can be sued in the court of law.

Is Winding up and dissolution are synonymous?

The terms "Winding up" and "Dissolution" are sometimes erroneously used to mean the same thing. But, the legal implications of these two terms are quite different and there are fundamental differences between them as regards the legal procedure involved. The main points of distinction are given below:

1. The entire procedure for bringing about a lawful end to the life of a company is divided into two stages – 'winding up' and 'dissolution'. Winding up is the first stage in the process whereby assets are realised, liabilities are paid off and the surplus, if any, distributed among its members. Dissolution is the final stage whereby the existence of the company is withdrawn by the law.
2. The liquidator appointed by the company or the Court carries out the winding up proceedings but the order for dissolution can be passed by the Court only.
3. According to the Companies Act the liquidator can represent the company in the process of winding up. This can be done till the order of dissolution is passed by the Court. Once the Court passes dissolution orders the liquidator can no longer represent the company.
4. Creditors can prove their debts in the winding up but not on the dissolution of the company.
5. Winding up in all cases does not culminate in dissolution. Even after paying all the creditors there may still be a surplus; company may earn profits during the course of beneficial winding up; there may be a scheme of compromise with creditors while company is in winding up and in all such events the company will in all probability come out of winding up and hand over back to shareholders/old management. Dissolution is an act which puts an end to the life of the company.

MODES OF WINDING UP

A company registered under the Companies Act, 1956 may be wound up by any of the following modes:

1. By the Court i.e. compulsory winding up;
2. Voluntary winding up, which may be either:
 - (a) Members' voluntary winding up; or
 - (b) Creditor's voluntary winding up;
3. Winding up subject to the supervision of the Court. (*omitted and the same is yet to be notified*)

Section 425 of the Companies Act, 1956 lays down the above three modes of winding up and provides that the provisions of the Act with respect to winding up shall apply, unless the contrary appears, to the winding up of a company in any of these three modes.

In every winding up, a liquidator or liquidators is or are appointed to administer the property of the company and he or they must apply the assets of the company, first, in the payment of the creditors in their proper order, and then, in distributing the residue among the members according to their rights.

WINDING UP BY THE COURT

Winding up by the Court or compulsory winding up is initiated by an application by way of petition to the appropriate Court for a winding up order. A winding up petition has to be resorted to only when other means of healing an ailing company are of absolutely no avail. Remedies are provided by the statute on matters concerning the management and running of company. The extreme and irretrievable step of winding up must be resorted to only in very compelling circumstances. [*Daulat Makanmal Luthrid v. Solatire Hotels* (1993) 76 Comp. Cas. 215 (Bom. HCD)]. It is primarily the High Court which has the jurisdiction to wind up companies under Section 10 of the Companies Act, 1956 in relation to the place at which registered office of the company concerned is situated except to the extent to which jurisdiction has been conferred on any District or District Courts subordinate to the High Court. The Central Government may empower any District Court to exercise that jurisdiction, presumably to reduce the burden of the High Court, only in respect of small companies with the paid-up capital of less than one lakh rupees and having their registered office within the District, with a view to achieving expeditious and efficient disposal of winding up proceedings.

Sections 435 to 438, confers wide powers upon the High Court to regulate the conduct of such proceedings. Accordingly the High Court which is the winding up Court may direct a District Court to retain and continue winding up proceedings which should not really have been commenced in that Court (Section 437). It may also withdraw any winding up which is in progress in a District Court from that Court and proceed with the winding up itself, or transfer it to another District Court (Section 436), and with respect to all proceedings subsequent to its own order of winding up, direct them to be had in a District Court or with the consent of any other High Court, in such High Court or in a District Court subordinate to that High Court, whereupon the Court in respect of which such direction is given shall be deemed to be the Court with all powers and jurisdiction of the High Court under the Act (Section 435). Lastly, the High Court can pass orders under any of the foregoing sections at any time and at any stage, whether or not an application in that behalf is made by any of the parties to the proceedings (Section 438). There must be strong reasons to order winding up as it is a last resort to be adopted. Temporary difficulty cannot be ground for liquidating company when company is on path of revival. *D. Ashokan v. S.T. Reddiar & Sons* (2002) 40 SCL (Ker. HC DB).

Grounds on which a Company may be wound up by the Court

A company under Section 433 may be wound up by the Court if

- (a) the company has passed a special resolution of its being wound up by the Court; or
- (b) default is made in delivering the statutory report to the Registrar or in holding the statutory meeting; or
- (c) it does not commence business within a year from its incorporation or suspends business for a whole year; or
- (d) the number of its members in the case of a public company is reduced below seven and in the case of a private company, below two; or
- (e) it is unable to pay its debts; or
- (f) the Court is of the opinion that it is just and equitable that it should be wound up.
- (g) the company has made a default in filing with the registrar its balance sheet and profit and loss account or annual returns for any five consecutive financial years.
- (h) the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality, or
- (i) the court is of the opinion that the company should be wound up under the circumstances specified in Section 424G.

Provided that the tribunal shall make order for winding up of a company under clause (h) on application made by the Central Government or a State Government.

The winding up petition is not a legitimate means of seeking to enforce payment of debt, which is *bonafide* disputed by the company.

CASE LAW

In *Shakti Agencies v. Manshuk Bhai Industries Ltd.* [(2007), 74 SCL 332 (RAJ)], decided on 14.8.2006, Petitioner firm filed a winding up petition against the respondent company for the recovery of a debt which was disputed by the respondent company. The Petition was dismissed.

The instant case was of bona fide disputed debt. Even from the petition for winding up, it was evident that for the payment of ₹ 10,50,000, the petitioner firm agreed to purchase shares of the respondent company.

In the additional affidavit filed by the respondent company, it was stated that application form was signed by the proprietor of petitioner with a sole view to settle the outstanding account pursuant to which the respondent proceeded to allot 70,000 shares to the petitioner and the certificates were dispatched, which were received by the representative of petitioner. The respondent disputed the debt and it could not be held that it neglected to pay the debt within the meaning of section 433(1)(a). The winding up petition is not a legitimate means of seeking to enforce payment of debt, which is bona fide disputed by the company.

The principles, on which the Court should act in disposing of winding up petition, may be deduced thus: (i) if the debt is not disputed on some substantial ground, the Court may make the order, (ii) if the debt is bona fide disputed, there cannot be 'neglect to pay' within the meaning of section 433(i)(a) and petition for winding up is not maintainable, (iii) dispute with regard to payment of interest is not a bona fide dispute, (iv) the defence of respondent company should be in good faith, one of substance and likely to succeed in point of law.

REVIEW QUESTIONS



Multiple Choice Question:

Under what conditions a Company may be wound up by the court?

- It does not commence business within a year from its incorporation or suspends business for a whole year.
- The Court is of the opinion that it is just and equitable that it should be wound up.
- The company has not been able to recruit employees from a long time.
- None of the above.

Correct Answer: (a) & (b)

Who may file Petition for the Winding up?

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 439 by any of the following persons:

- the company; or
 - any creditor or creditors, including any contingent or prospective creditor or creditors; or
 - any contributory or contributories; or
 - all or any of the parties specified above in clauses (a), (b), (c) whether together or separately; or
 - the Registrar; or
 - any person authorised by the Central Government in the case falling under Section 243, i.e., following upon a report of inspectors.
- *(g) by the Central government or state Govt., in a case falling under clause (h) of Section 433.*

The Official Liquidator or any of the persons mentioned above as being entitled to present a petition under Section 439, will have a right to present a winding-up petition when a company is already being wound up voluntarily or subject to the supervision of the Court, and such voluntary winding up cannot be continued with due regard to the interests of the creditors or contributories or both (Section 440). In *Mumbai Labour Union v. Indo French Time Industries* (2002) 38 SCL 924, it was held that a trade union can not file winding up petition for unpaid wages of workmen/employees. They are disentitled as other legitimate and efficacious remedy under labour laws is available. In such case, filing winding up petition is abuse of law.



State whether the following statement is “True” or “False”

Any contributory or contributories or the Registrar may petition for the winding up of a company.

True

False

Correct Answer: True

* inserted Vide Companies (Second Amendment) Act, 2002

Jurisdiction of Court for entertaining Winding up Petition

In terms of the provisions of Section 10 of the Companies Act, 1956, the jurisdiction for entertaining winding up petition vests either in the High Court having jurisdiction in relation to the place where the registered office of the company is situated or the District Court of the area subordinate to the High Court, in which the jurisdiction has been vested either by the Act or by the Central Government by notification in the Official Gazette. In *GTC Industries Ltd. v. Parasrampuria Trading* (1999) 34 CLA 380 (All HC), it was held that only High Court where the registered office is situated has jurisdiction in winding up, even if there was agreement between parties that dispute between parties will be resolved before High Court where registered office is not situated. Regardless of where agreement is executed, Company Court having jurisdiction over the place where the registered office is situated, will have the jurisdiction to entertain a petition for winding up. *LKP Merchant Financing v. Arwin Liquid Gases* (2001) 103 Comp. Cas. 211 (Guj.).

For the purposes of jurisdiction to wind up companies, the expression 'Registered Office' means the place which has longest been the registered office of the company during the six months immediately preceding the presentation of the petition for winding up. In *Kalpana Trading v. N.C.L. Industries Ltd.* [(1996) 1 Comp. LJ 152], the Orissa High Court refused to entertain the petition for winding up as the Company had its place of Registered Office at Hyderabad.

VOLUNTARY WINDING UP

The companies are usually wound up voluntarily as it is an easier process of winding up. It is altogether different from a compulsory winding up. In voluntary winding up the company and its creditors are left to settle their affairs without going to a Court, although they may apply to the Court for directions or orders, as and when necessary. One or more liquidators are to be appointed by the company in general meeting for the purpose of winding up the affairs and distributing the assets of the company. The remuneration of the liquidators is also required to be fixed by the company in general meeting. Unless the remuneration as aforesaid is fixed the liquidators shall not take charge of his/their offices (Section 490). The circumstances in which a company may be wound up voluntarily are:

- (a) when the period fixed for the duration of the company as mentioned in its articles has expired; or the event, on the happening of which the articles provide that the company is to be dissolved has occurred; and the company passes a resolution in general meeting requiring the company to be wound up voluntarily;
- (b) if the company passes a special resolution that the company be wound up voluntarily [Section 484(1)].

Thus, a company may be wound up voluntarily on the expiry of the term fixed for duration of the company or on the occurrence of the event as provided in its articles. In these two cases only an ordinary resolution may be passed in the general meeting of the company. Apart from these two cases, a company may be voluntarily wound up for any other reason for which a company has to pass a special resolution. A proper notice required for the respective meetings must be given to all the members and in the latter case the text of the special resolution to be passed together with the reason to wind up voluntarily must be explained therein.

The resolution (whether ordinary or special), when passed, must be advertised within 14 days of the passing of the resolution in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. A default in complying with the above requirements renders the company and every officer of the company, who is in default, liable to a penalty which may extend to five hundred rupees for every day during which the default continues. A liquidator of the company is deemed to

an officer of the company for the purposes of the above requirements (Section 485).

A voluntary winding up commences from the date of the passing of the resolution for voluntary winding up. This is so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court.

The effect of the voluntary winding up is that the company ceases to carry on its business except so far as may be required for the beneficial winding up thereof. The corporate status and the powers of the company, however, continue until it is dissolved [Section 487].

Kinds of Voluntary Winding Up

Section 488(5) divides voluntary winding up into two kinds:

- (i) Members' voluntary winding up; and
- (ii) Creditors' voluntary winding up.

Members' Voluntary Winding Up

When the company is solvent and is able to pay its liabilities in full, it need not consult the creditors or call their meeting. Its directors, or where they are more than two, the majority of its directors may, at a meeting of the Board, make a declaration of solvency verified by an affidavit stating that they have made full enquiry into the affairs of the company and that having done so they have formed an opinion that the company has no debts or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration.

In *Shri Raja Mohan Manucha v. Lakshminath Saigal* (1963) 33 Comp. Cas. 719, it was held that where the declaration of solvency is not made in accordance with the law, the resolution for winding up and all subsequent proceedings will be null and void. Such a declaration must be made within five weeks immediately preceding the date of the passing of the resolution for winding up the company and be delivered to the Registrar for registration before that date. The declaration must be accompanied by a copy of auditor's report on the balance sheet and profit & loss account as at the latest practicable date before the making of the declaration and also embody a statement of the company's assets and liabilities as at that date. Any director making a declaration without having reasonable grounds for the aforesaid opinion, shall be punishable with imprisonment extending up to six months or with fine extending up to ₹ 50,000 or with both [Section 488].

A winding up in the case of which such a declaration has been made and delivered in accordance with Section 488 is referred to as "a member's voluntary winding up".

REVIEW QUESTIONS



Choose the Correct Answer:

Who appoints the liquidator in case of Members voluntary winding up?

- (a) The court
- (b) The creditors
- (c) The members
- (d) The registrar

Correct Answer: (c)

Creditors' Voluntary Winding Up

As discussed earlier, where a declaration of solvency of the company is not made and delivered to the Registrar in a voluntary winding up it is a case of creditor's voluntary winding up.

Distinction between Members' and Creditors' Voluntary Winding Up

The main differences between the two are as follows:

1. A member's voluntary winding up results where, before convening the general meeting of the company at which the resolution of winding up is to be passed, the majority of the directors file with the Registrar a statutory declaration of solvency. A creditors' voluntary winding up is one where no such declaration is filed.
2. In a member's voluntary winding up, the creditors do not participate directly in the control of the liquidation, as the company is deemed to be solvent; but in a creditors' voluntary winding up, the company is deemed to be insolvent and, therefore, the control of liquidation remains in the hands of the creditors.
3. There is no meeting of creditors in a members' voluntary winding up and the liquidator is appointed by the company; whereas in a creditors' voluntary winding up, meetings of creditors have to be called at the beginning and subsequently the liquidator is appointed by the creditors.
4. In a members' voluntary winding up the liquidator can exercise some of his powers with the sanction of a special resolution of the company; but in a creditors' voluntary winding up he can do so with the sanction of the Court or the Committee of Inspection or of a meeting of creditors.

REVIEW QUESTIONS



Multiple choice question:

Under what conditions a company may be wound up voluntarily?

- (a) The event, on the happening of which the Articles provide that the company is to be dissolved has occurred.
- (b) The company has made a default in filing with the Registrar its balance sheet.
- (c) The period fixed for the duration of the company as mentioned in its Articles has expired.
- (d) None of the above

Correct Answer: (a), (c)

Powers of the Court to Intervene in Voluntary Winding Up

In voluntary winding up it is left to the company, the contributors and the creditors to settle their affairs without intervention of the Court as far as possible. However, the Companies Act, 1956, contains certain provisions which provide a means of access to the Court with a view to speed up the liquidation proceedings and to overcome the difficulties that may arise in the course of liquidation. The Court will intervene in the voluntary winding up whenever it is satisfied that such an intervention will be just and beneficial. In appropriate cases the Court can be approached for compulsory winding up (Section 440) or winding up being conducted under the supervision of the Court (Section 522).

The Court is vested with the following powers in voluntary winding up:

- (i) To appoint the Official Liquidator or any other person as liquidator where no liquidator is acting [Section 515(1)].
- (ii) To remove the liquidator and appoint the Official Liquidator or any other person as liquidator on justifiable cause being shown [Section 515(2)].
- (iii) To determine the remunerations of liquidator when the Official Liquidator is appointed as a liquidator [Section 515(3)].
- (iv) To amend, vary, confirm or set aside the arrangement entered into between a company and its creditors on an appeal being made by any creditor or contributory within 3 weeks of the completion of the arrangement (Section 517).
- (v) On an application of the Liquidator or contributory or creditor:
 - (a) to determine any question arising in the winding up of a company [Section 518(1)(a)];
 - (b) to exercise, as respects the enforcing of calls, the staying of suits or other legal proceedings or any other matter, all or any of the powers which the Court might exercise if the company were being wound up by the Court [Section 518(1)(b)].
- (vi) To set aside any attachment, distress or execution started against the estate or effects of the company after the commencement of the winding up on such terms as it thinks fit on an application made by the liquidator, creditor or contributory if the Court is satisfied that it is just and beneficial to do so [Section 518(3) and (4)].
- (vii) To order public examination of any person connected with promotion or formation of a company or any officer connected with the affairs of the company in regard to matters of promotion or formation or conduct of the business of the company or as to his conduct or dealing as officer thereof. Such an examination can be ordered on a report of the liquidator where he is of the opinion that a fraud has been committed by the persons aforesaid in the formation or promotion of the company or in the conduct of its affairs [Section 519(1)].

COMMENCEMENT OF WINDING UP

Section 441 of the Companies Act provides for the provisions relevant to commencement of winding up. The winding up of a company by the Court is deemed to commence at the time of the presentation of the petition for winding up. But where, before the presentation of the petition a resolution has been passed by the company, for voluntary winding up, the winding up shall be deemed to have commenced at the time of the passing of the resolution. Any proceedings taken in voluntary winding up will be deemed to have been validly taken unless the Court directs otherwise on proof of fraud or mistake.

In all other cases, the winding up of a company must be deemed to have commenced at the time of the presentation of the petition for the winding up [Section 441]. Where an order is made by the Court on more than one petition the commencement of the winding up dates from the earliest petition. [See *Kent v. Freehold Land Co.*, (1868) 3 Ch. App. 493]. It may be noted here that voluntary winding up shall be deemed to commence at the time when resolution for voluntary winding up is passed (Section 486).

In *Rishabh Agro Industries Ltd. v. PNB Capital Services Ltd.* (2000) AIR SCW 1753, it was held that the words 'shall be deemed to have commenced' clearly show the intention of legislature that although the winding up of a company does not in fact commence at the time of presentation itself, but it shall be presumed to commence from that stage. The word 'deemed' used in Section 441 would thus mean 'suspended', 'considered', 'construed', 'thought', 'taken to be' or 'presumed'.

REVIEW QUESTIONS



Choose the correct answer:

Whose jurisdiction is it to wind up companies under Section 10 of the Companies Act, 1956?

- (a) Supreme Court
- (b) High Court
- (c) District Court
- (d) None of the above

Correct Answer: (b)

MODES OF WINDING UP UNDER COMPANIES ACT 2013

Under Companies Act 2013, the Company may be wound up in any of the following modes:

1. By National Company Law Tribunal (Tribunal);
2. Voluntary winding up:

WINDING UP BY THE TRIBUNAL

Let us study the following:

1. What are the grounds of winding up by tribunal?
2. Who can file winding up petition with the tribunal?
3. What are the powers of NCLT?
4. What are the procedural aspects involved in winding up by tribunal?

Grounds on which a Company may be wound up by the Tribunal

A company under Section 271(1) may be wound up by the tribunal if

- (a) if the company is unable to pay its debts;
- (b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (d) if the Tribunal has ordered the winding up of the company under Chapter XIX(i.e Revival and Rehabilitation of Sick Companies);
- (e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up

Inability to pay debts (Section 271(2))

A company shall be deemed to be unable to pay its debts,—

- (a) if a creditor, by assignment or otherwise, to whom the company is indebted for an amount exceeding one lakh rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty-one days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor;
- (b) if any execution or other process issued on a decree or order of any court or tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part; or
- (c) if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.

Special Resolution

Where the Company has, by Special Resolution, resolved that the company may be wound up by the Tribunal, it may present an application for winding up to the tribunal.

Just and Equitable

If the Tribunal is of opinion that it is just and equitable that the company should be wound up, it may be ordered to be wound up.

Who may file Petition for the Winding up?

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 272 by any of the following persons:

- (a) the company; or
- (b) any creditor or creditors, including any contingent or prospective creditor or creditors;
- (c) any contributory or contributories;
- (d) all or any of the parties specified above in clauses (a), (b), (c) together
- (e) the Registrar;
- (f) any person authorised by the Central Government in that behalf;
- (g) by the Central Government or State Government in case falling under clause (c) of Section 271(1) i.e. Company acting against the interest of the sovereignty and integrity of India.

Petition by the Company

The company may make a petition through its directors with the authority of a special resolution passed at a general meeting.

A petition by the Company for winding up before the tribunal will be admitted only if it is accompanied by the statement of affairs, prescribed in form 4 and shall state the facts upto the date which shall not be a date more than fifteen days prior to the date of making the statement. This statement shall be certified by a

chartered accountant. (Section 272(5) read with Rule 5 made under Chapter XX of the Companies Act 2013)

Every contributory or creditor of the company shall be entitled to be furnished, by the petitioner or his authorized representative, with a copy of a petition. The contributory may seek an electronic copy from the registry of tribunal on payment of prescribed fee. (Rule 5(4) of the rules made under Chapter XX of the Companies Act 2013.

Let us remember!!

The petition to be accompanied by the statement of affairs, stating the facts upto a date which not 15 days prior to making the statement.

Contributory and creditor are to be furnished with a copy of the petition.

Petition by Creditor

A creditor or creditors (including any contingent or prospective creditor) may make petition before the tribunal would make a winding up order on such petition if the creditor proves that the claims are undisputed debt.

Contingent or prospective Creditor

Section 272(6) states that before a petition for winding up of a company presented by a contingent or prospective creditor is admitted, the leave of the Tribunal shall be obtained for the admission of the petition and such leave shall not be granted, unless in the opinion of the Tribunal there is a *prima facie* case for the winding up of the company and until such security for costs has been given as the Tribunal thinks reasonable.

Rule 5(3) of Chapter XX states that a contingent or prospective creditor is one who is able to prove that he has a bonafide and *prima facie* case to establish his claim to the satisfaction of the Tribunal and his application shall be in accordance with sub-section (6) of section 272 to seek the leave of the Tribunal for the admission of the petition in Form No. 5. along with the fees as prescribed.

Creditor

The expression "creditors" includes the assignee of debt, a decree holder, a secured creditor, a debenture holder or the trustee for debenture holders. But a creditor whose debt is unliquidated cannot apply for winding up order. A contingent or prospective creditor can present petition on giving security for costs and showing that a *prima facie* case has arisen. A petition by a secured creditor for winding up may not be allowed by the Court where the security is ample and the petition is not supported by the other creditors.

In the case of State of Andra Pradesh V Hyderabad Vegetable Products Co Ltd (1962) 32 Comp. Cases 64(AP), the term creditor as occurring in Section 439(1) (b) of the 1956 Act(Presently section 272(1)(b))is not limited to one to whom a debt is due at the date of the petition and who can demand immediate payment. Every person having a pecuniary claim, whether actual or contingent is a creditor.

As per Section 272(2), a secured creditor, the holder of any debentures, whether or not any trustee or trustees have been appointed in respect of such and other like debentures, and the trustee for the holders of debentures shall be deemed to be creditors.

In *Gramercy Emerging Market Fund v. Essar Steels* (2002) 39 SCL 435 (Guj. HC). it was held that debentureholder can file application for winding up. However trustee is a necessary party if there is no direct covenant between the company and debentureholder, but the covenant is between company and trustee. This principle is not applicable where there is a direct covenant between company and debentureholder.

Moreover trustee can sue the company in its own right as a covenanting party.

Petition by Contributory

Who is a Contributory?

Section 2(26) defines “contributory” means a person liable to contribute towards the assets of the company in the event of its being wound up. For the purposes of this clause, it is hereby clarified that a person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory;

Section 273(2) states that a contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder.

Petition by Registrar

The Registrar shall be entitled to present a petition for winding up under sub- section (1) on any of the grounds specified in sub-section (1) of section 271, except on the grounds specified in clause (b), clause (d) or clause (g) of that sub-section.

Accordingly the registrar can present a petition on the following grounds.

1. if the company is unable to pay its debts;
2. if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
3. if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
4. if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years;

The Registrar shall not present a petition on the ground that the company is unable to pay its debts unless it appears to him either from the financial condition of the company as disclosed in its balance sheet or from the report of an inspector appointed under section 210 that the company is unable to pay its debts:

The Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition: The Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.

VOLUNTARY WINDING UP

Circumstances in which a company may be wound up voluntarily

As per Section 304(1), a company may be wound up voluntarily,—

- (a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved; or
- (b) if the company passes a special resolution that the company be wound up voluntarily.

PROVISIONS APPLICABLE TO EVERY MODE OF WINDING UP

The provisions applicable to every mode of winding up are comprehensively stated in Sections 324 to 365 of the Act and these apply to every mode of winding up whether it be a voluntary winding up and winding up by tribunal.

These sections broadly cover the following aspects:

- Application of insolvency rules in case of winding up of insolvent companies
- Overriding preferential payments
- Preferential payments
- Fraudulent preference and rights & liabilities of persons fraudulently preferred
- Effect of floating charge
- Disclaimer of onerous property
- Offences, penalties and liabilities of different persons including officers, directors of the company
- Appointment of official liquidator
- Summary procedure for liquidation
- Order for dissolution etc.

LESSON ROUND-UP

- Winding up of a Company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. An administrator called the liquidator is appointed and he takes control of the company, collects its assets, pays debts and finally distributes any surplus among the members in accordance with their rights. At the end of winding up, the company will have no assets or liabilities. When the affairs of a Company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of companies and its legal personality as a corporation comes to an end.
- Winding up is only a process while the dissolution puts an end to the existence of the company.
- There are three modes of winding up: winding up by Court (Tribunal) i.e. compulsory winding up, voluntary winding up and winding up subject to supervision of the Court.
- Section 433 lays down the grounds on which a company may be wound up, in compulsory winding up.
- Section 439 specifies the persons by whom a petition for winding up of a company may be presented to the Court (tribunal) in compulsory winding up.
- When a company is wound up by the members or the creditors without the intervention of Court (tribunal), it is called as voluntary winding up, though it involves directions of the court.
- Section 484 specifies the circumstances in which a company may be wound up voluntarily. Section 488 divides voluntary winding up into two kinds i.e. Member's voluntary winding up and creditor's voluntary winding up.

- Under Companies Act 2013, the Company may be wound up in any of the following modes:
 - (a) By National Company Law Tribunal(Tribunal);
 - (b) Voluntary winding up:
- A company under Section 271(1) may be wound up by the tribunal if
 - (a) if the company is unable to pay its debts;
 - (b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
 - (c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
 - (d) if the Tribunal has ordered the winding up of the company under Chapter XIX(I.e Revival and Rehabilitation of Sick Companies);
 - (e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
 - (f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
 - (g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up
- As per Section 304(1), a company may be wound up voluntarily,—
 - (a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved;

or

 - (b) if the company passes a special resolution that the company be wound up voluntarily.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What are the various modes of winding up?
2. What is compulsory winding up? Who are entitled to make a petition to the Court ?
3. Distinguish between winding up and dissolution.
4. Distinguish between Members' and Creditors' voluntary winding up.
5. What are the different modes of winding up provided under Companies Act 2013?
6. What are the circumstances under which a company may be wound up by National Company Law Tribunal?
7. What are the circumstances under which a Company may be wound up voluntarily?

Lesson 33

Striking off Name of Companies

LESSON OUTLINE

- Meaning of 'striking off'.
- Procedure for striking off a company.
- Striking-off by Registrar of his own motion
- Striking-off on company's application
- Ministry of Corporate Affairs (MCA) Circulars.
- Rights of person aggrieved by company having been struck off the register.
- Restoration of names strike off
- Effect of restoration order.
- Mode of sending letter/ notice
- Who can apply for restoration of name.

LEARNING OBJECTIVES

Name is the identity of a company. The name of company is being decided according to the Name Availability Guidelines issued by the Ministry of Corporate Affairs.

Section 560 of the Companies Act, 1956 prescribes the procedure for striking off the name of defunct companies which are not carrying on any business, from the register of companies maintained by the Registrar. This is an alternative to winding up of a company subject to statutory criterion specified under the section. The powers under this section regarding restoration of names which are already struck off shall be transferred to the tribunal to be exercised by it in place of the court w.e.f. a date yet to be notified for enforcement of companies (second amendment) Act, 2002. The Ministry of Corporate Affairs provides for Fast Track Exit mechanism and has issued a circular in this regard in 2011. **The provisions of Companies Act, 2013 relating to striking off is yet to be notified. The provisions relating to dormant companies which is already notified are dealt in this chapter. The Companies Act, 1956 will continue to apply for striking off names.**

After reading this lesson you will be able to understand the regulatory provisions with regard to striking off names by registrar, procedural aspects involved in striking of names/restoration, etc.

1. MEANING OF 'STRIKING OFF'

A company comes into existence by registration in the office of the Registrar of Companies. Section 34(1) of the Companies Act, 1956 provides that on the registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company, that the company is limited.

On registration of a company, the Registrar issues a certificate called Certificate of Incorporation, which certifies that the company is incorporated. The validity of the incorporation cannot be challenged thereafter.

According to Section 34(2) of the Companies Act, 1956 from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act.

Regulation 21 of the Companies Regulations, 1956 provides that in the office of each Registrar, there shall be maintained a "Register of Companies" in form III in which the names of the companies shall be entered in the order in which they are registered. Every company so registered shall be assigned a number in one consecutive series. (Corporate Identity Number)

A company registered under the Act cannot be removed from the Register of companies maintained by the Registrar nor can the Certificate of Incorporation be cancelled unless the company is dissolved by the process of law, either as a result of its winding-up or its amalgamation with another company. However, the Companies Act provides a short-cut to the dissolution, namely striking it off the Register of Companies by the Registrar of Companies under Section 560, in case the company is a defunct company. Section 560 of the Act contains provisions for striking defunct companies off the register, which is an alternative to winding-up of a company. It is a mode of dissolution of a company without winding up, the only statutory criterion being that there should be a reasonable cause to believe that the company is not carrying on business or is not in operation. Section 560 of the Act prescribes the procedure which Registrar is required to follow in striking off any company.

'Striking-off' implies removal. The expression "defunct company" for the purposes of Section 560, means a company which is no longer in effect or use; not operating or functioning; not carrying on any business or is not in operation.

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, the Registrar can, on his own, exercise the power conferred upon him by Section 560 and remove the company from his Register of Companies by following the procedure laid down in that section.

Despite the striking-off, the liability, if any, of every director, manager or other officer who was exercising any power of management, and of every member of the company, shall continue and may be enforced as if the company had not been dissolved.

2. WHEN A COMPANY IS STILL IN OPERATION

A company which is in the course of being wound-up voluntarily is still in operation within the meaning of the section [Langlagate Proprietary Co. (1912) 28 TLR 529]. A company, although not carrying on business, may

be in operation. [*Central India Mining Co. v. Society Coloniale* (1920) 1 KB 753] A company if it is operating as a company for doing something in relation to its past obligations or to avoid future pecuniary liability, it will be deemed to be in operation.

3. PROCEDURE FOR STRIKING OFF A COMPANY

The striking off a company may be effected by following two ways:

(A) Striking-off by Registrar of his own motion

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation. If the Registrar does not receive any answer to the letter sent by him within one month, he shall send a second letter, within 14 days after the expiry of the month, to the company referring the first one and stating that no answer has been received to the first letter and if an answer to the second letter is not received within one month from the date thereof, a notice for striking off the name of the company will be published in the Official Gazette.

If the Registrar received an answer within one month (after sending the second letter) from the company to the effect that it is not carrying on business or not in operation or if the Company does not reciprocate to the second letter, the registrar send a notice to the company by registered post and also publish such notice in the Official Gazette stating that the after expiration of three month from the date of notice the name of the company will be struck off the register and the company will be dissolved.

After the expiry of time mentioned in the notice the registrar may, unless cause to the contrary is previously shown by the company, strike its name off the register and shall publish notice thereof in the Official Gazette and on the publication of this notice in the Official Gazette the Company shall stand dissolved.

(B) Striking-off on company's application

The Registrar can exercise the power conferred on him by Section 560, when an application is received by him from the company for striking it off on the ground that it is a defunct company, i.e. it is not carrying on business or in operation. After the receipt of application from the Company, the Registrar may proceed to strike its name off the register, and shall publish notice thereof in the Official Gazette.

In a recent case, the name of a company was struck off the Register of Companies, upon its failure to file necessary annual accounts, returns and other documents with the Registrar of Companies, after due compliance with the procedure prescribed under section 560 of the Companies Act, 1956. In a petition under section 560 of the Act, the company sought restoration of its name in the register of companies.

It was contended, inter alia, that the firm of chartered accountants engaged by it to perform the task of filing the returns with the office of the Registrar of Companies had failed to do so. No objection certificates of the directors as well of the shareholders for restoration of the name of the company in the register were also placed on record.

The court held that the company was a running concern and had filed the petition within the limitation period. The petition was to be allowed and the name of the company, its director and member was to be restored to the register of companies as if it had not been struck off.

In the case of *Sitaram Singh Construction P. Ltd. v. Union of India* [2010] 156 Comp Cas 127 (Pat), the issue was whether the Registrar can strike off a company without publishing a gazetted notification in this regard?

In this case, the Registrar of Companies had neither published the notice in the Official Gazette nor sent the

notice to the company by registered post as required under section 560(3) of the Companies Act, 1956. On the other hand, the company was continuously carrying on business.

It was held that although, there was a serious omission on the part of the company in not filing its annual returns, the mandatory requirement under section 560(3) of the Act was not complied with by the Registrar. Therefore, the notice issued under section 560(5) of the Act was to be quashed and the name of the company was to be restored.

4. FAST TRACK EXIT (FTE) MODE BY MINISTRY OF CORPORATE AFFAIRS

Striking off the name of the companies

There are a number of companies, which are registered under the Companies Act, 1956, but due to various reasons they are inoperative since incorporation or commenced business but became inoperative or defunct later on. Such companies may be desirous of getting their names strike off from the Register of Companies maintained by Registrar of Companies.

As per section 560 of the Companies Act, 1956, Registrar of Companies may strike off the name of companies on satisfying the conditions therein. As per present practice, a company desirous of getting its name struck off, has to apply to Registrar of companies in e-form 61. All pending statutory returns are required to be filed along with e-form 61.

In order to give an opportunity for fast track exit by a defunct company, for getting its name struck off from the register of companies, the Ministry of Corporate Affairs has decided to modify the existing route through e-form – 61 and has prescribed the new Guidelines on June 07, 2011.

MCA guidelines 2011 on East Exit Scheme

The salient features of the same in addition to routine procedural matters, are as under:

For Fast Track Exit mode (FTE), it is stated as under:-

- (a) Any company will be called as “defunct company” for the purpose of these guidelines, which has nil asset and liability and
 - (i) has not commenced any business activity or operation since incorporation; or
 - (ii) is not carrying over any business activity or operation for last one year before making application under FTE.
- (b) Any defunct company which has active status or identified as dormant by the Ministry of Corporate Affairs, may apply for getting its name strike off from the Register of Companies;
- (c) Any defunct company which is a Government Company shall submit ‘No Objection Certificate’ issued by the concerned Administrative Ministry or Department or State Government along with the application;
- (d) the decision of the Registrar of Companies in respect of striking off the name of company shall be final.
- (e) The fast track exit mode is not being extended to the following companies namely:-
 - (i) listed companies;
 - (ii) companies that have been de-listed due to non-compliance of Listing Agreement or any other statutory Laws,

- (iii) companies registered under section 25 of the Companies Act, 1956;
- (iv) vanishing companies;
- (v) companies where inspection or investigation is ordered and being carried out or yet to be taken up or where completed prosecutions arising out of such inspection or investigation are pending in the court;
- (vi) companies where order under section 234 of the Companies Act, 1956 has been issued by the Registrar and reply thereto is pending or where prosecution if any, is pending in the court;
- (vii) companies against which prosecution for a non-compoundable offence is pending in court;
- (viii) companies accepted public deposits which are either outstanding or the company is in default in repayment of the same;
- (ix) company having secured loan ;
- (x) company having management dispute;
- (xi) company in respect of which filing of documents have been stayed by court or Company Law Board (CLB) or Central Government or any other competent authority;
- (xii) company having dues towards income tax or sales tax or central excise or banks and financial institutions or any other Central Government or State Government Departments or authorities or any local authorities.

The company shall disclose pending litigations if any, involving the company while applying under FTE;

The Form FTE shall be accompanied by an affidavit, which should be sworn by each of the existing director(s) of the company before a First Class Judicial Magistrate or Executive Magistrate or Oath Commissioner or Notary, to the effect that the company has not carried on any business since incorporation or that the company did some business for a period up to a date (which should be specified) and then discontinued its operations, as the case may be;

Form FTE shall further be accompanied by an Indemnity Bond, duly notarized, to be given by every director individually or collectively, to the effect that any losses, claim and liabilities on the company, will be met in full by every director individually or collectively, even after the name of the company is struck off the register of Companies;

The Company shall also file a Statement of Account annexed to FTE, prepared as on date not prior to more than one month preceding the date of filing of application in Form FTE, duly certified by a statutory auditor or Chartered Accountant in whole time practice, as the case may be.

5. RESTORATION OF THE COMPANIES UNDER SECTION 560(6) OF THE COMPANIES ACT 1956

As per Section 560 if a company, or any member or creditor thereof, feels aggrieved by the company having been struck off the register, the Tribunal(ie court at present), on an application made by the company, member or creditor before the expiry of twenty years from the publication in the Official Gazette of the notice aforesaid, may, if satisfied that the company was, at the time of the striking off, carrying on business or in operation or otherwise that it is just that the company be restored to the register, order the name of the company to be restored to the register; and the court may, by the order, give such directions and make such provisions as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

Accordingly, restoration of name by Registrar of Companies is governed by Companies (Court) Rules, 1959.

Rule 11 of Companies (Courts) Rules 1959 requires the member or creditor to file a petition under Section 560(6)

Rule 92: *Notice to Registrar of Companies* - A petition under section 560(6) to restore the name of a company to the Register of Companies shall be served on the Registrar of Companies and on such other persons as the Court may direct, not less than 14 days before the date fixed for the hearing of the petition.

Rule 93: *Delivery of order and advertisement thereof* - Where the Court makes an order restoring the name of a company to the Registrar of Companies, the order shall direct that the petitioner to deliver to the Registrar of Companies a certified copy thereof within 14 days from the date of the order, and that on such delivery, the Registrar of Companies do, in his official name, advertise the order in the Gazette of the State or Union Territory concerned.

6. THE RIGHTS OF PERSON AGGRIEVED BY THE COMPANY HAVING BEEN STRUCK OFF THE REGISTER [SECTION 560(6)]

The company having been struck off the register or any member or creditor of such company, if feels aggrieved by the company having been struck off may make an application to the Court, for the restoration of the company to the register. Such an application must be made before the expiry of 20 years from the publication in the official gazette of the notice of striking-off.

The Court may order the name of the company to be restored to the register, if it is satisfied that-

- the company was, at the time of the striking off, carrying on business or in operation; or
- Otherwise that it is just that the company be restored to the register.

One of the reasons for exercising the Court's direction in favour of restoring a company must be that after restoration the company will be in a position to carry on the business of the company. Court would not exercise discretion when there is no evidence of substantial benefit to member or creditors.

In such a case the court may, by the order, give such directions and make such provision as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

The company must file electronically with the Registrar a certified true copy of the order passed by the Court, along with e-form No. 21. Upon a certified copy of the order under sub-section (6) being delivered to the Registrar for registration, the company shall be deemed to have continued in existence as if its name had not been struck off.

REVIEW QUESTIONS



Choose the correct answer:

Within _____ from publication of notice of striking off in official gazette, an application be made by the company/member/creditor to the court for restriction.

- (a) 5 years
- (b) 10 years
- (c) 15 years
- (d) 20 years

Correct Answer: (d)

7. EFFECT OF RESTORATION ORDER

Where the Court orders for restoration of name of company, the effect of an order is to place the company whose name was struck off by the Registrar in the same position as if the name of the company had never

been struck off during the interregnum. If a court of competent jurisdiction directs restoration of the name of the company, it shall be deemed to have continued throughout.

The effect of the provision in Section 560(7) that the company shall be “deemed to have continued in existence as if its name had not been struck off” was not only that the corporate existence of the company was preserved, but was also retrospective, so that at the date of the hearing of the application the company was to be regarded as never having been dissolved. Another consequence was that the rights of all parties would be as though there had been no cessation or interruption in the existence of the company on account of the striking off and subsequent restoration.

Company Law Board has no power to restore the company in terms of Section 560(6), as the powers under that section were vested in the High Court.

8. MODE OF SENDING LETTER/NOTICE

A letter or notice to be sent under this section to a company may be addressed by the Registrar in any of the modes mentioned below:

- (a) to the company at its registered office; or
- (b) if no office has been registered, to the care of some director, manager or other officer of the company; or
- (c) if there is no director, manager or officer of the company whose name and address are known to the Registrar, to each of the persons who subscribed the memorandum, addressed to him at the address mentioned in the memorandum.

9. WHO CAN APPLY FOR RESTORATION OF NAME?

An application for restoration can only be made by the company, member or creditor. It must be shown that at the date when the company was dissolved the petitioner was a member or creditor thereof, and anyone, whether in ignorance of the dissolution or not, who purported to become a member or creditor afterwards, was not so qualified. One who acquires shares or a debt of a company whose name has been struck off the register, and who at the time of acquisition has knowledge of that fact, is not a ‘person aggrieved’ within this sub-section.

A third party unless he is a creditor has no locus standi to apply. The expressions “member” or “creditor” used in sub-section (6) of Section 560 includes the personal representatives of a deceased member or creditor.

When a suit is actually pending against a company and is being contested by it at the time of removal of its name from the register, it is proper to direct the restoration of the name of the company, particularly when the directors were aware of the fact of the contested litigation and were actually taking part in it.

The Registrar is not bound to remove a company from the register, even though an application be made for the purpose where the object of the application to the Registrar under this section is to avoid liability on a suit pending against the company, the application must be rejected.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

A third party has a locus standi to apply for restoration of the company.

- True
- False

Correct Answer: False

A third party, unless a creditor, has no locus standi to apply.

PROVISIONS OF COMPANIES ACT 2013 RELATING TO DORMANT COMPANIES

MEANING OF DORMANT COMPANY

Section 455(1) of the Act defines that when a company is formed and registered under this act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed in form no. MSC. 1

- (i) **Meaning of inactive company** - Explanation of the section 455 provides that the "inactive Company" means a company which has not been carrying on any business or operation , or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years
- (ii) Significant Accounting Transaction -means any transaction other than
 - (a) payment of fees by a company to the Registrar;
 - (b) payment made by it to fulfill the requirements of this Act or any other law;
 - (c) allotment of shares to fulfil the requirements of this Act; and
 - (d) payments for maintenance of its office and records

Rule 3 of Companies(Miscellaneous)Rules 2014

Application for obtaining status of dormant company.- For the purposes of sub-section (1) of section 455, a company may make an application in Form MSC-1 along with such fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 to the Registrar for obtaining the status of a Dormant Company in accordance with the provisions of section 455 after passing a special resolution to this effect in the general meeting of the company or after issuing a notice to all the shareholders of the company for this purpose and obtaining consent of at least 3/4th shareholders (in value):

Provided that a company shall be eligible to apply under this rule only, if-

- (i) no inspection, inquiry or investigation has been ordered or taken up or carried out against the company;
- (ii) no prosecution has been initiated and pending against the company under any law;
- (iii) the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon;
- (iv) the company is not having any outstanding loan, whether secured or unsecured:

Provided that if there is any outstanding unsecured loan, the company may apply under this rule after obtaining concurrence of the lender and enclosing the same with Form MSC-1 ;

- (v) there is no dispute in the management or ownership of the company and a certificate in this regard is enclosed with Form MSC-1;
- (vi) the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities etc.;
- (vii) the company has not defaulted in the payment of workmen's dues;
- (viii) the securities of the company are not listed on any stock exchange

within or outside India.

POWER AND ROLE OF THE REGISTRAR IN CASE OF DORMANT COMPANY

Section 455(2) provides that the Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect.

455(3) provides that the Registrar shall maintain a register of dormant companies in such form as may be prescribed in Rule 5 under Companies (Miscellaneous) Rules, 2014.

455(4) provides that in case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

Rule 4 of Companies(Miscellaneous)Rules 2014

Certificate of status of dormant company.-

The Registrar shall, after considering the application filed in Form MSC-1, issue a certificate in Form MSC-2 allowing the status of a Dormant Company to the applicant.

MINIMUM NO. OF DIRECTORS IN DORMANT COMPANY

455(5) Provides that a dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed in Rule 6 & 9 under Companies (Miscellaneous) Rules, 2014 to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and requisite fee as may be prescribed.

455(6) provides that the Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.

NOTED THAT!!!!

Rule 6 of Companies (Miscellaneous) Rules,2014 provides that the minimum number of directors –

Public company – 3 directors

Private company – 2 directors

OPC- 1 directors

Rule 9 (c) & Rule 3 provides that fees payable under 455 shall be provided in the Companies(Registration Offices & Fees) Rules, 2014.

Rule 5 of Companies(Miscellaneous)Rules 2014

Register of dormant companies.- The Register maintained under the portal maintained by the Ministry of Corporate Affairs on its web-site www.mca.gov.in or any other website notified by the Central Government, shall be the register for dormant companies.

Rule 7 of Companies(Miscellaneous)Rules 2014

Return of dormant companies.- A dormant company shall file a "Return of Dormant Company" annually, inter-alia, indicating financial position duly audited by a chartered accountant in practice in Form MSC- 3 along with such annual fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within a period of thirty days from the end of each financial year:

Provided that the company shall continue to file the return or returns of allotment and change in directors in

the manner and within the time specified in the Act, whenever the company allots any security to any person or there is any change in the directors of the company.

Rule 8 of Companies(Miscellaneous)Rules 2014

Application for seeking status of an active company.- (1) An application, under sub-section (5) of section 455, for obtaining the status of an active company shall be made in Form MSC-4 along with fees as provided in the Companies (Registration Offices and Fees) Rules, 2014 and shall be accompanied by a return in Form MSC-3 in respect of the financial year in which the application for obtaining the status of an active company is being filed:

Provided that the Registrar shall initiate the process of striking off the name of the company if the company remains as a dormant company for a period of consecutive five years.

(2) The Registrar shall, after considering the application filed under subrule (1), issue a certificate in Form MSC-5 allowing the status of an active company to the applicant.

(3) Where a dormant company does or omits to do any act mentioned in the Grounds of application in Form MSC-1 submitted to Registrar for obtaining the status of dormant company, affecting its status of dormant company, the directors shall within seven days from such event, file an application, under sub-rule (1) of this rule, for obtaining the status of an active company.

(4) Where the Registrar has reasonable cause to believe that any company registered as 'dormant company' under his jurisdiction has been functioning in any manner, directly or indirectly, he may initiate the proceedings for enquiry under section 206 of the Act and if, after giving a reasonable opportunity of being heard to the company in this regard, it is found that the company has actually been functioning, the Registrar may remove the name of such company from register of dormant companies and treat it as an active company.

PROVISIONS OF COMPANIES ACT 2013 RELATING TO STRIKING OFF NAMES(YET TO BE NOTIFIED)

POWER OF REGISTRAR TO REMOVE THE NAMES

Section 248(1) of the Act provides that when the registrar has reason to believe that:-

- (a) a company has failed to commence its business within one year of its incorporation;
- (b) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay within a period of one hundred and eighty days from the date of incorporation of a company and a declaration under section 11(1) [declaration filed by the director] to this effect has not been filed within one hundred and eighty days of its incorporation; or
- (c) a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455.

OTHER GROUNDS WHEN THE REGISTRAR CAN REMOVE THE NAMES OF THE COMPANIES FROM THE REGISTER OF COMPANY

According to section 4(5) of Chapter II states that when after reservation of the company's name it is found that the name applied by furnishing wrong or incorrect information, ;-

In case where company is incorporated, the Registrar may, after giving the company an opportunity of being heard, can take action for striking off the name of the company from the register of companies.

Section 7(7) provides that where a company has been incorporated by furnishing any false or incorrect information , the Tribunal may pass such orders as it thinks fit including removal of name from register or making the liability of the members as unlimited or pass an order for the winding up of the company.

Section 11(3) provides that when no declaration has been filled by the director for obtaining the commencement certificate with the registrar within a period of 180 days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on business or operations, he may remove the name of the company from the register of companies.

LET US REMEMBER!!!

Registrar can remove the name of the company if:-

The company not commence business within 1 year from the date of incorporation; or

The subscriber to the memorandum didn't pay the subscription amount within 180 days from the date of incorporation; or

The company is not carrying business for a period of 2 years immediately preceding the financial year.

COMPANIES WHICH CAN'T BE REMOVED BY REGISTRAR

Draft rules made under chapter XVIII provides that the following companies, are not eligible for taking action by the Registrar:-

- (i) Listed companies;
- (ii) Companies that have been delisted due to non-compliance of listing agreement or any other statutory laws;
- (iii) Vanishing companies;
- (iv) Companies where inspection or investigation is ordered and being carried out or to be taken up or where completed prosecutions arising out of such inspection or investigation or pending in the Court;
- (v) Companies where notice under section 206(Power to call for information, inspect books and conduct inquiries) has been issued by the Registrar and reply thereto is pending or where prosecution if any, is pending with court;
- (vi) Companies against which prosecution for non- compoundable offence is pending in Court;
- (vii) Companies accepted Public Deposits which are either outstanding or the company is in default in repayment of the same;
- (viii) Company having secured loan.

VANISHING COMPANY-“Vanishing company” means a company, registered under the Companies Act and listed with Stock Exchange which, has failed to file its returns with Registered of Companies and Stock Exchange for a consecutive period of two years, and is not maintaining its registered office at the address notified with the Registrar of Companies or Stock Exchange and none of its Directors are traceable.

CIRCUMSTANCES WHERE COMPANY APPLY FOR THE REMOVAL OF NAME

Section 248(2) provides that without contravening the provisions of section 248 (1), a company may, after

extinguishing all its liabilities, by a special resolution or consent of seventy-five per cent. members in terms of paid-up share capital, file an application in the prescribed manner to the Registrar for removing the name of the company from the register of companies on all or any of the grounds specified in section 248 (1) and the Registrar shall, on receipt of such application, cause a public notice to be issued in the prescribed manner.

Provided that in the case of a company regulated under a special Act, approval of the regulatory body constituted or established under that Act shall also be obtained and enclosed with the application.

NOTED THAT

Section 248(1) & (2) doesn't applies on Section 8 companies.[section 248(3)]

*Section 8 companies means an Association not for profit

LET US REMEMBER!!!!

A company can only apply for removal of name if it extinguishing its all liabilities by way of

Passing special resolution; or

By consent of 75% members in terms of paid up share capital.

ELIGIBILITY CRITERIA FOR THE COMPANY FOR MAKING AAPLICATION

Section 249(1) provides that an application under section 248 (2) on behalf of a company shall not be made if, at any time in the previous three months, the company—

- (a) has changed its name or shifted its registered office from one State to another
- (b) has made a disposal for value of property or rights held by it, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal or gain in the normal course of trading or otherwise carrying on of business;
- (c) has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application under that section, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;
- (d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or
- (e) is being wound up under Chapter XX, whether voluntarily or by the Tribunal.

NOTED THAT:-

Draft Rules under chapter XVIII explains that a company may file the application with the registrar in Form No. 18.2 along with the prescribed fee for removing its name from the register of companies on all ground(s) specified in section 248(1).

FRAUDULENT APPLICATION FOR REMOVAL OF NAME

Section 251(1) provides that:-

(1)when it is found that an application by a company under section 248(2) has been made with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the persons in charge of the management of the company shall, notwithstanding that the company

has been notified as dissolved—

- (a) be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and
 - (b) be punishable for fraud in the manner as provided in section 447(Punishment for Fraud).
- (2) Without prejudice to the provisions contained in sub-section (1), the Registrar may also recommend prosecution of the persons responsible for the filing of an application under section 248(2).

PUBLIC NOTICE OF REMOVAL OF NAME BY REGISTRAR

Under proviso of section 248(1) explains that registrar shall send a notice to the company and all the directors of the company, of his intention to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents, if any, within a period of thirty days from the date of the notice. In Form No. 18.1 as prescribed in Draft rules made under chapter XVIII.

MANNER OF PUBLICATION OF PUBLIC NOTICE

Section 248(4) provides that a notice issued under section 248(1) & (2) shall be published In the prescribed manner and also in the Official Gazette for the information of the general public.

Draft Rules of Chapter XVIII prescribes the following manner of publishing the public notice in the official gazette:-

- (i) The notice must be published at least once in English language in a leading English newspaper and at least once in vernacular language in a leading vernacular newspaper having wide circulation in the state in which the registered office of the company is situated within seven days of the issue of notice under section 248(1) or receipt of completed in Form no. 18.2 under section 248(2), as the case may be.
- (ii) The public notice must be a consolidated notice including therein the names of all the companies to whom notices are issued.
- (iii) It must be placed on the official website of the Ministry on a separate link established on such website in this regard and on the company's website.
- (iv) The registrar of companies shall within fifteen days intimate the concerned regulatory authorities regulating the company, if any, Income tax authorities, Central excise authorities and service tax authorities having jurisdiction over the company ,the chief secretary of the state where the registered office of the company situated, about the issue of such notice under section 284(1) & (2) by way of a letter of intimation along with such notice for comments/objections, if any, within thirty days from the date of issue receipt of such Letter of Intimation.

Names of companies to which the order under Section 248 is made, to be placed on the website of the ministry.

Under draft rules made under chapter XVIII provides that Registrar of Companies shall put names of the companies to whom Notice has been issued under section 248(1) & (2) on the ministry's web-site.

- (i) The Registrar of Companies shall maintain and place on its website, the list of Companies to whom the notice under section 248(1) has been issued and from whom notice under section 248(2) have been received.
- (ii) The Registrar of Companies shall update the list prescribed under this rule on the official website of the Ministry on a weekly basis.

Publication of notice in the official gazette on striking off the name of the company

Section 248(5) provides that at the expiry of the mentioned in the notice, the registrar may, unless cause to the contrary is shown by the company, strike off its name from the register of companies, shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the company shall stand dissolved.

Liabilities to continue after dissolution.

Section 248(7) provides that the liability, if any, of every director, manager or other officer who was exercising any power of management, and of every member of the company dissolved under section 248(5), shall continue and may be enforced as if the company had not been dissolved.

EFFECT OF A COMPANY NOTIFIED AS DISSOLVED

Section 250 of the Act provides that when a company stands dissolved under section 248, it shall on and from the date mentioned in the notice under section 248(5) cease to operate as a company and the Certificate of Incorporation issued to it shall be deemed to have been cancelled from such date except for the purpose of realising the amount due to the company and for the payment or discharge of the liabilities or obligations of the company.

Obligations of company with respect to discharge of liabilities and the necessary undertakings in this regard

Section 248(6) provides that the Registrar, before passing an order under section 248(5), shall satisfy himself that sufficient provision has been made for the realisation of all amount due to the company and for the payment or discharge of its liabilities and obligations by the company within a reasonable time and, if necessary, obtain necessary undertakings from the managing director, director or other persons in charge of the management of the company.

Proviso to Section 248(6) states that, without contravening the undertakings referred to in this sub-section, the assets of the company shall be made available for the payment or discharge of all its liabilities and obligations even after the date of the order removing the name of the company from the register of companies.

Power of National Company Law Tribunal(Tribunal) to wind up a company

Section 248(8) provides that nothing in this section shall affect the power of the Tribunal to wind up a company the name of which has been struck off from the register of companies.

APPEAL TO TRIBUNAL

Section 252(1) provides that any person aggrieved by an order of the Registrar, notifying a company as dissolved under section 248, may file an appeal to the Tribunal within a period of three years from the date of the order of the Registrar and if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies.

OPPORTUNITY TO BEING HEARD

First proviso to section 252 provides that before passing any order under this section, the Tribunal shall give a reasonable opportunity of making representations and of being heard to the Registrar, the company and all the persons concerned.

RESTORATION OF NAMES IF STRUCK OFF INADVERTENTLY

Second proviso to section 252 provides that if the Registrar is satisfied, that the name of the company has been struck off from the register of companies either inadvertently or on the basis of incorrect information furnished by the company or its directors, which requires restoration in the register of companies, he may within a period of three years from the date of passing of the order dissolving the company under section 248, file an application before the Tribunal seeking restoration of name of such company.

ORDER OF TRIBUNAL SHALL BE FILED WITH THE REGISTRAR

Section 252(2) prescribes that a copy of the order passed by the Tribunal shall be filed by the company with the Registrar within 30 days from the date of the order and on receipt of the order, the Registrar shall cause the name of the company to be restored in the register of companies and shall issue a fresh certificate of incorporation.

Application to Tribunal for restoration by Member, Creditor or workmen as the case may be

Section 252(3) provides that if a company, or any member or creditor or workman thereof feels aggrieved by the company having its name struck off from the register of companies, the Tribunal on an application made by the company, member, creditor or workman before the expiry of twenty years from the publication in the Official Gazette of the notice under sub-section (5) of section 248 may, if satisfied that the company was, at the time of its name being struck off, carrying on business or in operation or otherwise it is just that the name of the company be restored to the register of companies, order the name of the company to be restored to the register of companies, and the Tribunal may, by the order, give such other directions and make such provisions as deemed just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off from the register of companies.

LESSON ROUND-UP

- A company which is not carrying on any business or in operation, is a defunct company and may be struck off from the register of companies under Section 560 of Companies Act, 1956.
- A Company or a member or a creditor may make an application to the court for restoration of the name of the company to the register, if they feel aggrieved by such decision of striking off.
- The effect of order of the court for restoration of the name of company is to place the company in same position as if its name had never been struck off.
- The Registrar may on its own motion proceed to strike off a company, if it has reasonable cause to believe that a company is not carrying on business.
- The Registrar can exercise the power to strike off on receiving an application from the Company for striking it off on the ground that it is a defunct company i.e. it is not carrying on business or in operation under Section 560 of the Companies Act, 1956.

SELF-TEST QUESTIONS

1. What do you mean by 'striking off'? Who can apply for striking off name of Company under Section 560?
2. "Striking off name of company under Section 560 is an alternative to winding up of a company subject to a statutory criterion specified under the section." Explain the statutory criterion.

Lesson 34

An Introduction to E-Governance and XBRL

LESSON OUTLINE

- Introduction
- Organisation of ROC offices under MCA-21
- Important features of e-filing of documents
- Other features of e-filing of documents
- Categories of e-forms
- Terms used while e-filing the e-forms
- Key benefits of MCA 21 Project
- General structure of an e-form and e-filing process.
- XBRL
- Benefits of XBRL

LEARNING OBJECTIVES

The era of technology have significantly impacted the world at large. The technological advancement leads to the revolutionary changes in every part of life. The functions under the gamut of companies have also impacted. The advancement in the technology is not static; it is developing day by day.

The concept of physical filing has given way to electronic filing. Now, the filing of forms with the Registrar of Companies is done in electronic manner with the help of internet and computer through MCA portal.

In Company Law, the e-filing was the outcome of this technology. It helps the companies to submit the returns, forms and other information in electronic mode. The data captured by electronic mode being easier to use and it helps the regulators to take steps immediately.

But, the information received through e-filing is not very useful to the regulator and investors due to its uneasiness to read. The development of XBRL is the milestone in the usability of the information. The XBRL is the language which can be used to use the information readable. After reading this lesson you will be able to understand the e-governance, e-filing of forms and XBRL.

"Developing and implementing IT governance design effectiveness and efficiency can be a multidirectional, interactive, iterative, and adaptive process."

– Robert E Davis

1. INTRODUCTION

MCA-21 stands for e-governance initiative of Ministry of Corporate Affairs (MCA) of the 21st Century. The project is named MCA-21 as it aims at repositioning MCA as an organization capable of fulfilling the aspirations of its stakeholders in the 21st Century. It is based on the Government's vision of National e-governance in the country. E-governance or Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. This project of MCA aims at moving from paper based to nearly paperless environment.

The scope of MCA-21 project covers only the offices of ROCs, Regional Directors, and the Headquarters at New Delhi at present. It does not include other offices of MCA like Official Liquidators, Company Law Board/Tribunal and Courts.

An e-form* is only a re-engineered conventional form notified and represents a document in electronic format for filing with MCA authorities through the Internet. This may be either a form filed for compliance or information purpose or an application seeking approval from the MCA.*

2. ORGANISATION OF ROC OFFICES UNDER MCA-21

The major components involved in this comprehensive e-governance project are front office and back office.

Front Office

The Front Office represents the interface of the corporate and public user with the MCA21 system. This comprises of Virtual Front Office and Physical Front Office.

(i) Virtual front office

Virtual front office is one of the various channels available to stakeholders (companies and the professionals) to enable them to do the statutory filing with ROC Offices across the country. Virtual Front Office facilitates online filing of the e-Forms using Internet. It merely represents a computer facility for filing of digitally signed eForms by accessing the MyMCA portal through Internet. It also pre-supposes availability of related facilities to convert documents into PDF format and scanning of documents wherever required. When a company or user does not have these computer facilities, it can avail of these facilities at the designated facilitation centers, known as the Physical Front Offices.

(ii) Physical Front Office (PFO)

To facilitate the change over from Physical Document Filing to Digital Document Filing, the Ministry of Corporate Affairs had established 53 Physical Front Offices known as facilitation centers for a initial period of three years. As on date only 4 facilitation centers are operational in the four metro cities i.e. Delhi, Mumbai, Kolkata and Chennai. PFOs have all facilities which will be required for online filing of e-forms including trained manpower, broadband connectivity, scanner, printer and related computer accessories. All the services for scanning and uploading of eForms are available free of cost at these Physical Front Offices.

* The e-forms are being constantly revised to be compatible with the technical requirements. The updated forms are available at the website of MCA (www.mca.gov.in).

Back Office

Back Office represents the offices of Registrar of Companies, Regional Directors and Headquarters' and takes care of internal processing of the forms filed by the corporate user as per MCA norms and guidelines. The e-forms are routed dynamically to the concerned authority for processing depending upon the assigned role. All the e-forms along with attachments are stored in the electronic depository, which the staff of MCA can view depending upon the access rights.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

The Back Office represents the interface of the corporate and public users with the MCA-21 system.

- True
- False

Correct Answer: False

The Back Office represents the offices of Registrar of Companies, Regional Directors and Headquarters.

Let us understand certain terms

- **E-form**

An e-form is the electronic equivalent of the paper form. The Ministry of Corporate Affairs has recently launched a major e-governance initiative MCA 21. In the new system, it is envisaged that all company related documents would be filed electronically. The new e-forms have been devised and notified by the Ministry for this purpose

- **Digital Signature Certificates (DSC)**

Digital Signature Certificates (DSC) are the digital equivalent (that is electronic format) of physical or paper certificates. Examples of physical certificates are drivers' licenses, passports or membership cards. Certificates serve as proof of identity of an individual for a certain purpose; for example, a driver's license identifies someone who can legally drive in a particular country. Likewise, a digital certificate can be presented electronically to prove your identity, to access information or services on the Internet or to sign certain documents digitally. Physical documents are signed manually, similarly, electronic documents, for example e-forms are required to be signed digitally using a Digital Signature Certificate.

The different types of Digital Signature Certificates are:

Class 2: Here, the identity of a person is verified against a trusted, pre-verified database.

Class 3: This is the highest level where the person needs to present himself or herself in front of a Registration Authority (RA) and prove his/ her identity.

- **Pre-scrutiny of forms**

Once you have filled up the eForm and done “Check Form”, you are required to click the “Pre-

Scrutiny" button on the eForm. Please ensure that when you click this button, your computer is connected to the internet. In case the MCA system finds some inconsistency in data, it will throw an error and advise the user to do the necessary rectifications. In case you have filled up the eForm correctly, the system will "lock" the eForm. If you need to modify any data after the successful pre-scrutiny, click on the "Modify" button. This will "Unlock" the eForm and remove the Digital signature (if already made) after which you can carry out the required modifications. Once the modifications are over you are required to do the Pre-Scrutiny again.

Stamp Duty payable on Filing of e-form INC-2/7 (including MOA & AOA), SH-7 and FC-1 can be paid through MCA21 system. When user selects option to pay stamp duty through MCA21 system, the system itself prefills relevant details in the e-form. In case user opts to pay stamp duty in With effect from 1st April, 2010, stamp duty shall have to be paid only through electronic mode for the states which have agreed for e-stamping. . There are two modes, stamp duty can be paid through MCA21 system either off-line or on –line.

Corporate Identity Number (CIN) based Search of Companies

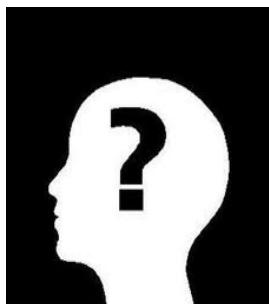
Every company has been allocated a Corporate Identity Number (CIN). CIN can be found from the MCA 21 portal through search based on:

- ROC Registration No.
- Existing Company Name
- Old Name of Company (in case of change of name, user is required to enter old name and the system displays corresponding current name).
- Inactive CIN [In case of change of CIN, the user is required to enter previous (inactive) CIN Number].

Foreign Company Registration Number (FCRN)

Every foreign company has been allocated a Foreign Company Registration Number (FCRN).

REVIEW QUESTIONS



State whether the following statement is "True" or "False"

Corporate Identity Number (CIN), works as a unique identifier of a company for Indian Companies as well as foreign companies.

- True
- False

Correct Answer: False

Corporate Identity Number (CIN), works as a unique identifier of an Indian company. Foreign Company Registration Number (FCRN) is a unique identifier in the case of a Foreign Company.

Digital Signature Certificate

The e-forms are required to be authenticated by the authorized signatories using digital signatures as defined under the Information Technology Act, 2000. A digital signature is the electronic signature duly issued by a certifying authority that shows the authority of the person signing the same. It is an electronic

analogue of a written signature. Every user who is required to sign an e-form for submission with MCA is required to obtain a Digital Signature Certificate. Under the MCA-21 system the following four types of users are identified as users of Digital Signatures and are required to obtain digital signature certificate:

1. MCA (Government) Employees.
2. Professionals (Company Secretaries, Chartered Accountants, Cost Accountants and Lawyers) who interact with MCA and companies in the context of Companies Act.
3. Authorized signatories of the Company including Managing Director, Directors, Manager or Secretary.
4. Representatives of Banks and Financial Institutions.

A person requiring a Digital Signature Certificate can approach any of the Certifying authorities identified by the MCA for issuance of Digital Signature Certificate.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Every user who is required to sign an e-form for submission with MCA is required to obtain a Digital Signature Certificate.

- True
- False

Correct Answer: True

4. OTHER FEATURES OF E-FILING OF DOCUMENTS UNDER THE MCA-21 SYSTEM

Certified Filing Centre (CFC)

CFC is an extended arm of the Ministry which is manned by professionals from three core areas i.e., Company Secretaries, Chartered Accountants and Cost Accountants. It is one of the various channels available to the stakeholders to enable them to do the statutory filing with ROC Offices across the country. These are managed and operated by professionals on user charge basis.

Infrastructure for e-filing

The Minimum system requirements for e-filing are:

- P-4 computer with printer;
- Windows 2000/Windows XP/Windows Vista/Windows 7;
- Internet Explorer 6.0 version and above;
- Above Acrobat Reader 9.4 and lower versions;
- Scanner; and
- Java Runtime Environment (JRE) 1.6 updated version 30.

Mode of payment of statutory fee under Companies Act

MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank

branches through DDs/Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/VISA]. In case a stakeholder chooses to pay through the off-line method (i.e. over the counter in a bank branch), it takes about two to three days time for the bank to intimate the realisation of payment to the MCA-21 system and the transaction gets passed on to the back office for processing only after payment is recognised by the banking system. On the other hand, the on-line payment through Internet banking/ Credit Card is instant. The transaction gets passed on the same day.

However, the Ministry of Corporate Affairs vide its Circular dated 9th March, 2011 has decided to accept payments of value upto ₹50,000, for MCA 21 services, only in electronic mode w.e.f. 27th March, 2011. For the payments of value above ₹50,000, stakeholders have the option to either make the payment in electronic mode, or paper challan. However such payments can also be made in electronic mode w.e.f. 1st October, 2011. This has improved the service delivery time and lead to speedier disposal of an application/e-form leading to convenience of stakeholders.

Further, in the following cases challan mode of payment is allowed for amount less than ₹50,000 (MCA Circular dated 27.05.2011):

- (i) Payment to 'Investor Education and Protection Fund' through 'Pay Misc. Fee' functionality
- (ii) Any payment made by user having category as 'Official Liquidator (OL) office'
- (iii) Any payment made by user having category as 'MCA employee'.

Service Request Number (SRN)

Each transaction under e-filing is uniquely identified by a Service Request Number (SRN). On filing of an e-form, the system will generate and provide a Service Request Number (SRN). A user can check the status of the document/ transaction, by entering the SRN.

Payment of Stamp Duty

Stamp duty is a state subject. It is payable on Memorandum and Articles of Association of every Company. In some states, duty is also payable on the authorized capital mentioned in the Memorandum of Association of the Company. Some states have authorized MCA to collect the stamp duty on their behalf and to remit the same to them.

Physical submission of certain documents

In view of practical constraints, certain documents requiring stamp paper or Stamp fees like stamped memorandum of association, declaration on stamp paper, original certified copy of the Company Law Board/Court order are required to be sent by the Companies in the physical form to the ROCs. The user will be providing SRN while sending these forms/documents to MCA. This would ensure the authenticity and reliability of such key documents and enable the MCA authorities to further act upon the same.

5. CATEGORIES OF E-FORMS

Topic-wise/Authority-wise list of e-Forms

S.No	Description	e-Form
1.	Approval Services (MCA)	
	Form for filing application or documents with Central Government	Form CG-1

2.	Approval Services (Regional Director)	
	Application to Regional director for conversion of section 8 company into company of any other kind	Form INC-18
	Application to Regional Director for approval to shift the Registered Office from one state to another state or from jurisdiction of one Registrar to another Registrar within the same State	Form INC-23
	Memorandum of Appeal	Form ADJ
	Form for filing Application to Central Government (Regional Director)	Form RD-2
	Applications made to Regional Director	Form RD-1
3.	Approval Services (Registrar of Companies)	
	One Person Company- Application for Conversion	Form INC-6
	Application for approval of Central Government for change of name	Form INC-24
	Application to Registrar for obtaining the status of dormant company	Form MSC-1
	Application for seeking status of active company	Form MSC-4
	Applications made to Registrar of Companies	Form GNL-1
	Application for striking off the name of company under the Fast Track Exit(FTE) Mode	Form FTE
4.	Change Services	
	Application for reservation of name	Form INC-1
	One Person Company- Nominee consent form	Form INC-3
	One Person Company- Change in Member/Nominee	Form INC-4
	Notice of situation or change of situation of registered office	Form INC-22
	Conversion of public company into private company or private company into public company	Form INC-27
	Notice to Registrar of any alteration of share capital	Form SH-7

	Particulars of appointment of Directors and the key managerial personnel and the changes among them	Form DIR-12
	Return of alteration in the documents filed for registration by foreign company	Form FC-2
	Annual accounts along with the list of all principal places of business in India established by foreign company	Form FC-3
	Form for intimating to Registrar of Companies of conversion of the company into limited liability company (LLP)	Form-14
5.	Charge Management	
	Application for registration of creation, modification of charge (other than those related to debentures)	Form CHG-1
	Particulars for satisfaction of charge thereof	Form CHG-4
	Notice of appointment or cessation of receiver or manager	Form CHG-6
	Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures	Form CHG-9
	Details of persons/directors/charged/specify	Form GNL-3
	Consolidation/Diversion/Increase in Share Capital or Members	SH-7
	Application to Central Government for extension of time for filling particulars of registration of creation/modification/satisfaction of charge OR For rectification of omission or misstatement of any particular in respect of creation/modification/satisfaction of charge	From-CHG-8
6.	DIN Forms	
	Application for allotment of Director Identification Number	Form DIR-3
	Intimation of change in particulars of Director to be given to the Central Government	Form DIR-6

	Application for surrender of DIN	DIR-5
7.	Incorporation services	
	Application for reservation of name	Form INC-1
	One Person Company- Application for Incorporation	Form INC-2
	One Person Company- Nominee consent form	Form INC-3
	Application for Incorporation of Company (Other than OPC)	Form INC-7
	Notice of situation or change of situation of registered office	Form INC-22
	Particulars of appointment of Directors and the key managerial personnel and the changes among them	Form DIR-12
	Application by a company for registration under section 366	Form URC-1
	Information to be filed by foreign company	Form FC-1
8.	Compliance Related Filing	
	Statement of amounts credited to investor education and protection fund	Form 1INV
	One Person Company- Intimation of exceeding threshold	Form INC-5
	Declaration prior to the commencement of business or exercising borrowing powers	Form INC-21
	Return of allotment	Form PAS-3
	Letter of offer	Form SH-8
	Return in respect of buy-back of securities	Form SH-11
	Filing of Resolutions and agreements to the Registrar	Form MGT-14
	Notice of resignation of a director to the Registrar	Form DIR-11
	Return of appointment of MD or whole-time director or manager	MR-1
	RoC Document- ScheduleIV, ScheduleII, MoA and AoA	Form GNL-2
	Annual Return of a Foreign company	Form FC-4
	Return of dormant companies	Form MSC-3
	Statement of unclaimed and unpaid amounts	Form 5INV

	Persons not holding beneficial interest in shares	Form MGT-6
	Statutory Report	Form 22
	Form for filing XBRL document in respect of cost audit report and other documents with the Central Government	Form I-XBRL
	Form for filing XBRL document in respect of compliance report and other documents with the Central Government	Form A-XBRL
9.	Informational Services	
	Intimation to Registrar of revocation/surrender of license issued under section 8	Form INC-20
	Notice of Order of the Court or any other competent authority	Form INC-28
	Information to be furnished in relation to any offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company	Form 35A
10.	Investor Services	
	Form for filing complaint(s) against the company	Investor Complaint Form
11.	Provisions related to Managerial personnel	
	Form of application to the Central Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration to directors	Form MR-2
	Application for removal of disqualification of director	DIR-10
	Return of appointment of MD/WTD/Manager	Form MR-1

12.	Annual filing eForms	
	Form for filing annual return by a company having a share capital with the Registrar (MCA has clarified vide circular dated June 25, 2014 that Form MGT-7 shall not apply to Annual Returns in respect of Companies whose financial year ended on 1 st April, 2014 or earlier years)	Form 20B
	Particulars of annual return for the company not having share capital	Form 21A
	Form for filing balance sheet and other documents with the Registrar	Form 23AC
	Form for filing Profit and Loss account and other documents with the Registrar	Form 23ACA
13.	Annual filing-XBRL-eForms (MCA has clarified vide circular dated 4.4.2014 that provisions of Companies Act 1956 would apply to financial years that commenced earlier than 1 st April, 2014 and in respect of financial years commencing on or after 1 st April, 2014, the provisions of Companies Act, 2013 would apply)	
	Form for filing XBRL document in respect of balance sheet and other documents with the Registrar	Form 23AC-XBRL
	Form for filing XBRL document in respect of Profit and Loss account and other documents with the Registrar	Form 23ACA-XBRL
	Form for filing addendum for rectification of defects or in completeness	Form 67(Pdd)

Annual filing

As a part of annual filing, companies incorporated under the Companies Act, 1956 are required to file the following documents along with the e-forms with the Registrar of Companies:

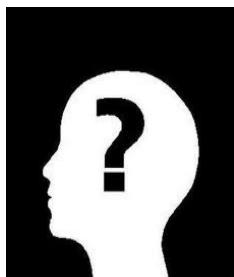
S.No.	Document	E-form
1.	Balance Sheet	Form 23AC to be filed by companies not covered under XBRL filing. Form 23AC-XBRL to be filed by companies for filing balance Sheet and other documents in XBRL mode.

2.	Profit and Loss Account	Form 23ACA to be filed by companies not covered under XBRL filing. Form 23ACA-XBRL to be filed by companies for filing Profit & Loss account and other documents in XBRL mode.
3.	Annual Return	Form 20B to be filed by companies having share capital.
4.	Annual Return	Form 21A to be filed by companies without share capital.
5.	Compliance Certificate	Form 66 to be filed by companies with paid up capital between ₹10 lacs to ₹5 crores.

Important points to Remember

1. Balance sheet and Profit and Loss Accounts are to be filed as two separate documents with different e-forms.
2. Annual Return, Balance Sheet and Profit and Loss Account are filed as attachments to the respective e-form.

REVIEW QUESTIONS



State whether the following statement is “True” or “False”

Balance sheet and Profit and Loss Account can be filed as a single document.

- True
- False

Correct Answer: False

Balance sheet and Profit and Loss Account are to be filed as two separate documents with different e-forms.

6. PRE-CERTIFICATION OF E-FORMS

Apart from authentication of e-forms by authorized signatories using digital signatures, some e-forms are also required to be pre-certified by practising professionals. Pre-certification means certification of correctness of any document by a professional before the same is filed with the Registrar.

This pre-certification is to be carried out by *inter-alia*, Company Secretaries, Chartered Accountants, Cost Accountants, in whole-time practice.

7. TERMS USED WHILE E-FILING THE FORMS

Pre-fill

Pre-fill is functionality in an e-Form that is used for filling automatically, the requisite data from the system without repeatedly entering the same. For example, by entering the CIN of the company, the name and registered office address of the company shall automatically be pre-filled by the system without any fresh entry.

Attachment

An attachment refers to a document that is sent as an enclosure with an e-Form by means of an attached file. The objective of the attachment is to provide details relevant to the e-Form for processing. While some attachments are optional some are mandatory in nature.

The attachments to an e-Form will be only in Adobe PDF format. MCA portal shall not accept attachment file of more than 2.5MB and the user is advised to keep the attachment size to minimum.

Check Form

By clicking "Check Form", the user will be in a position to find out whether the mandatory fields in an e-Form are duly filled-in. For example, if the user enters alphabets in "Date of Appointment of Director" field, he/she will be asked to correct the entered information.

If the size of attachment is much bigger then the details may be submitted in a floppy or compact disc at the ROC office. For example, In the case of Annual Return filed by the companies having large shareholders base, the list of shareholders may be submitted separately in a CD at the concerned ROC office indicating SRN No. of e-form filed

Modify

Once the user has done 'Check Form', the form gets locked and it cannot be edited. If the user wishes to make any alterations, the form can be overwritten by clicking "Modify" button.

Pre-Scrutiny

Pre-scrutiny is a functionality that is used for checking whether certain core aspects are properly filled in the e-Form. The user has to login on MCA portal to perform the pre-scrutiny of e-form. The necessary attachments and digital signatures should be affixed before submitting the e-Form for pre-scrutiny. The difference between check form and pre-scrutiny is that the Check form is done by internal features of the form which ensure that all the mandatory and required field are filled up and attachment are made to the e-form, while Pre-Scrutiny is a complete legal and technical scrutiny of an e-form done by the MCA portal before accepting the form.

Addendum to e-Form

The user may have to submit some additional supporting documents that are not submitted during the e-Form (application) filing but are required for the processing of the e-Form. MCA may also ask the applicant to provide some additional documents in support of the e-Form already filed so as to expedite the processing of the same.

The user can initiate this on their own by checking the track transaction status on MyMCA portal or on being notified by MCA through email. Payment of fees is not required for filing an addendum.

The supporting documents that the applicant uploads, as an addendum, gets duly associated with the e-Form that was submitted earlier with the given SRN.

Online Inspection of Documents

The documents filed online, once taken on record by ROC Offices shall be available for public viewing on payment of requisite fees. These documents, which shall be in the domain of public documents, include documents relating to incorporation, charges, annual returns and balance sheets and change in directors. A certified copy of the documents can also be obtained by anyone so interested.

8. E-STAMP

Registrars of Companies have to ensure that proper stamp duty is paid on the instruments registered with their office. Accordingly, physical submission of documents is necessary to ascertain that applicable stamp duty has been paid. In the MCA-21 system, even though the eForm is submitted instantly, the RoC office has to wait for receipt of physical stamp papers to initiate necessary processing. It results in service delivery time getting longer. Hence, in furtherance of e-governance initiatives, provisions regarding stamp duty applicable on filing of e-forms have been amended and stakeholders shall have facility to pay stamp duty in electronic manner also. It provides that if the stamp duty on documents which are required to be filed on non-judicial stamp paper is paid electronically through Ministry of Corporate Affairs portal www.mca.gov.in, in such case, the company shall not be required to make physical submission of such documents, in addition to their submission in the electronic form.

Keeping in view the requirement of stakeholders awareness, process of e-stamp has not been made mandatory, meaning thereby, stakeholders have option to pay stamp duty in electronic manner through MCA21 system or in physical form as per the existing procedure. Further this process shall be applicable only to such States/Union Territories which have agreed to the request of Ministry of Corporate Affairs for collection of e-stamp duty on their behalf.

List of eForms to which e-Stamping will be applicable

INC-2, (including MoA, AoA)

INC-7, (including MoA, AoA)

FC-1

SH-7

10. KEY BENEFITS OF MCA 21 PROJECT

MCA 21 seeks to fulfill the requirements of the various stakeholders including the Corporates, Professionals, Public Financial Institutions and Banks, Government and the MCA employees. The key benefits of MCA 21 project are as follows:

1. On-line incorporation of companies.
2. Simplified and easy mode of filing of Forms/Returns.
3. Registration as well as verification of charges anytime and from anywhere.
4. Inspection of public documents of companies anytime from anywhere.
5. Corporate-centric approach.
6. Building up a centralized database repository of corporates operating in India.
7. Enhanced service level fulfillment and customer relationship building.
8. Total transparency through e-Governance.
9. Timely redressal of investor grievances.
10. Availability of more time for MCA employees for qualitative analysis of corporate information.

11. CLARIFICATIONS ISSUED BY MCA

1. The filing will be done only through the portal MCA 21 and not through e-mail.
2. The transaction will be deemed as completed only after clearance of the payment by the bank.
3. Pre-certification of certain e-forms by CS/CA/CWA (in whole-time in practice) is a mandatory requirement.

4. Digital Signature Certificate (DSC) is required for filing all the e-forms. Therefore, the Directors and Company Secretary of the Company who are the authorized signatories for e-filing purpose, should obtain DSC.
5. Data in e-forms is required to be given as per the format. However, additional information, if any, which is not formatted can be given by way of an attachment to the form.
6. The forms may be filled online or offline after downloading. MCA recommends that the forms be filled offline and then submitted on the portal.

12. GENERAL STRUCTURE OF AN E-FORM AND E-FILING PROCESS

An e-Form contains certain standardized features. Each e-Form contains the form reference and the description as well as the particular section of the Companies Act or the relevant rules or regulations under which it is required to be submitted. It starts with the Corporate Identity Number (CIN), which works as a unique identifier of an Indian Company and the Foreign Company Registration Number in the case of a Foreign Company that is required to be filled up. By entering the CIN, the company details to the extent these are available in static form in the database, are automatically filled in by using the pre-fill functionality.

Features of e-form and e-filing process has been given as below:

- The e-Form contains a number of mandatory fields which are required to be filled-in. Certain other fields are non-mandatory in nature which may be filled-in as may be relevant in any particular case.
- An instruction kit is available for each e-Form, which contains details of the instructions for properly filling the e-Form.
- An e-Form may be filled in either online or offline. Online filling implies that the e-Form is filled while being still connected to MyMCA portal through the Internet. Offline filling denotes that the e-Form is downloaded into the user's computer and filled later without being connected to the Internet.
- An e-Form may require certain mandatory attachments to be filed along with it. Optional attachments may also be filed with an e-Form. The list of such attachments is displayed in the e-Form.
- Next to attachment, there is a declaration that is sought from the person filing the e-Form to the effect that the information given in the e-Form and the attachments is correct and complete.
- Most of the e-Forms require the digital signature of the Managing Director or Director, Manager or Secretary of the company for successful filing/ submission.
- Further, the digital signature of a third party may also be required in certain cases. In the case of an e-Form for creation or modification of charges, such digital signature is also required from the Bank or Financial Institution.
- In certain cases, certification from the Chartered Accountant or Cost Accountant or Company Secretary in whole-time practice is also required to authenticate the particulars contained in the e-Form. For example, this requirement is mandatory in the case of an e-Form for creation or modification of charges.
- There are built-in facilities to check the filled-in e-Form for requisite validations, to do pre-scrutiny and to modify the e-Form when the same is required to be re-submitted.
- When the "Submitted" button is pressed, the e-Form gets uploaded into the MCA central document repository.
- Thereafter, the requisite fees as applicable for the e-Form should be paid either on-line or off-line.

- Once the e-Form has been accepted and payment of fees has been acknowledged, a work item is created and assigned to the appropriate MCA employee based on pre-defined assignment rules as part of MCA back office workflow automation.
- In the case of an e-Form, the authorized officer affixes his/her digital signature for registering/approving/rejecting the same.
- After the processing of the e-Form is completed, an acknowledgement email is sent to the user regarding its approval/rejection.

13. REVISION/UPDATION OF E-FORMS

The e-forms are being constantly revised by the government in line with the legal changes, so that they could be compatible with the technical requirements of the MCA-21. The latest revised eforms are available on MCA website i.e. www.mca.gov.in

15. XBRL

XBRL is a language for the electronic communication of business and financial data which is revolutionising business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data. It is an open standard, free of licence fees, being developed by a non-profit making international consortium. Other pages on this web site provide detailed information on XBRL, its technical features and its business opportunities.

XBRL is a data-rich dialect of XML (Extensible Markup Language), the universally preferred language for transmitting information via the Internet. It was developed specifically to communicate information between businesses and other users of financial information, such as analysts, investors and regulators. XBRL provides a common, electronic format for business reporting. It does not change what is being reported. It only changes how it is reported.

XBRL is a world-wide standard, developed by an international, non-profit-making consortium, XBRL International Inc. (XII). XII is made up of many hundred members, including government agencies, accounting firms, software companies, large and small corporations, academics and business reporting experts. XII has agreed the basic specifications which define how XBRL works.

XBRL tags

In XBRL, information is not treated as a static block of text or set of numbers.

Instead, information is broken down into unique items of data (e.g. total liabilities = 100). These data items are then assigned mark-up tags that make them computer-readable. For example, the tag <Liabilities>100</Liabilities> enables a computer to understand that the item is liabilities, and it has a value of 100.

Computers can treat information that has been tagged using XBRL ‘intelligently’; they can recognize, process, store, exchange and analyse it automatically using software.

Because XBRL tags are formed in a universally-accepted way, they can be read and processed by any computer that has XBRL software. XBRL tags are defined and organized using categorization schemes called taxonomies.

XBRL taxonomies

Different countries use different accounting standards. Reporting under each standard reflects differing

definitions. The XBRL language uses different dictionaries, known as 'taxonomies', to define the specific tags used for each standard. Different dictionaries may be defined for different purposes and types of reporting. Taxonomies are the computer-readable 'dictionaries' of XBRL. Taxonomies provide definitions for XBRL tags, they provide information about the tags, and they organize the tags so that they have a meaningful structure.

As a result, taxonomies enable computers with XBRL software to:

- understand what the tag is (e.g. whether it is a monetary item, a percentage or text);
- what characteristics the tag has (e.g. if it has a negative value);
- its relationship to other items (e.g. if it is part of a calculation).

This additional information is called meta-data. When information that has been tagged with XBRL is transmitted, the meta-data contained within the tags is also transmitted.

Taxonomies differ according to reporting purposes, the type of information being reported and reporting presentation requirements. Consequently, a company may use one taxonomy when reporting to a stock exchange, but use a different taxonomy when reporting to a securities regulator. Taxonomies are available for most of the major national accounting standards around the world.

16. BENEFITS OF XBRL

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision-making. All types of organisations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data.

XBRL enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time-consuming comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and manipulate XBRL information.

Data Collection and Reporting

By using XBRL, companies and other producers of financial data and business reports can automate the processes of data collection. For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently if the sources of information have been upgraded to using XBRL. Once data is gathered in XBRL, different types of reports using varying subsets of the data can be produced with minimum effort. A company finance division, for example, could quickly and reliably generate internal management reports, financial statements for publication, tax and other regulatory filings, as well as credit reports for lenders. Not only can data handling be automated, removing time-consuming, error-prone processes, but the data can be checked by software for accuracy.

Data Consumption and Analysis

Users of data which is received electronically in XBRL can automate its handling, cutting out time-consuming and costly collation and re-entry of information. Software can also immediately validate the data, highlighting errors and gaps which can immediately be addressed. It can also help in analysing, selecting, and processing the data for re-use. Human effort can switch to higher, more value-added aspects of analysis, review, reporting and decision-making. In this way, investment analysts can save effort, greatly simplify the selection and comparison of data, and deepen their company analysis. Lenders can save costs and speed

up their dealings with borrowers. Regulators and government departments can assemble, validate and review data much more efficiently and usefully than they have hitherto been able to do.

LESSON ROUND-UP

- An e-form is a re-engineered conventional form, represents a document in electronic format.
- Director Identification Number (DIN), Corporate Identity Number (CIN) and Digital Signature Certificate (DSC) are the important features under e-governance mode (MCA-21).
- MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank branches through DDs/ Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/ VISA].
- Each transaction under e-filing is uniquely identified by a Service Request Number (SRN). On filing of an e-form, the system will generate and provide a Service Request Number (SRN). A user can check the status of the document/ transaction, by entering the SRN.
- If the stamp duty on documents which are required to be filed on non-judicial stamp paper is paid electronically through Ministry of Corporate Affairs portal www.mca.gov.in, in such case, the company shall not be required to make physical submission of such documents, in addition to their submission in the electronic form.
- The e-forms are being constantly revised. The updated e-forms are available at the website of MCA (www.mca.gov.in).

SELF-TEST QUESTIONS

1. Explain the terms CIN and DIN.
2. What are the key benefits of MCA-21 project?
3. Write short note on Digital Signature Certificate.
4. Briefly explain the general structure of an e-form and the e-filing process.

**EXECUTIVE PROGRAMME
COMPANY LAW**

EP-CL

TEST PAPERS

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet ‘A Guide to CS Students” providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download from <http://www.icci.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf>

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

EXECUTIVE PROGRAMME
COMPANY LAW

TEST PAPER 1

Time Allowed: 3 hours

Maximum Marks: 100

NOTE: Answer All Questions.

Total Number of Questions: 6

All references to the sections relate to Companies Act 2013 , Unless stated otherwise

1. (a) "According to section 71 a company may issue debentures either with an option to convert such debentures into shares wholly or partly at the time of redemption."
- (b) The articles of a company shall contain the regulations for management of the company
- (c) "The remuneration of the auditor of a company shall be fixed in its general meeting"
- (d) The registrar has power to call for information, inspection of books and conduct enquiries"

(5 marks each)

Attempt ALL parts of either Q.No. 2 or Q. No. 2A

2. Distinguish between the Following:

- (a) 'Statement of repatriation of profits' and 'statement of transfer of funds'
- (b) 'Annual general meeting' and 'Extra ordinary general meeting'
- (c) 'Creation of charges' and 'modification of charges'.
- (d) 'ESOS' and 'ESOP'

(4 marks each)

OR

- 2A. (i) "In case of criminal liability of any audit firm , the liability other than fine shall devote only on the concerned partner or partners, who acted in a fraudulent ,manner or abetted or as the case may be colluded in a fraud" discuss. *(4 marks)*
- (ii) There are certain restrictions on making application under section 248 in certain situations. Discuss. *(4 marks)*
- (iii) Discuss the provisions related to appointment of director elected by small shareholders. *(4marks)*
- (iv) Write a note on committees of Board. *(4 marks)*

3. Attempt all parts of either Q. No. 3 or Q. No. 3A

- (i) Discuss the powers of board provided by the Companies Act 2013.
- (ii) List the disclosures to be made with the board's report under the rules prescribed under companies act 2013.
- (iii) What are the duties of a company secretary prescribed by the Rules made under the companies act 2013

- (iv) What do you mean by quorum? What is the requirement of quorum while conducting meetings?
(4 marks each)

OR (Alternate question to Q.No. 3)

- 3A. (i) List the circumstances when the resolutions require special notice.
(ii) Write down the matters to be stated in prospectus.
(iii) What are the penal provisions for non-compliance of provisions regarding disclosure of interest of director?
(iv) What is the effect of non-transfer of the dividend amount to the unpaid dividend amount?
(4 marks each)
4. (i) RED Ltd desires to shift its registered office from Delhi to Kanpur, U.P. the Company has filed an application in Form no. INC 23 along with fee. List all the documents that shall be accompanied with the form.
(ii) Describe the procedure of Audit of Government Company. (8 marks each)
5. (i) Explain the procedure for Buy-back of securities.
(ii) The XYZ Ltd. Wants to appoint an Internal Auditor. Advise the Company assuming yourself as a Company secretary regarding such appointment.
(iii) "Discuss Corporate Social Responsibilities Activities according to the Rules made under the companies act 2013.
(iv) What do you mean by Branch Audit? What are the duties of the company's auditor with reference to the audit of branch and the branch auditor? (4 marks each)
6. Write notes on the following:
(i) Books of account
(ii) Advertisement of prospectus
(iii) Resident director
(iv) Secretarial Audit
(4 marks each)
-

TEST PAPER 2*Time allowed: 3 hours**Total marks: 100 Marks*

NOTE: 1. Answer ALL Questions.

2. All references to sections relate to the Companies Act, 2013 unless stated otherwise.

1. Comment on the following:-

- (a) Certain class or classes of companies is required to have at least one women director.
 - (b) A private company which is OPC shall mention the words “OPC” in bracket below its name.
 - (c) The Board of directors of a company may declare interim dividend in case the company has incurred any losses during the current financial year.
 - (d) Every auditor shall comply with the auditing standards as may prescribed by the Central Government.
- (5 marks each)*

Attempt all parts of either Q No. 2 or Q No. 2A

2. Distinguish between the following:-

- (a) ‘Annual return’ and ‘Annual report’
 - (b) ‘Voting by show of hands’ and ‘ Voting through Electronic means’
 - (c) ‘Shelf Prospectus’ and ‘ Red Herring Prospectus’
 - (d) ‘ Nomination and Remuneration Committee’ and ‘ Stakeholders Relationship Committee’
- (4 marks each)*

OR (Alternate question to Q. No. 2)

- 2A. (i) State the disclosures in Board’s Report under listing agreement. *(4 marks)*
- (ii) Write the definition of the ‘Independent Director’ given under Companies Act, 2013. *(4 marks)*
- (iii) What are the types of transactions that are covered under Related Party Transaction. *(4 marks)*
- (iv) Discuss the powers of inspectors to conduct investigation in to the affairs of related companies under Companies Act, 2013. *(4 marks)*

Attempt all parts either Q. No. 3 or Q. No. 3A

3. (i) Discuss the provisions given under Companies Act 2013 on removal of Directors.
- (ii) “An individual shall not be Chair person and Managing Director or Chief Executive officer at the same time”. Discuss in the light of Section 203 of the Act.
- (iii) What are the various rules prescribed under Companies Act 2013 regarding issue of sweat equity share issued by an unlisted company?
- (iv) Discuss penal provisions of contravention of any provisions of Chapter VI Registration of Charges. *(4 marks each)*

OR (Alternate Question to Q. No. 3)

- 3A. (i) What is ‘Floating charge” and how it crystallised.

- (ii) Write the brief procedure to obtain Director Identification Number (DIN).
- (iii) List the grounds where a Registrar can remove the name of a company from the register of companies.
- (iv) Write the exemptions given under Section 185 relating to loan to Directors. (4 marks each)
4. (i) Write the circumstances where a Tribunal can call a meeting of members and call the annual general meeting.
- (ii) 'The Central Government to establish a fund to be called the Investor Education and Protection Fund, to which amounts specified under section 125 are to be credited.' Discuss in detail. (8 marks each)
5. (a) Write down the framework for constitution of National Financial Reporting Authority (NFRA) under Companies Act, 2014.
- (b) Write the Procedure for reduction of share capital.
- (c) Write the duties of a Director given under Companies Act, 2013.
- (d) Write the remedies available with the shareholder when a company refuse to register the transfer/ transmission of shares. (4 marks each)
6. Write short notes on the following:-
- (a) Pass resolution by Postal ballot
- (b) Corporate Social Responsibility Committee
- (c) Appointment of Key Managerial personnel
- (d) Removal and replacement of provisional liquidator. (4 marks each)
-

Table containing provisions of Companies Act, 2013 as notified up to date and corresponding provisions thereof under Companies Act, 1956

Note: This is a ready reckoner for the information of stakeholders. Please refer to the relevant notifications and circulars issued separately.

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
1.	Section 2		
	Clause (1)	2(1)	Nil
	Clause (2)	211(3C)	Nil
	Clause (3)	2(1A)	Nil
	Clause (4)	2(1B)	Nil
	Clause (5)	2(2)	Nil
	Clause (6)	Nil	Nil
	Clause (7)	Nil	Nil
	Clause (8)	Nil	Nil
	Clause (9)	2(5)	Nil
	Clause (10)	2(6); 252(3)	Nil
	Clause (11)	2(7)	Nil
	Clause (12)	2(8)	Nil
	Clause (13)	209(1)	Nil
	Clause (14)	2(9)	Nil
	Clause (15)	Nil	Nil
	Clause (16)	124	Nil
	Clause (17)	Explanation to section 33(2)	Nil
	Clause (18)	Nil	Nil
	Clause (19)	Nil	Nil
	Clause (20)	2(10) and 3	Nil
	Clause (21)	2(23) and 12(2)(b)	Nil
	Clause (22)	2(23) and 12(2)(a)	Nil
	Clause (24)	2(45)	Nil
	Clause (25)	2(45A)	Nil
	Clause (26)	Nil	428 The term 'Contributory' shall continue for the purposes winding up.
	Clause (27)	Nil	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
	Clause (28)	233B1	Nil
	Clause (29) (Except Sub-clause (iv))	2(11), 2(14), 10	622
	Clause (30)	2(12)	Nil
	Clause (31)	Explanation to 58A (11)	Nil
	Clause (32)	2(12A)	Nil
	Clause (33)	2(12B)	Nil
	Clause (34)	2(13)	Nil
	Clause (35)	2(14A)	Nil
	Clause (36)	2(15)	Nil
	Clause (37)	2(15A)	Nil
	Clause (38)	59(2)	Nil
	Clause (39)	Nil	Nil
	Clause (40)	Nil	Nil
	Clause (41) [except first proviso]	2(17)	Nil
	Clause (42)	Nil	Nil
	Clause (43)	Explanation to section 2	Nil
	Clause (44)	Nil	Nil
	Clause (45)	2(18), 617	Nil
	Clause (46)	2(19), 4	Nil
	Clause (47)	Nil	Nil
	Clause (48)	Nil	Nil
	Clause (49)	Nil	Nil
	Clause (50)	Nil	Nil
	Clause (51)	Nil	Nil
	Clause (52)	2(23A)	Nil
	Clause (53)	2(24)	Nil
	Clause (54)	2(26)	Nil
	Clause (55)	2(27), 41	Nil
	Clause (56)	2(28)	Nil
	Clause (57)	2(29A)	Nil
	Clause (58)	Nil	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
	Clause (59)	2(30)	Nil
	Clause (60)	2(31), 5, 7	Nil
	Clause (61)	Nil	448
	Clause (62)	Nil	Nil
	Clause (63)	Nil	Nil
	Clause (64)	2(32)	Nil
	Clause (65)	Explanation to section 192A	Nil
	Clause (66)	2(33)	Nil
	Clause (67)[except sub-clause (ix)]	2(34)	Nil
	Clause (68)	2(35)	Nil
	Clause (69)	Explanation (a) to section 62(6)	Nil
	Clause (70)	2(36)	Nil
	Clause (71)	2(37)	Nil
	Clause (72)	4A	Nil
	Clause (73)	2(39)	Nil
	Clause (74)	Nil	Nil
	Clause (75)	2(40)	Nil
	Clause (76)	Nil	Nil
	Clause (77)	2(41), 6 and schedule IA	Nil
	Clause (78)	Explanation to 198	Nil
	Clause (79)	2(42)	Nil
	Clause (80)	2(43)	Nil
	Clause (81)	2(45AA)	Nil
	Clause (82)	2(45B)	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
	Clause (83)	Nil	Nil
	Clause (84)	2(46)	Nil
	Clause (85)	Nil	Nil
	Clause (86)	Nil	Nil
	Clause (87)	2(47), 4	Nil
	Clause (88)	Explanation II to Section 79A	Nil
	Clause (89)	2(48)	Nil
	Clause (90)	2(49A)	Nil
	Clause (91)	Nil	Nil
	Clause (92)	12(2)(c)	Nil
	Clause (93)	Nil	Nil
	Clause (94)	Explanation to Section 269	Nil
	Clause (95)	2(31A), 2A	Nil
2.	Section 3	12	Nil
3.	Section 4	13,14,15,15A,15B, 20, 37	Nil
4.	Section 5	26,27,28,29,30	Nil
5.	Section 6	9	Nil
6.	Section 7 (except sub-section (7))	33,34(1),35	Nil
7.	Section 8 (except sub-section (9))	25	Nil
8.	Section 9	34(2)	Nil
9.	Section 10	36	Nil
10.	Section 11	149	Nil
11.	Section 12	17A, 146, 147	Nil
12.	Section 13	16,17,18,19,21,23	Nil
13.	Section 14 (except second proviso to sub-section (1) and sub-	31 (except proviso to sub-	Proviso to sub-section (1) of section 31;

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
	section (2))	section (1) and Sub-section (2A); 43	
			Sub-section (2A) of section 31
14.	Section 15	40	Nil
15.	Section 16	22	Nil
16.	Section 17	39	Nil
17.	Section 18	32	Nil
18.	Section 19	42	Nil
19.	Section 20	51, 52, 53	Nil
20.	Section 21	54	Nil
21.	Section 22	47, 48	Nil
22.	Section 23	67	Nil
23.	Section 24	55A	Nil
24.	Section 25	64	Nil
25.	Section 26	55,56,57,58,59,60, Sch. II	Nil
26.	Section 27	61	Nil
27.	Section 28	Nil	Nil
28.	Section 29	68B	Nil
29.	Section 30	66	Nil
30.	Section 31	68	Nil
31.	Section 32	60B	Nil
32.	Section 33	56(3)	Nil
33.	Section 34	63	Nil
34.	Section 35	62	Nil
35.	Section 36	68	Nil
36.	Section 37	Nil	Nil
37.	Section 38	68A	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
38.	Section 39	69, 75	Nil
39.	Section 40	73, 76	Nil
40.	Section 41	Nil	Nil
41.	Section 42	67	Nil
42.	Section 43	2(46A), 85, 86	Nil
43.	Section 44	82	Nil
44.	Section 45	83	Nil
45.	Section 46	84	Nil
46.	Section 47	87	Nil
47.	Section 49	91	Nil
48.	Section 50	92	Nil
49.	Section 51	93	Nil
50.	Section 52	78	Nil
51.	Section 53	79	Nil
52.	Section 54	79A	Nil
53.	Section 55 except sub-section (3)	80 and 80A (except Proviso to section 80A(1) and section 80A(2))	Proviso to section 80A(1) and section 80A(2)
54.	Section 56	108, 108A to 108 I, 109, 110, 113	Nil
55.	Section 57	116	Nil
56.	Section 58	111	Nil
57.	Section 59	111A	Nil
58.	Section 60	148	Nil
59.	Section 61 except proviso to clause (b) of sub-section (1)	94	Nil
60.	Section 62 except sub-sections	81 except sub-sections (4) to (7)	sub-sections (4) to (7) of section 81 and section 94A

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
	(4) to (6)		
61.	Section 63	Proviso to 205 (3)	Nil
62.	Section 64	94A(3), 95,97	Nil
63.	Section 65	98	Nil
64.	Section 67	77	Nil
65.	Section 68	77A	Nil
66.	Section 69	77AA	Nil
67.	Section 70	77B	Nil
68.	Section 71 except sub-sections (9) to (11)	117,117A,117B,117C,118,119, 122 Except 117B(4) and 117C (4) and (5)	117B(4) and 117C (4) and (5)
69.	Section 72	109A,109B	Nil
70.	Section 73	58A, 58AA, 58AAA, 58B, 59	Nil
71.	Sub-section (1) of section 74	Nil	Nil
72.	Section 76	58A	Nil
73.	Section 77	125,128, 129,132, 133, 145	Nil
74.	Section 78	134	Nil
75.	Section 79	127,135	Nil
76.	Section 80	126	Nil
77.	Section 81	130	Nil
78.	Section 82	138	Nil
79.	Section 83	139,140	Nil
80.	Section 84	137	Nil
81.	Section 85	131, 136,143,144	Nil
82.	Section 86	142	Nil
83.	Section 87	141	Nil
84.	Section 88	150,151,152,152A,153, 153A, 153B, 157, 158	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
85.	Section 89	187C	Nil
86.	Section 90	187D	Nil
87.	Section 91	154	Nil
88.	Section 92	159,160,161,162,Sch V	Nil
89.	Section 93	Nil	Nil
90.	Section 94	163	Nil
91.	Section 95	164	Nil
92.	Section 96	165,166, 170	Nil
93.	Section 100	169 (9)	Nil
94.	Section 101	171,172	Nil
95.	Section 102	173	Nil
96.	Section 103	174	Nil
97.	Section 104	175	Nil
98.	Section 105	176, Schedule IX	Nil
99.	Section 106	181,182,183	Nil
100.	Section 107	177, 178	Nil
101.	Section 108	Nil	Nil
102.	Section 109	179,180,184,185	Nil
103.	Section 110	192A	Nil
104.	Section 111	188	Nil
105.	Section 112	187A, 187B	Nil
106.	Section 113	187	Nil
107.	Section 114	189	Nil
108.	Section 115	190	Nil
109.	Section 116	191	Nil
110.	Section 117	192	Nil
111.	Section 118	193,194,195,197	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
112.	Section 119 (except sub-section (4))	196	Nil
113.	Section 120	Nil	Nil
114.	Section 121	Nil	Nil
115.	Section 122	Nil	Nil
116.	Section 123	Section 205 Sub-section (3) of section 205A	Nil
		Section 206	
117.	Section 126	206A	Nil
118.	Section 127	207	Nil
119.	Section 128	209 214	Nil
120.	Section 129	210, 211, 212, 213, 221, 222, 223	Nil
121.	Section 133	211 (3C)	Nil
122.	Section 134	215, 216, 217, 218	Nil
123.	Section 135	Nil	Nil
124.	Section 136	219	Nil
125.	Section 137	220	Nil
126.	Section 138	Nil	Nil
127.	Section 139	224, 224A, 619	Nil
128.	Section 140 [except second proviso to sub-section (4) and sub-section (5)]	225 except proviso to sub-section (3)	Proviso to sub-section (3) of section 225
129.	Section 141	226	Nil
130.	Section 142	224(8)	Nil
131.	Section 143	227, 228, 263A	Nil
132.	Section 144	Nil	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
133.	Section 145	229, 230	Nil
134.	Section 146	231	Nil
135.	Section 147	232, 233, 233A	Nil
136.	Section 148	233B	Nil
137.	Section 149	252, 253, 258, 259	Nil
138.	Section 150	Nil	Nil
139.	Section 151	Proviso to sub- section (1) of section 252	Nil
140	Section 152	254, 255, 256, 264	Nil
141	Section 153	266A	Nil
142	Section 154	266B	Nil
143	Section 155	266C	Nil
144	Section 156	266D	Nil
145	Section 157	266E	Nil
146	Section 158	266F	Nil
147	Section 159	266G	Nil
148	Section 160	257	Nil
149	Section 161	260, 262, 313	Nil
150	Section 162	263	Nil
151	Section 163	265	Nil
152	Section 164	202, 274	Nil
153	Section 165	275, 276, 277, 278, 279	Nil
154	Section 166	312	Nil
155	Section 167	283	Nil
156	Section 168	Nil	Nil
157	Section 169 except sub-section (4)	284 except sub-section (4)	Sub-section (4) of section 284
158	Section 170	303, 307	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
159	Section 171	304	Nil
160	Section 172	Nil	Nil
161	Section 173	285, 286	Nil
162	Section 174	287, 288	Nil
163	Section 175	289	Nil
164	Section 176	290	Nil
165	Section 177	292A	Nil
166	Section 178	Nil	Nil
167	Section 179	Section 291 Section 292	Nil
168	Section 180	293	Nil
169	Section 181	Nil	Nil
170	Section 182	293A	Nil
171	Section 183	293B	Nil
172	Section 184	299, 305	Nil
173	Section 185	295, 296	Nil
174	Section 186	372A	Nil
175	Section 187	49	Nil
176	Section 188	294, 294A, 294AA, 297, 314	Nil
177	Section 189	301	Nil
178	Section 190	302	Nil
179	Section 191	319, 320, 321	Nil
180	Section 192	Nil	Nil
181	Section 193	Nil	Nil
182	Section 194	Nil	Nil
183	Section 195	Nil	Nil
184	Section 196	197A, 267, 311, 317, 384, 385, 388	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
185	Section 197	198, 201, 309, 310, 387	Nil
186	Section 198	349	Nil
187	Section 199	Nil	Nil
188	Section 200	637AA	Nil
189	Section 201	640B	Nil
190	Section 202	318	Nil
191	Section 203	269, 316, 386	Nil
192	Section 204	Nil	Nil
193	Section 205	Nil	Nil
194	Section 206	234 [except sub-section (8)]	Nil
195	Section 207	209A	Nil
196	Section 208	Nil	Nil
197	Section 209	234A	Nil
198	Section 210	235	Nil
199	Section 211	Nil	Nil
200	Section 212 [except sub-section (8) to (10)];	Nil	Nil
201	Section 214	236	Nil
202	Section 215	238	Nil
203	Section 216 [except sub-section (2)]	247 [except sub-section 1A]	Sub-section (1A) of section 247
204	Section 217	240	Nil
205	Section 219	239	Nil
206	Section 220	240A	Nil
207	Section 223	241, 246	Nil
208	Section 224[except sub-section (2) and (5)]	242, 244	Section 243
209	Section 225	245	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
210	Section 228	Sub-section (8) of Section 234	Nil
211	Section 229	Nil	Nil
212	Section 366	565	Nil
213	Section 367	574	Nil
214	Section 368	575	Nil
215	Section 369	576	Nil
216	Section 370 [except proviso]	Section 577 except proviso	Proviso to section 577
217	Section 371	Section 578	Nil
218	Section 374	Nil	Nil
219	Section 379	Nil	Nil
220	Section 380	592, 593	Nil
221	Section 381	594	Nil
222	Section 382	595	Nil
223	Section 383	596	Nil
224	Section 384	600	Nil
225	Section 385	601	Nil
226	Section 386	602	602
227	Section 387	603	Nil
228	Section 388	604	Nil
229	Section 389	605	Nil
230	Section 390	605A	Nil
231	Sub-section (1) Section 391	607	Nil
232	Section 392	598, 606	Nil
233	Section 393	599	Nil
234	Section 394	619A	Nil
235	Section 395	Nil	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
236	Section 396	609	Nil
237	Section 397	610A	Nil
238	Section 398	610B	Nil
239	Section 399 except reference of word Tribunal in sub-section (2)	610	Nil
240	Section 400	Nil	Nil
241	Section 401	610D	Nil
242	Section 402	610E	Nil
243	Section 403	611, Schedule X	Nil
244	Section 404	612	Nil
245	Section 405	615	Nil
246	Section 406	620A	Nil
247	Section 407	Explanation to 10FD	Nil
248	Section 408	10FB, 10FC	Nil
249	Section 409	10FD	Nil
250	Section 410	10FR	Nil
251	Section 411	Nil	Nil
252	Section 412	10FX	Nil
253	Section 413	10FE, 10FT	Nil
254	Section 414	10FG, 10FW	Nil
255	Section 439	621, 624	Nil
256	Section 442	Nil	Nil
257	Section 443	624A	Nil
258	Section 444	624B	Nil
259	Section 445	Nil	Nil
260	Section 446	626	Nil
261	Section 447	Nil	Nil

S. No.	Provisions of Companies Act, 2013 as notified	Corresponding provisions of Companies Act, 1956	Corresponding provisions of Companies Act, 1956 continue to remain in force
262	Section 448	628	Nil
263	Section 449	629	Nil
264	Section 450	629A	Nil
265	451	Nil	Nil
266	452	630	Nil
267	453	631	Nil
268	Section 454	Nil	Nil
269	Section 455	Nil	Nil
270	456	635A	Nil
271	Section 457	635AA	Nil
272	Section 458	637	Nil
273	Section 459	637AA	Nil
274	Section 460	637B	Nil
275	Section 461	638	Nil
276	Section 462	Nil	Nil
277	Section 463	633	Nil
278	Section 464	11	Nil
279	Section 467	641	Nil
280	Section 468	643	Nil
281	Section 469	642	Nil
282	Section 470	Nil	Nil
	Schedule I	Schedule I	Nil
	Schedule II	Schedule XIV	Nil
	Schedule III	Schedule VI	Nil
	Schedule IV	Nil	Nil
	Schedule V	Schedule XIII	Nil
	Schedule VI Schedule VII	Nil Nil	Nil

