

BASIC UNDERSTANDING ABOUT COMPANIES

Compulsory registration under the Companies Act

Pursuant to section 11(2) of the Companies Act, 1956, where more than twenty persons jointly desire to carry on any business (Ten person in case of banking company) with the object of acquisition of gain, they can go about to pursue that objective only if they form a company and get it registered under the provisions of the Act.

What is a company?

Company is a voluntary association of persons formed for the purpose of doing business having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from the members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession.

As per definition given by Companies Act, 1956, a 'company' includes company formed and registered under the Act or an existing company *i.e.* a company formed or registered under any of the previous company laws.

Advantages or features of a company

- (i) A company is a legal entity, distinct and independent of those persons who from time to time are its members.
- (ii) The liability of the company's members can be limited to the extent they have agreed to contribute towards the capital of the company with reference to the number of shares and/or the amount of guarantee respectively undertaken by them.
- (iii) Its members are not personally liable for any act or omission on the part of the company, unless the law expressly provides otherwise.
- (iv) The company being a juristic person, distinct from the members constituting it, can acquire, own, enjoy and alienate property in its own name.
- (v) The company being a legal entity can sue and also be sued in its own name.
- (vi) The continuity of the company is not effected by the death or disability of any of its members. This feature is referred to as "perpetual succession".
- (vii) Transfer of member's interest in the company can be readily attained without in any way adversely affecting its property, business, or existence.
- (viii) The members of the company equitably share the profit by way of dividend and the company's assets in the event of its winding up in proportion of its capital respectively contributed by them.

- (ix) Incorporation of company provides better borrowing facilities as the company can raise large amount, on comparatively easier terms. Even banking and financial institutions prefer to render financial assistance to incorporated companies.
- (x) Once the company is brought into existence on its incorporation, it can only be dissolved with the provisions of the law.

Disadvantages of a company form of organisation

- (i) Unlimited liability: It is pertinent to note that while the members' liability is limited, the company itself is fully liable for its debts and thus has unlimited liability.
- (ii) Personal liability of directors and members arises in following cases:
 - (a) when the number of members of a private company is reduced below two and in case of a public company reduced below seven and the company continues to carry on business for more than 6 months, every person who is a member of the company and has knowledge of the fact, shall be severally liable for the debts contracted during that time;
 - (b) when in any act or contract, the name of the company has been mis-described, those who have actually done the act or made the contract, shall be personally liable for it;
 - (c) holding and subsidiary companies are generally viewed as independent entities. However, this independence is reduced to a certain extent when such companies are required to present accounts and financial position of the group as a whole to its creditors, shareholders and public.
- (iii) Formalities and expenses: Many formalities like obtaining Directors Identification Number, Digital Signature and expenses are involved in the incorporation of the company and
Day-to-day management and compliance of the company, such as holding meetings of the Board of directors and general meetings, preparation of accounts and auditing, passing of resolutions, preparation of statutory register and records, filing of on-line documents with the Registrar, etc.
- (iv) Company is not a citizen.

Characteristics of a company

A company registered under the Companies Act has the following features: —

- (i) separate legal entity;
- (ii) incorporated body;
- (iii) artificial legal person;
- (iv) perpetual succession;
- (v) limited liability;

- (vi) common seal;
- (vii) right to own property;
- (viii) right to sue;
- (ix) right to enter into contracts;
- (x) flexibility of investment;
- (xi) separation of control from the ownership.

Classification of companies

Companies under the Companies Act, 1956 may be classified on various grounds as under:

I. On the basis of business activities undertaken:

(1.) Manufacturing Companies: Companies mainly engaged in any type of manufacturing activities are primarily classified as manufacturing companies. These companies are required to comply with the provisions of Companies Act, 1956 alongwith *the Companies (Auditor's Report) Order, 2003 (CARO)*.

(2.) Service Companies: Companies mainly engaged in any type of service activities like consultancy, management, information technology, etc., although they may have other businesses, are termed as service companies. These companies have to comply with the provisions of Companies Act, 1956 alongwith the rules prescribed in the Companies (Auditor's Report) Order, 2003 (CARO).

(3.) Non-Banking Finance Companies: Companies, which are not banking companies but are engaged in the business activities, related to loan, finance, investment, leasing, hire purchase and other fund-based activities, are termed as Non-Banking Financial Companies. There are certain criteria for NBFC Companies viz. Compulsory registration with the RBI for commencement/continuance of NBFC activities, minimum Net Owned Fund, requirement of compulsory rating and RBI compliance before acceptance of deposits, etc.

(4.) Non-profit making Companies: Any association desirous of being incorporated as a company with limited liability, without the addition of word "Limited" or the words "Private Limited" as the case may be shall make an application electronically to the **Central Government (powers delegated to the Regional Director)** on behalf of such company/proposed company as the case may be, for grant of licence under section 25.

It is usual to form such companies whose objects may be to protect and promote the interests of traders and business groups or to promote art, science, religion, charity or

such other general purpose, which is in the overall interest of the community. Section 25 of the Companies Act, 1956 deals with the powers of the Central Government to dispense with 'Limited' in the name of charitable or other companies on fulfillments of certain conditions and is entrusted with the power to grant licence to association that for the companies proposed to be formed without the word "Limited" or "Private Limited" in their names or to companies already formed to delete the said words from their names where the Central Government is satisfied that:—

- (a) the object for which the company is proposed to be formed or already formed is to promote commerce, art, science, religion, charity or any other useful objects;
- (b) profits, if any, earned in carrying out the object and other income are proposed to be applied only for promoting its objects; and
- (c) the company intends to prohibit the payment of dividend to its members.

II. On the basis of liabilities of the members and directors:

(1) Companies with Limited liability: In such types of companies, the liabilities of members are always limited subject to some exceptions.

Companies limited by shares

These types of companies are quite common in commercial, trading and industrial world. Such companies are characterised with an authorised share capital of a certain amount, which is divided into shares. The authorised share capital may comprise of more than one kind of shares, viz. ordinary or equity shares (voting and non-voting) and preference shares. The liability of each member of such company is limited to the unpaid amount of shares and premium, if any, held by him.

Companies limited by guarantee and having share capital

Such a company by way of undertaking in its Memorandum of Association restricts the liabilities of its members to a certain fixed amount, for payment of the debts and liabilities of the company in the event of winding up. The members are liable only for the amount contracted before he ceased to be a member or payment of the debts and liabilities within one year after he ceased to be a member. Such companies may also have share capital whenever necessary. In that event, the members will be liable for the amount, if any, remaining unpaid on the shares subscribed by them, in addition to the above guaranteed amount.

Companies limited by guarantee without having share capital

Companies limited by guarantee without having share capital are exactly similar in nature to the guarantee companies as referred above except that there will be no share capital. The members will be liable, in the circumstance referred to above, to contribute an amount not exceeding the sum specified in the Memorandum of Association.

(2) Companies with unlimited liability: Every member in such a company is jointly and severally liable for all the debts and liabilities of the company.

III. On the basis of membership pattern/size:

(1) Public Limited Companies: The Company defined under section 3(1)(iv) of the Companies Act, 1956 is a public company which—

- (i) is not a private company;
- (ii) has a minimum paid-up capital of Rs. 5 lakhs or such higher capital as may be prescribed;
- (iii) is a private company but subsidiary of a public company.

(2) Private Companies: Section 3(1)(iii) defines a private company as one which—

- (a) has a minimum paid-up share capital of Rs. 1 Lakh or such higher capital as may be prescribed; and
- (b) by its Articles of Association:
 - (i) restricts the right to transfer its shares;
 - (ii) limits the number of its members to 50 which will not include:—
 - A. members who are employees of the company; and
 - B. members who are ex-employees of the company and were members while in such employment and who have continued to be members after ceasing to be employees;
 - (iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company; and
 - (iv) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

A private company, in addition to the earlier conditions, shall have a minimum paid-up share capital of Rupees One Lakh or such higher capital as may be prescribed and its Articles shall prohibit invitation or acceptance of deposits from persons other than its members, directors or their relatives. In case of such companies, public interest is not involved.

The basic characteristics of a private company in terms of section 3(1)(iii) of the Act do not get altered just because it is a subsidiary of a public company in view of the fiction in terms of section 3(1)(iv)(c) of the Act that it is a public company. May be it is a public company in relation to other provisions of the Act but not with reference to its basic characteristics. Therefore, all the provisions in the articles to maintain the basic characteristics of a private company in terms of section 3(1)(iii) will continue to govern the affairs of the company even though it is a subsidiary of a public company.

In a decided case of **Hillcrest Realty SDN.BHD v Hotel Queen Road (P) Ltd. (2006) 72 CLA 245 (CLB)** it was held that one of the basic characteristics of a private company in

terms of that section is restriction on the right to transfer and the same will apply even if a private company is a subsidiary of a public company.

(3) Government Companies: Section 617 of the Companies Act, 1956 defines Government Company on the basis of amount invested in the capital of the company. Such types of companies may be private limited, public limited whether listed or not.

If not less than fifty-one per cent of the paid-up share capital of the company is held by the Central Government or by a State Government or State Governments or partly by the Central or partly by one or more State Governments, then the company shall be treated as Government Company and includes any subsidiary of a Government Company. Government Companies is exempted from certain provisions of the Companies Act, 1956.

IV. On the basis of place of registration:

(1) Indian Company (Incorporated in India) (2) Foreign Company (Company incorporated outside India but having place of business in India)

V. On the basis of control over the management:

(1) Holding Company (2) Subsidiary Company

Holding and Subsidiary Companies

A Company shall be deemed to be subsidiary of another if the other company controls the composition of the Board of directors of the former; or the other company exercises or controls more than half of the total voting power of the former where that former company was incorporated prior to the commencement of the Companies Act, 1956 in which the holders of the preference shares issued prior to such commencement have the same voting rights as equity shares; or the other holds more than half in nominal value of the equity shares of the former; or the former company is a subsidiary of any other company which is the subsidiary of the other. [Section 4(1)]

Composition of directors in the subsidiary company

The composition of a Board of directors of the company shall be controlled by the another company if the latter by the exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person can appoint or remove the all or majority of the directors of the former company, if any of the following conditions is satisfied:

- (i) that a person cannot be appointed as a director of a former company without the exercise in his favour of the power by the latter company;
- (ii) that a person's appointment as a director in the former company follows necessarily from his appointment as director or manager of, or to any other office or employment, in the latter company;

(iii) that the directorship is held by an individual nominated by the latter company or its subsidiary.

An agreement to provide authority to the lenders to appoint directors in the company may be deemed to be control over the composition of the Board of directors

It is possible to obtain control in regard to composition of the Board by agreement by which one company may agree to advance funds to another company and in return be given control to appoint all or majority of the Board of directors in the borrowing company. This right would be sufficient to constitute the lending company as holding company and the borrowing company as subsidiary.

Ascertainment whether the company is a subsidiary of another company

To ascertain whether one company is a subsidiary of another, following points may also be noted:

- (i) Any shares held in a company in a fiduciary capacity on behalf of some other person will not come under the shareholding held by the other.
- (ii) Any shares held by a nominee for the other company will be included in the other company's shareholding. Further, shares held by a subsidiary or by a nominee for the subsidiary shall be treated as held or exercisable by that other company.
- (iii) Where the ordinary business of the other or its subsidiaries includes lending of money and shares are held or power exercisable by way of security only, such shares shall not be taken to be the shareholding of the other.

Where a body corporate is incorporated in a country outside the country, a subsidiary or holding company of the body corporate under the law of that country shall be deemed to be a subsidiary or holding company of the body corporate within the meaning of this Act, whether the requirements of section 4 are fulfilled or not. [Section 4(6)]

Producer Companies

By the Companies (Amendment) Act, 2002, a new Part IXA has been inserted under the Act with the main objective to provide provisions for formation of co-operative society as a company and to convert existing co-operative societies into companies as the provisions available under Part IX were available for conversion of a partnership firm into a company.

The conversion of co-operatives into producer companies is purely voluntary. The conversion option by co-operative society can be exercised only if two-thirds of the members of the concerned society vote in favour of the resolution to that effect. The producer company indicate that only certain categories of persons can participate in the ownership of such companies, the members of the producer company have necessarily to be "primary producers", that is persons engaged in an activity connected with, or relatable to, primary produce.

The Companies (Amendment) Act, 2002 provides a statutory and regulatory framework that creates the potential for producer-owned enterprises to compete with other enterprises on a competitive footing by way of various forms of companies. This will provide an opportunity to cooperative institutions to voluntarily transform themselves into new form of producer companies.

Scope of the Act

The Companies Act applies to all trading and other corporations, which are incorporated under the Act or any of the earlier Companies Act. But it does not apply to universities, co-operative societies, unincorporated trading, scientific and other societies.

THE INDIAN COMPANIES ACT, 1956

BASIC CONCEPT

1. What is the meaning of a Company?

The word company means an association formed by a number of persons for some common object.

When such an association of persons is registered under the companies act, it becomes an artificial person with perpetual succession and common seal.

2. How is a company defined?

According to sec. 3(1) (i) of the company act, 1956: A company is defined as, 'a company formed and registered under this act or an existing company.' An existing company means 'a company formed and registered under any of the previous company laws.'

The definition given by the companies' act does not define the company clearly as to its features. Chief Justice Marshall of U.S.A. has defined the term company, as 'a company is a person, artificial, invisible, intangible and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence.'

3. What are the characteristics of the company?

The following are the characteristics of the company:

1. **Incorporated Association:** Under the Companies Act, a company must be registered or incorporated. The minimum numbers of persons required for incorporation are seven in case of public co. and two in case of private company.
2. **Artificial person:** It is an artificial legal person enjoying same rights and owing same obligation as a natural person.
3. **Separate Legal Entity:** A company is separate and distinct from the persons who constitute it.
4. **Limited Liability:** the liability of its members is limited to the unpaid value of the shares held by them or guarantee given by them.
5. **Separate Property:** Company is entitled to own and hold property as distinct from its members.
6. **Transferability of Shares:** Shares of the company are freely transferable which makes the life of the company independent of the lives of its members.
7. **Perpetual Existence:** A company being an artificial legal person, it is not affected by the death, insolvency or retirement of the members. Members may come and members may go out but the company can go on forever.
8. **Common seal:** Common seal is the official signature of the company because a company cannot sign like a natural person.
9. **Company may sue and be sued in its own name:** One of the consequences of separate legal entity is that a company may sue and be sued in its own name.

4. What is meant by corporate veil?

A company is a legal person and is distinct from its members. This principle is regarded as a curtain or a veil between the company and its members protecting the latter from the liabilities of the former. This veil is the corporate veil and is impassable as an iron curtain.

5. What is meant by Lifting of the Corporate Veil?

As per the judicial point of view, a company is a separate legal entity different from its members (Saloman Vs. Saloman & co. Ltd.). When there are cases of dishonesty and fraudulence in incorporation, the law lifts the veil. This veil is a fictional veil and not a wall between the company and its members. Lifting the corporate veil may be defined as looking behind the company as a legal person and identifying the persons who are behind the scene and are responsible for the preparation of fraud.

The circumstances under which the court may lift the corporate veil may be broadly divided into following two heads:-

1. Judicial Interpretation
2. Statutory Provision

1. **Judicial Interpretation:** following are the cases under which the court has lifted the corporate veil:-

- a. **Avoidance of welfare legislation:** Where the device of incorporation is used for reducing the amount to be paid by way of bonus to the workmen, the Supreme Court can uphold the lifting of the veil to look at the real transactions: [workmen of Associated Rubber Industry Vs. Associated Rubber Co.]

b. **Protection of Revenue:** Where the medium of the company has been used for tax evasion or to circumvent tax obligation, courts have lifted the veil and looked at the realities of situation [In Sir Dinshaw Mancekjee Petit]

c. **Where company is a sham:** When the court finds that company is a mere cloak or sham and is used for some illegal or improper purpose, it may lift veil. The leading case on this was P.N.B. Finance V. Shital Prasad, where a person borrowed money from a company and invested it into three different companies, the lending company was advised to bring together the assets of all the three companies, as they were created to do fraud with the lending company.

d. **Where the company is acting as the agent of the shareholders:** Where a company is devised to act as an agent of its shareholders or of another company it will be responsible for its acts. However, it will be a question of fact every case whether the company is acting as agent for its shareholders.

e. **Determination of character:** Test of control is adopted in the cases when the trade is conducted with enemy country. In such cases the court will lift the veil at the times of war to see whether a company is controlled by enemy aliens. Consequently a company registered in England may be alien enemy if its agents or the persons in default controls of its affair are alien.

f. **Provision of fraud or improper conduct:** The court will disregard the separate existence of the company, where it is shown the company is formed for evading contractual and statutory obligations [Gilford Motor Co. Ltd. V. Home]

2. **Statutory Provision :** cases are as follows:-

a. Number of member below statutory minimum [sec. 45]

When at any time the number of member of a company is reduced below two in case of a private company or below seven in case of a public company and then too it continues its business for more than six months, the every member who knows the fact will become liable to an unlimited extend for the payment of the whole debt of the company done during that time. The reason behind this is to withdraw the advantage of incorporation when the conditions are not fulfilled.

b. **Company not mentioned on the bills of exchange [sec. 147]:** When the bills of exchange, promissory note, cheque or order for money or goods are signed by officer of the company or any other person on behalf of the company, and the name of company is not fully or properly mentioned. Then the person who signed the instrument will be personally liable. Unless the amount is paid by the company.

c. **Failure to refund application money [sec. 69]:** In case of issue of shares by a company to the public, if the company is unable to receive minimum subscription within 120 days from the first issue of the prospectus than all money received from application shall have to be returned. If the amount is not refunded within 10 days, the directors shall be liable to repay the money with interest at the rate of 6% per annum.

d. **Fraudulent trading [sec. 542]:** On the winding up procedure of the company, if it is found that any business of the company has been carried on to defraud creditors, the court shall declare those persons personally liable for the debts and other liabilities of the company.

e. **Group accounts [sec. 212]:** Where the company has subsidiaries and group accounts, than the principle of separate legal entity may be disregarded. Along with the own profit and loss account and balance sheet, subsidiaries and group accounts have also to be laid down.

Thus, these are the circumstances where the veil can be lifted.

6. What are the various types of companies?

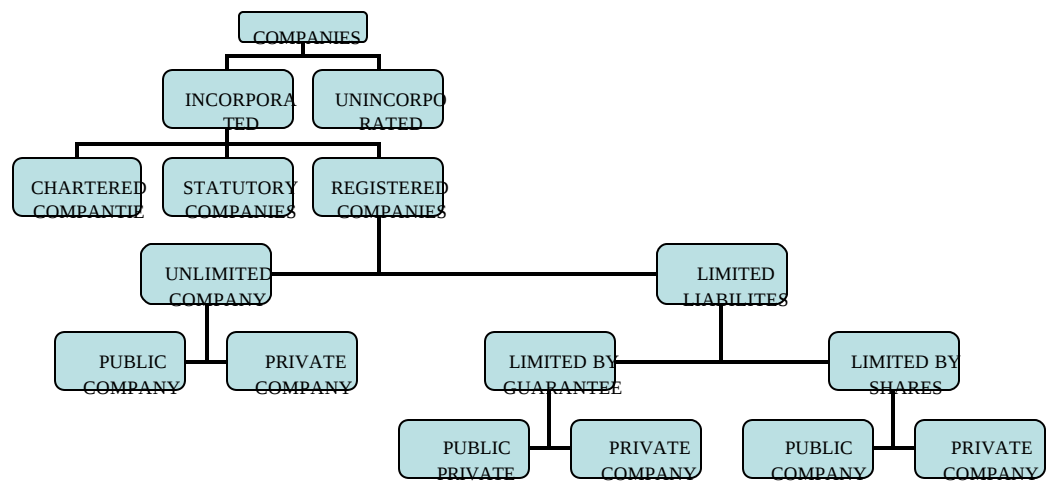
Generally there are two common types of companies which are registered under this Act, they are:-

1. Private company
2. Public company

However, there are other types of companies which are shown as under:-

1. **Chartered Companies:** The companies which are incorporated by a charter granted by the "Crown" in exercise of royal prerogative Eg. East India Company.
2. **Statutory Companies:** The companies incorporated by means of Statute of special Act of the parliament or any State Legislative Eg. RBI, LIC etc.
3. **Registered Companies:** The companies registered under the companies Act, 1956 or the earlier Companies Act.

Registered Companies are of the following types:



- (i) **Companies limited by Share:** The companies in which the liability of the members are limited by the memorandum to the amount, if any, unpaid on the share respectively held by them.
- (ii) **Companies limited by Guarantee:** The companies in which the liability of the members are limited to such amounts as they may respectively undertake by the memorandum to contribute to the assets of the company in the event of being its wound up.
- (iii) **Unlimited Companies:** The companies in which the liability of the members is not limited at all.

7. What is meant by a private company?

According to Section 3(1) (iii) as amended by the companies (amended) Act, 2000, a private company means:-

A company which has a minimum paid up capital of one lakh rupees, or such higher paid up capital as may be prescribed by its articles provides for the following restrictions.

1. Restricts the rights of members to transfer the shares
2. Limits the number of its members to fifty and
3. Prohibits any invitation to the public to subscribe for any shares or debentures of the company.
4. Prohibits any invitation or acceptance of deposit from persons other than its members, director's or their relatives.

However, u/s. 25, companies not for profit have been exempted from the provision of minimum paid up capital of Rs. 1 lakh.

8. How is a Public company defined?

According to sec, 3(1) (iv) as amended by the companies (amended) Act, 2000, a public company means:

A company which:-

1. Is not a private company
2. Has a minimum paid-up capital of Five lakh Rupees or such higher paid -up capital as may be prescribed.
3. Is a private company, which is a subsidiary of a public company.

9. What is meant by Holding and Subsidiary company?

A company which controls another company is knows as the holding company and the company so controlled is the subsidiary company.

Section 4, provides that:-

A company is a holding company if it

1. Controls the composition of board of directors of another company.
2. Holds more than half of the nominal value of equity share capital of another company.
3. Is a subsidiary of any company which is in twin a subsidiary of another company.

Restrictions:

If it is authorized by the memorandum only then a company can become a member of another company, but under section 42(1) a company excepts in certain specified cases cannot become a member of its holding company, if any allotment or transfer of shares takes place in a company to its subsidiary or nominee for its subsidiary it will be void.

There are two cases where section 42(1) will not apply. They are as follows.

1. Where, the subsidiary is concerned as a legal representative of a deceased member or
2. Where the subsidiary is concerned as a trustee unless the holding company or a subsidiary or it is beneficially interested under the trust and is not so interested only by it in the ordinary course of a business.

At the time of the commencement of the companies Act, 1956 if a subsidiary was the member of its holding company then it shall continue to be its members. But it shall not except in two cases mentioned in section 42(2) have any voting right at the holding company's meeting.

As per sub-section (4) of section 42, the restrictions contained in sub-section (1) can be extended to the cases where a body corporate which is a subsidiary is not holding any shares in the holding company in its own name but through its nominee.

In the case of subsidiary company having any membership interest in the holding company which is either limited by guarantee or an unlimited company whether it has a share capital or not the prohibition contained in the sub-section (1) shall be applicable.

10. Which financial institutions are regarded as Public Financial Institution?

According to section 4A of the companies Act, 1956 the following institutions will be regarded as Public Financial Institutions :-

1. The Industrial Development Bank Of India.
2. The Industrial Credit And Investment Corporation Of India
3. The Life Insurance Corporation Of India.
4. The Unit Trust Of India
5. The Industrial Finance Corporation Of India.
6. The Infrastructure Development Finance Company Ltd.
7. The Reconstruction Company Or The Securitization Company that has been recognised under the securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

According to section 4A(2) the Central Government has the power to add or increase to the institution list, the addition can be done only when the notification or it is given in the official gazette. The institution will be added to existing list on when they fulfill the following two conditions:

- (a) It must have been established or constituted by or under any Central Act, or
- (b) Not less than 51% of the paid up share capital of such an institution is held or controlled by the Central Government. Till now Central Government has specified 39 institutions to be public financial institutions. Some of them are :-
 1. The Oriental Fire And General Insurance Company Limited
 2. The National Insurance Company Ltd
 3. Export Import Bank Of India.
 4. The Shipping And Credit And Investment Company Of India Ltd.
 5. National Housing Bank
 6. Small Industrial Development Bank Of India.
 7. NABARD etc.

11. What is the difference between a private company and a public company?

Sr.	Basis	Section	Public section	Private section
1.	Formulation of company	149	After receiving the certificate of commencement of business	After receiving the certificate of incorporation
2	Minimum no. of members to form a company	12(1)	Seven	Two

3	Maximum no. of members	12(1)	No restriction	Fifty
4.	Minimum paid up capital		Five lakhs rupees or such higher capital as may be prescribed.	One lakhs rupees of such higher capital as may be prescribed.
5.	Minimum no. of directors	252(1)	Three	Two
6.	Maximum no. of directors	259	Twelve for more than 12 approval of Central Government is necessary.	No such restriction.
7.	Appointment of small shareholders Director	252(1)	Applicable if the company's paid-up capital is Rs.5 Crore or more and having at least one thousand small shareholders.	Not applicable.
8.	Appointment of casual directors	252(1)	Applicable, subject to any regulation in the articles of the company.	Not applicable
9.	Subscription of shares	3(1)	No such restrictions.	Prohibits any invitation to the public to subscribe for any shares in or debenture of the company.'
10.	Issue of share warrants	114(1)	Can issue subject to authorization in the articles of the companies, with the previous approval of Central Government and in respect of fully paid up shares	Not applicable
11.	Further issue of capital	81	Applicable, subject to certain exceptions.	Not applicable
12.	Audit committee	292A	Applicable to every public company whose paid-up capital is not less than five crores of rupees	Not applicable
13.	Statutory meeting	165	Shall hold within a period of not less than one months from the date at which the company is entitled to commence business	Not applicable
14.	Quorum for a general meeting	174(1)	Five members personally present	Two members personally present
15.	Appointment of proxy	176(1)	No restriction	Not entitled to accept more than one proxy for each member.

12. What are the privileges available to a Private Company?

1. A private company may be formed by only 2 members
2. A private company can commence business after getting the certificate of incorporation
3. Minimum capital contribution required in the case of private co. is Rs. 1,00,000.
4. A private co. can allot shares before minimum subscription
5. Prospectus and statement in lieu of prospectus is not required to be issued.
6. A private company is not required to have a statutory meeting or file a statutory report.
7. A private company need not have more than two directors.
8. Rotational retirement not necessary
9. No permission is required for increasing directorship
10. Directors are not required to take qualification shares
11. In case of further issue of capital, the shares need not be first offered to the existing shareholders.

12. A director appointed on or before 1st April, 1952, cannot be removed by the company in general meeting.
13. A private company need not maintain for general meeting.
14. Only 2 persons are required quorum for general meeting.
15. A private company may call and hold its general meeting by giving a notice shorter than 21 clear days.
16. A private company may remunerate the Managerial personnel by a profit percentage which can be higher than 11%.
17. Profit and Loss of a private company need not to be made open to public.
18. Rotational retirement of directors is not applicable to private company.
19. Directors are not required to file with the registrar, their consent to act as directors.
20. No approval of Central Government is required for appointment of a whole time director or managing director.
21. No restriction applies on directors, regarding the no. of companies he can be appointed as directors.
22. Loans to directors are not prohibited.
23. A private company is free to make its own provision in respect of method of determining net profit for remuneration.
24. The provisions of Sec. 372(A) with respect to inter company investment do not apply to private companies.
25. The Company law board is not empowered to interfere, to prevent change in Board of Directors.

(i) **Default of complying with the condition constituting a private company :** If contravention is made in fulfilling the provisions contained in Sec. 3(i)(iii), the company will lose all the privileges and exemption given to it by the companies Act, 1956 and the act shall apply to it as if it were not a private company [section 43]

But there is a solution to the problem. The solution is that the company can apply to the Company Law Board for the relief. If company is in a position to satisfy the Company Law Board that the failure in compliance with the said requirement was not deliberate but was accidental then the CLB may relieve the Company from such consequences. The grounds to grant relief should be just and equitable (provision to section 43).

(ii) **Consequences of membership falling below legal minimum:** In the case of the public company the minimum number of member required is 7. The number of member in this case is reduced to 5 i.e. below the minimum limit. While the number is 5 reduced, and the company carries on business for more than six months then every person who is a member of during that time shall be personally liable for the payments of the whole debts of the company and will be severally sued there for. (section 45)

To overcome this problem the existing members must transfer some of their shares to some nominees or other persons and thereby increase the number of members of the company, up to or more than 7 within the time mentioned.

13. How is a Public Company converted into a Private Company?

The Company Act does not allow a Public Company to turn itself into a private company, but it neither prohibits such conversion. The conversion can take place in following ways:-

1. A Public company can be converted into a private company by altering the articles, incorporating the three restrictions, mentioned in section 3(i)(iii).
2. Approval of the central government is necessary for converting a Public company into a private company.
3. Special resolution is to be passed within 30 days, after obtaining the approval of the Central Government for conversion.
4. The word private Ltd. is used.

The conversion of a public company into a private company does not affect the identity of the company.

14. What is the procedure laid down in the provisions of the companies Act, 1956 for converting a private company into a public company?

There are three ways through which the conversion of a private company into a public company takes places.

1. Conversion by default
2. Conversion by operation of law
3. Conversion by choice

1. Conversion by default:-

- (i) According to section 43, if a default is made in complying the statutory requirement as laid down in Section 3(i)(iii) of the act, a private company gets converted into a public company automatically (that is if it permits free transferability of shares, if its membership exceeds 50 or when it extends invitation to the public to subscribe to shares or debentures or to make deposits.)

- (ii) As a result of this the private company will not be able to enjoy the privileges and exemptions conferred on it and the provisions of the companies Act shall apply to it as if it were a public company.
- (iii) Further, if the company wants to remain a private company, than it should apply to the Company Law Board for relief.
- (iv) However, the CLB on being satisfied, that the failure to comply with the condition was accidental or due to inadvertence or to some other reason, it may grant relief from such consequences, as aforesaid.
- (v) The relief may be granted on grounds, which the CLB feels just and equitable.

2. **Conversion by the operation of Law:** There are four circumstances mentioned in section 43A which would force a private company to become a public company. They are –

- (i) Where 25% or more its paid-up share capital is held by one or more bodies corporate or public company.
- (ii) Where the average annual turnover is not less than 25 crores for three consecutive financial years.
- (iii) Where a private company holds out not less than 25% of the paid-up share capital of a public company.
- (iv) Where the private company accepts by invitation or renews deposits from the public, other than from its members or directors and their relatives, than the private company will become a public company, the day it accepts the deposits.

Note: - the Companies (amended) Act 2000 has by introducing sub section (ii) to section 43A, made the section inoperative except sub section 2A.

3. **Conversion by choice:** A private company may by its own choice becomes a public company. The steps necessary for this purpose are as follows:

- (i) **Special Resolution:** A private company desiring to become public company must pass a special resolution, deleting from its articles the requirement of section 3(i)(iii). A copy of resolution so passed must be filed with the Registrar of companies within 30 days.
- (ii) **Increase in number of directors (section 252):** If the numbers of directors are less than three, it should be raised to three.
- (iii) **Increase in membership (section 12):** If the numbers of member is less than 7, it should be raised to 7.
- (iv) Raising of paid up capital to the minimum, prescribed for public companies that is Rs. 5 Lakhs
- (v) According to section 44(1)(b), a prospectus or statement in lieu of prospectus in the prescribed form (schedule IV) must be filed with the registrar with 30 days from the passing of the special Resolution.
- (vi) Every prospectus files under sub-section (1) should state the matter specified in part I or schedule II, and sets out the reports specified in part II of that schedule [section 44(2)(a)]
- (vii) The statement in lieu of prospectus filed, should be in the form and contain particular set out in Schedule IV [section 44(2)(b)]
- (viii) If the company and every officer of the company makes a default, than they shall be punishable with a fine, which may extend to Rs. 5000 for every day during which the default continues.
- (ix) If any untrue statement is filed in the prospectus or statement in lieu of prospectus, than the person authorized shall be punishable with fine or Rs. 50,000 with imprisonment upto 2 years or both.

15. What is the procedure for registration of a company ?

A company comes into existence when a number of persons come together with a view to exploit some business opportunity. According to section 12, for a private company any two persons or more and for a public company any seven persons or more may incorporate a company, by subscribing their names to the Memorandum of Association and complying with other requirements, in respect of registration.

The memorandum for registration of a company should be presented to the registrar of the state in which the business office of the company is to be situated.

Documents to be filed with the registrar: -

- 1. Application for availability of name
- 2. Memorandum of Association
- 3. Articles of Association
- 4. Copy of proposed agreement
- 5. Statement on nominal capital

6. Address of the registered office
7. List of directors and their consent
8. Undertaking to take up qualification shares
9. Statutory declaration

When the Registrar of Companies is satisfied by the filed documents, he registers the company and places its name on the register of companies. If there are small defects in the documents, the registrar can get it rectified and then get the company registered. But, if there is a material defect, he may refuse for registration.

Restrictive conditions on the basis of which a company may be incorporated as a private company : The conditions of restriction with which a private company is incorporated under the companies Act, 1956 are as follows: -

1. Every private company should have paid up capital of Rs. 1 Lakh or such higher as may be prescribed.
2. The right to transfer share is restricted
3. The number of members is limited to 50 excluding the past and present employees who are the members of the company.
4. Prohibition on inviting public to subscribe to any shares or debentures of the company.
5. Prohibition on invitation or acceptance of deposit from person other than its members, directors or their relatives [section 3(i)(iii) of companies Act, 1956].

16. What is the procedure for registration of Non-profit Organisation as a company?

Association not for profit: An “Association not for profit” means a association which is formed not for earning profit but for commerce, art, science, charily, religion or other useful social purpose. These associations may or may not be registered as a company under the companies Act. When such type of the association are registered as a company as a company with limited liability, they must be granted a license by the Central Government.

As per section 13, the name of a limited company must end wit the word ‘Limited’ in case of a public Company and with the words ‘Private Limited’ in case of private company. Section 25 of the companies Act, 1956 however allows the registration under a licence granted by the Central Government, of an association not for profit with limited or the words Private Limited to its name.

Condition for the grant of licence: When the following two conditions are satisfied than only the Central Government will grant the licence to an association, conditions are as follows: -

1. Intends to apply or use its profits of other income in promoting its objects and to prohibits the payment of any dividend to its members and
2. Is important to form a limited company for promoting commerce, science, religion charity or for other useful object.

As per section 25(1) when the two conditions are fulfilled, the Central Government may by licence direct that the association may be registered as a company with limited liability, without the addition to its name of the word “Limited” or the words “Private Limited”. On getting itself registered it enjoys all the privileges and is subject to all types of obligation of limited companies.

The Central Government will grant licence on such conditions and subject to such regulations as it thinks fit. The association will be bound to follow the conditions and regulation on which the licence is granted. The Central Government has the power to revoke the licence at any time after giving an opportunity to the company for being heard.

Procedure for registration of a Company under section 25:

1. As per section 25 the first step is that the promoter must apply to the Central Government for a licence.
2. The second step for the registration of a company is that the promoters must fulfill all the conditions subject to which the licence is to be issued.
3. Thereafter he should apply to the registrar of companies for the incorporation of a company in same way as the other companies are registered i.e. filling the documents like MOA, AOA, list of first director, declaration in prescribed form.

17. What is Certificate of Incorporation?

On registration of the company when the documents required for registration of a proposed company is filed by the company along with the necessary fees. The registrar of Companies issues a Certificate that the company is incorporated. This certificate is called Certificate of Incorporation. In case of a limited company the fact that the company is limited is mentioned in the certificate [section 34]

A certificate of incorporation is conclusive as to all administrative act relating to incorporation and as to date of incorporation.

The following are the effect of incorporation:-

1. It becomes a body corporate distinct from its members
2. It has a perpetual succession and a common seal
3. A company can sue and be sued in its own name
4. The debts of company are the liabilities of the company only
5. The property of the company belongs to the company and not to its members.

Therefore, the certificate of incorporation is conclusive evidence.

18. When can a company commence its business?

A private company can begin its business immediately after getting the certificate of incorporation. Whereas, a public company cannot start its business after incorporation unless it has obtained this certificate. The company may comply with the provision of section 149 of the companies Act. The method for obtaining the certificate varies with the fact whether the company has issued a prospectus or not.

If the company has share capital and the prospectus is issued the company cannot commence its business until:-

1. Shares up to the amount of minimum subscription have been allotted by the company.
2. Every director has paid up the application and allotment money on the shares taken
3. No money is to be repaid to the application for failure to apply or obtain permission for the shares to be dealt in any recognised stock exchange
4. A statutory declaration duly verified by one of the directors has been complied with [section 149(1)]

Where the company has not issued a prospectus: If the company has a share capital but has not issued a prospectus to the public, it shall not commence the business unless:-

1. Statement in lieu of prospectus has been filed with the registrar.
2. Every director has paid in cash the application and allotment money on the shares taken by him
3. A statutory declaration duly verified by one of the directors or the secretary or where the company has not appointed a secretary in whole time practice in the prescribed form, that the above conditions have been complied with, has been filed with the registrar [section 149(2)]

When the company has complied with the aforesaid conditions, the registrar of Companies will issue a certificate to commencement of business.

19. Who is a Promoter?

The "Promoter" is a person who brings a company into existence.

A promoter is one who undertakes to form a company with reference to a given object and to set it going and who takes the necessary steps to accomplish that purpose.

The Promoters of a company decide the scope of the business activity. They are not the agent of the Company.

OBJECTIVE QUESTIONS

1. A certificate of incorporation issued by the Registrar of Companies is not valid if all the signatures of the subscribers to memorandum of association have been forged.

Ans: **False:** According to section 35 of the companies Act, 1956 a certificate of incorporation given by the registrar shall be conclusive evidence that all the requirement of this Act with respect of Registration have been complied with. Accordingly even if all the signatures of the subscribers to the memorandum of association have been forged, registration of company will remain valid, if the registrar of companies issued a certificate of incorporation.

DESCRIPTIVE QUESTIONS

1. What is meant by "deemed public company"? Under what circumstances a private company may be treated by the law as "deemed public company"? What are the special privileges and exemptions enjoyed by such companies as compared to other public companies under the companies Act, 1956?

Ans: Section 43A was introduced in 1960, in which a private company is converted into a deemed public company with the fulfillment of some condition. A deemed public company is neither a private company nor is it a public company but a company, in a third category.

According to section 43A, a private company will be deemed as public company in the following case:-

1. When the private company holds 25% or more of the paid up capital of a public company

2. When the average turnover for the last three consecutive years is Rs. 25 cores or more.
3. When the deposits are invited from the public through an advertisement.
4. When the private company has public company as its shareholders holding in aggregate 25% or more of its paid up share capital.

There are some other features also with the help of which a private company will be deemed to become a public company

1. The number of members may be below the statutory minimum of 7 members required for a company.
2. A statement in lieu of prospectus is to be filed; when section 44 of the Act is not applicable.
3. Their article may contain provisions of section 3, which related to private company.

By virtue of section 43A of the Act, all the provisions of the Act relating to public company will apply to companies becoming public company.

2. Explain the consequences and remedy, if any in respect of the following situations:

1. **A private company has contravened the provisions of section 3(i)(iii) (redefinition of a private company) of the companies Act, 1956.**
2. **The number of members of a company registered as a public company is reduced to five.**

Ans: **(i) default in complying with the condition constituting a private company:** if contravention is made in fulfilling the provisions and exemption given to it by the companies Act, 1956 and the Act shall apply to it as if it were not a private company [section 43]

But there is a solution to the problem. The solution is that the company can apply to the company Law Board for the relief. If company is in position to satisfy the Company Law Board that the failure in compliance with the said requirement was not deliberate but was accidental than the CLB may relieve the company from such consequences. The grounds to grant relief should be just and equitable (provision to section 43)

(ii) Consequences of membership falling below legal minimum: In the case of the public company the minimum number required is 7. The number of member in this case is reduced to 5 that are below the minimum limit. While the number is 50 reduced and the company carries on business for more than six months than every person who is a member of during that time shall be personally liable for the payments of the whole debts of the company and will be severally sued therefore (section 45)

To overcome this problem the existing members must transfer some of the shares to some nominees or other persons and thereby increase the numbers of the company, up to or more than 7 within the time mentioned.

3. Define a private company.

Ans: **Private company :** According to section 3(i)(iii) of the Companies (Amended) Act, 2000 a private means a company which has a minimum paid up capital of one lakh rupees or such higher paid-up capital as may be prescribed by and its articles provide for the following restriction:

1. Restricts the right to transfer its shares if any.
2. Prohibits any invitation to the public to subscribe for any shares or debentures of the company.
3. Limits the number of its members to 50 not including its employees members (present part).

4. Examine the position of the following with regard to membership in a company : (i) An insolvent (ii) Partnership Firm.

(i) **An Insolvent** An insolvent can remain the member of the company as long as his name appears in the register of members. He is a member and is in a position to vote even though his shares vest with the official receiver or assignee.

(ii) **Partnership Firm:** A partnership firm is an unincorporated association, a firm is not a person and as such it cannot become the member of the company. But the firm can hold shares in the individual's name of the partners as joint shareholders.

5. Explain clearly the concept of "Perpetual Succession" and "Common Seal" in relation to a company incorporated under the Companies Act, 1956

Ans: Unlike a natural person a company never dies. It is an entity with a perpetual succession. The life of the company does not depend upon the life of any of its members; it is independent from the lives of its members. Even the death, insolvency, mental disorder or retirement of a member does not affect the corporate existence of the company. It is created by the process of law and can be put to an end only by the process of law. Members may come and go out the company will carry on to exist unless it is wound up. The companies continuous to exist even if its all members are dead.

A company is of perpetual succession in the sense that inspite of the change in the membership of the company it persist to exist.

Common Seal: Since a company has no physical existence, it cannot sign its name on a contract. So it takes the help of the seal which is used as a substitute for its signature. Every company must possess their own seal with its name engraved on it. It acts as the official signatures of the company. the documents that do not bear the common seal, of the company do not bind the company.

6. What is meant by a Guarantee company? State the similarities and dissimilarities between the Guarantee Company and a Company having share Capital.

Ans: **Meaning:** Where it is proposed to register a company with limited liability, it can be limited Guarantee Company by shares or by Guarantee. Section 12(2) (b) of the companies Act, 1956 defines as a company having the liability of its members limited by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the members of a Guarantee company is limited by a stipulated amount mentioned in the memorandum. The members cannot be called upon to contribute more than the stipulated amount for which articles of association of such company shall state the number of members with which the company is to be registered.

Similarities between the Guarantee Company and the Company having share capital: The common features between a “Guarantee company” and the “company having share capital” are legal personality and limited liability. In case of the later company, the members’ liability is limited by the amount remaining unpaid on the shares, which each member holds, both of them have to state this fact in their memorandum that the members’ liability is limited.

Dissimilarities between the Guarantee Company and the Company having share capital: Dissimilarities between the Guarantee company and the company having share capital is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in later case, they may be called upon to do so at any time, either during the company’s life or during its winding up.

7. What will be the consequence in case if a private company incorporated under the provisions of Indian companies Act, 1956 defaults in complying with conditions constituting a private Company in terms of section 3(i)(iii) of the companies Act, 1956.

Ans: Definition of a private company is given under section 3(i)(iii) as follows:

Private company means a company which has a minimum paid up capital of one lakh rupees and which by its articles (a) Restricts the right to transfer its shares

- (a) Limits the number of its members to 50, excluding Employee member and ex-employees.
- (b) Prohibits issue of its shares or debenture to the public.
- (c) prohibits acceptance of deposits from persons other than its members, directors or their relatives.

According to section 43 of the companies Act, 1956 if a private company makes default in co mplying with any of the above mentioned conditions, the company shall become a private company, provided that the Central Government may on the application of the company, on such consequences as aforesaid.

If a private company is converted into a public company, it will have to make the following consequential changes:

- 1. Change name clause of memorandum of association by deleting the word private from its name.
- 2. Increase authorized capital and paid up capital up to Rs. 5 Lakhs, if it is less than this amount
- 3. Increase its directors to three
- 4. Increase its numbers of members, to seven.
- 5. Delete those clauses from articles which are not suitable for a public company.
- 6. Give notice to ROC.

PRACTICE QUESTIONS

1. The registrar of companies issued a Certificate of Incorporation actually on 8th January, 1999, by mistake, the Certificate was dates “5th January 1999”. An allotment of shares was made on 7th January,1999. Could the allotment be declared void on this ground that it was made before the company was incorporated?

Ans: The allotment of shares cannot be declared void. According to the section 35 of the companies Act 1956 a certificate of incorporation issued by the Registrar of the companies will be the conclusive evidence or proof of the fact that all the requirement o f the Act has been complied within the respect of registration.

It has been assumed that the Certificate of Incorporation is conclusive as to all administrative act relating to the incorporation and as to the date of incorporation. In the above mentioned case the Registrar issued the certificate on 8th

January. It was held that allotment of shares on 7th January could not declare to be void on the ground that it was made before incorporation of the company, therefore, the certificate will not be considered a conclusive evidence as all the objects of the company as given in the memorandum are legal.

2. MR. V along with six other persons desires to float a company for charitable purpose, as permissible under section 25 of the companies Act, 1956. He seeks your advice about the procedure to be followed to give effect to the above proposal. Advise him.

Ans: As per section 25 of the companies Act, 1956 if the Central Government is satisfied that an association is to be formed for promoting commerce, art, science, charity or any other useful object and prohibits payment of any dividend to its members, it may by license direct that the association may be registered as a limited company without addition to its name the word limited or words Private Limited as the case may be. The licence may be granted by the Central Government on such conditions and subject to such regulation as the Central Government thinks fit and the conditions may be inserted in the memorandum of association and Articles of association of the company if so directed by the Central Government.

Procedure to obtain licence – In terms of section 25 of the Act and provisions of the companies Regulation, 1956 the following procedures are to be followed for incorporation of a company for charitable purpose.

1. The name of the company should be finalized and confirmation of availability of the name should be obtained from the Registrar of Companies as in the case of other companies i.e. by applying in form no 1A.
2. The memorandum of association and the Articles of association shall be prepared keeping in view of the provisions of section 25 of the Act.
3. An application to the regional Director should be made for issuance of a licence under section 25 of the Act for incorporation of the company without the word 'Limited' of 'Private limited'. The power of the Central Government has been delegated to the Regional Director. The application shall be accomplished by the following documents:
 - a. 3 copies of the Memorandum of association and Articles of association of the company.
 - b. 3 copies of the list containing name, address, occupation of the promoters, proposed directors, names of the other companies where those persons are director of at higher positions.
 - c. A statement showing the assets and liabilities of the company as on the date of application
 - d. A statement of estimated future incomes and expenditures with the source of income
 - e. A statement giving brief description of the work done.
 - f. A declaration by an advocate of the Supreme Court or High Court or a Chartered Accountant or Company Secretary in practice certifying that the requirements of the Act and the regulation have been complied with in respect with the registration of application.
 - g. A declaration by each person who are making the application
 - h. A statement specifying the ground on which the application is made.
 - i. Documents showing the payment of the requisite fee.
4. 3 copies of the report and accounts of the company if in existence for 2 year and if exists for less than 2 years, immediately preceding the date of application, for all the years.
5. A copy of the application together with the enclosures shall also be sent to the Registrar of Companies.
6. A public notice as per Form set out in Annexure II of Regulation shall be made within one week of submission of the application. The public notice can also be made within one week before submission of the application.
7. The Registrar of Companies shall within 15 days from the date of receipt of the application sent its comments to the Regional Directors.
8. The Registrar may refer the matter to the District Magistrate for his views and a copy of letter containing the view of the magistrate shall be sent to the Regional Director. The regional Director may also seek the view of the Central Government or the state Government. Considering all the views and all aspects if any alteration of modification is required in their memorandum of association and Articles of association of the company, the Regional Director shall refer the matter to the applicant for necessary action.
9. On compliance with the instruction, if any, of the Regional Director may if satisfied issue the licence to the company.
10. The company shall thereafter incorporate the conditions set out by the Regional Director in the Memorandum of association and Articles of association of the company and print the same.

11. All documents i.e. Memorandum of association and Articles of association of the company, the declaration in Form 1 etc. which are required under section 33 of the Act for incorporation of a company together with the copy of the licence shall be filed with the Registrar of Companies.
12. The Registrar of Companies if satisfied shall then issue necessary certificate of incorporation.

MEMORANDUM AND ARTICLES OF ASSOCIATION

1. What is Memorandum of association?

As per section 2(28) of the Companies Act, 1956, “Memorandum” means “Memorandum of Association of a company as originally framed and altered from time to time in pursuance of any provisions of company laws or of this Act”. This definition does not give any idea as to what memorandum really is.

According to Palmar, “the Memorandum of Association is a document of great importance in relation to the proposed company. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its action cannot go. It defines as well as confines the power of company. If anything is done beyond these power that will be ultra vires the Company and so void. Thus, it is evident that the memorandum is the charter and defines the limitation of the power of a company.

Requirement to be stated in the memorandum: According to section 1, for the incorporation of the company, there must be at least 7 persons in case of the public company and at least 2 persons in case of the private company. Section 13 requires the Memorandum of a limited company to contain the following clauses:-

1. The name of the company with limited as the last word in case of a public limited company and with Private Limited as the last word in the case of a Private Limited Company.
2. The state in which the registered office of the company is to be situated.
3. The objects of the company must be separated on two basis :-
 - (i) The main objects of the company to be pursued by the company on its incorporation and objects incidental to be fulfillment of the main object
 - (ii) Other objects which are not included above.
4. The amount of authorized share capital divided into shares of fixed amounts.
5. The liability of members is limited if the company is limited by shares or by Guarantee.
6. In case of companies with objects not confined to one state, the state to whose territories the objects extend.
Clause 4 and 5 will not be included in the Memorandum of Association of an unlimited company.

In case of a company limited by Guarantee, its Memorandum of Association should state that each members undertakes to contribute to the asset of the company in the events of its being wound up while he is a member or within one year after he ceases to be a member for –

1. Payment of debts of the company
2. Payments of liabilities of the company, the costs, charges and expenses of winding up and
3. Adjustment of right of contributories among themselves, such amount as may be required not exceeding a specified amount.

2. What are the contents of Memorandum of Association?

There are six clauses in the Memorandum of Association [u/s. 13]-

1. Name clause: This clause requires a company to state its name. A company to establish its identity must have a name. But no company should be registered by name which in the opinion too of the Central Government is undesirable and is identical with or which nearly resemble the name of an existing company [u/s. 20]. Every public company must use the word limited after its name and every private company must use the word private limited after its name.
2. The registered office clause: it is a clause, which states the name of the state where the registered office of the company is to be situated. The two reasons for which the registered office clause is important are as follows:-
 - (i) It ascertains the domicile and the nationality of the company.
 - (ii) It is a place where various registers relating to the company are kept and to which all the messages and notices must be sent.

The notice of registered office should be given within 10 days from the date of incorporation, to the Registrar of Companies.

3. The Object Clause: - It is one of the most essential clause in the Memorandum of Association of a company because it not only depicts the objects but also helps in determining the extent of the powers which the company can exercise in order to achieve the object or objects.
4. The liability clause: It is a clause, which states the nature of the liability of the members. In case of a company limited by shares, the liability extends only to the amount unpaid on the shares taken. In case of a company limited by guarantee the members are liable only to the extent of the amount undertaken to be contributed by them to the assets of the company in event of its being wound up.
5. Capital Clause: It is a clause which state the amount of the share capital with which the company is registered. And the number of shares into which the capital is divided and the amount of each share. It states the limit beyond which the company cannot go.
6. Association or Subscription clause: The Association clause generally works in the following form “we the several persons whose names and addresses are subscribed are desirous of being formed into a company in pursuance of the Memorandum of Association and we respectively agree to take the number of shares in the capital of the company set opposite our respective names”.

Each subscriber to the Memorandum should pay for the shares for which he has subscribed.

3. How is a Memorandum of Association altered?

1. **Alteration of name clause:** section 21 provides that the name of a company may be changed at any time by passing a special Resolution at a general meeting of the company and with the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of name involves only the addition or deletion of the word “private” (i.e. when public company is converted into a private company or vice versa).

Procedure:

The application for change of name is required to be made to the Registrar of Companies in Form 1A along with the prescribed fees to ascertain availability of the name. The period of validity of the name so allowed is six months.

The change must be communicated to the Registrar of Companies by filling form 23 prescribed under the companies (Central Government's) General Rules and Regulation within thirty days of the passing thereof. The change in name shall be submitted by the registrar in the light of guidelines prescribed by the Central Government in this behalf.

Change by ordinary resolution:

If through inadvertence or otherwise, a company on its first registration or on its registration by a new name has been registered with a name which in the opinion of the Central Government, is identical with or too closely resembles the name of the existing company, the company may change its name by passing an ordinary resolution and by obtaining the approval of the Central Government in writing [sec. 22]. Again, the company may change its name by following the aforesaid procedure, where an application has been made by a registered proprietor of a trade mark and in the opinion of the Central Government, the name is identical with or too nearly resembles trade mark of such proprietor under the Trade Marks Act, 1999.

The Registrar of Companies will enter the new name on the register in place of the old name and shall issue a fresh certificate of incorporation with necessary alteration [section 23(1)]

The change of name becomes effective on the issue of fresh certificate on incorporation. The Registrar of Companies will also make the necessary alteration in the Memorandum of Association of the company. [Section 23(2)]

2. **Alteration of Registered Office Clause:** the change of the Registered office may include:-

- (i) Change of registered office from one place to another place in the same city, town
- (ii) Change of registered office from one town to another town in the same state
- (iii) Change of registered office from one state to another state is possible by alteration in the Memorandum of Association.

Procedure:

Following are the procedure for the change of the registered office:

- (i) For the alteration of this clause, a special resolution should be given by the company [section 17(1)]. An Advertisement should be given by the company in the newspaper for the declaration of the change proposed to be made and also a notice to the state Government (Rule 36 of CLB Rules 1975). All the shareholders should be informed about it by the notice.
- (ii) The alteration of the provision of Memorandum of Association relating to the change of the registered office from one state to another state shall take effect only when it is confirmed by CLB on petition [section 17(2)]

- (iii) The company Law Board before giving confirmation to the alteration must get itself satisfied that the sufficient notices have been delivered to every person whose interest will be affected by the alteration. And that the opinion of the creditor of the company has been obtained or their debts or claims have been discharged or secured. [section 17(3)]
 - (iv) The Company Law Board shall cause a notice of the petition for confirmation of the alteration to be served public on the registrar. The registrar will then give a reasonable opportunity to appeal before Company Law Board and state his obligation and suggestion if any, with respect to the confirmation of alteration [section 17(4)].
 - (v) An order confirming the alteration must be given by the Company Law Board on such terms and conditions as it think fit [section 17(5)]
 - (vi) A regard is given by Company Law Board to the right and interest of the members and creditors of the company. [section 17(6)]
 - (vii) A certified copy of the order of Company Law Board confirming the alteration must be filled by the company with the registrar within 3 months from the date of order alongwith the printed copy of Memorandum of Association. [section 18(1)(a)]
 - (viii) The certificate will be conclusive evidence that all the requirement of the act have been fulfilled [section 18(2)]
 - (ix) All the records of the company shall then be transferred to the Registrar of Companies of the state in which the registered office of the company is transferred [section 18(3)].
 - (x) The alteration becomes void and inoperative, if the order is not filed within 3 months. [section 19]
3. **Alteration of Object clause:** section 17 of the companies act, 1956 empowers a company to alter its articles by passing a special Resolution . A company may change its object clause in so far as it is necessary for any of the following purposes given below:-
- (i) To carry on its business more economically or more efficiently [section 17(1)(a)]
 - (ii) To attain its main purpose by new or improved means [section 17(1)(b)]
 - (iii) To enlarge or change the local area of its operation [section 17(1)(c)]
 - (iv) To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company [section 17(1)(d)]
 - (v) To restrict or abandon any of the objects specified in the memorandum [section 17(1)(e)]
 - (vi) To sell or dispose of the whole or any part of the undertaking to the company [section 17(1)(f)]
 - (vii) To amalgamate with any other company or body of persons [section 17(1)(g)]

Procedure:

To alter the object of the company, a special resolution is to be passed at a general meeting.

A printed or a typewritten copy of the special resolution is required to be filled with the Registrar of Companies within 30 days of the passing thereof.

The Registrar of Companies will register the documents and issue within one month, a certificate which will be conclusive evidence that everything required has been done [section 18]

If the required documents are not filled within the specified time. The alteration will at the completion of such period, become void and inoperative. [section 19]

4. **Alteration of the liability clause:** in normal way a liability clause cannot be altered to make the liability unlimited, but still the alteration are done in the liability clause:

- (i) Conversion of unlimited liability into a limited liability: the procedure is to get it re-registered.
- (ii) Limited liability into unlimited liability: All the members have to give consent and the consent should be written.

5. **Alteration of Capital Clause:**

Section 94 provides that, if the articles authorize, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as –

- (i) To increase its authorized share capital by such amount as it thinks expedient by issuing fresh shares;
- (ii) To consolidate and divide all or any of its share capital into shares of larger amount than its existing shares e.g. 10 shares of Rs. 10 each may be consolidated into one share of Rs. 100 each;
- (iii) To convert all or any of its fully paid up shares into stock, and reconvert that stock into fully paid up shares of any denomination

- (iv) To sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion of paid and unpaid on each share must remain the same.
- (v) To cancel shares which, at the date of passing of the resolution in that behalf, have not been taken by any person and thus diminish the amount of its share capital by the amount of the shares so cancelled.

4. What is the Doctrine of Ultra Vires?

The company Act requires that the Memorandum of Association of every company must state the object of the company. The object clause must determine the boundaries and must identify the object in such plain and unambiguous manner so that the reader can identify the field of industry within which corporate activities are to be confined. The company must bind itself to work within the framework of those object as stated in its memorandum of association and to no other. The activities which are not expressly or impliedly authorized by the Memorandum of Association are ultra vires the company.

Ultra vires is the combination of two words and they are 'ultra' means beyond and 'vires' means power. An act will be said to be Ultra vires, when it is performed which though legal in itself, is not permitted by the objects clause in the Memorandum of Association or the statute. These types of acts are void and they cannot be ratified even by unanimous resolution of all the shareholders. Ultra vires act may be categorized under the following three heads:-

1. Acts ultra vires the director:- These acts are out of the scope of the direction of the company. They are not totally void or inoperative. They can be ratified by the shareholders in a general Meeting.
2. Acts ultra vires the Articles of association of the company: The acts will be ultra vires if they are beyond the powers of the company given to its by its Articles of association. They are also not void and inoperative. They can also be ratified by the company by altering the articles through a special resolution.
3. Acts ultra vires the memorandum of association of the company: These acts are beyond the powers of the company, so called. "Ultra vires the company". They are wholly void, inoperative and cannot be ratified by whole body of the shareholders.

Implication of Ultra Vires Acts:

The effect of the ultravires transactions are discussed under the following heads.

1. **Injunction:** In case a company is going to undertake an ultravires act, any member of the company can get an order of injunction from the court to restrain the company for going ahead with the ultravires acts.
2. **Personal liability of the directors:** it is one of the duties of directors to see that the corporate money is used for the legitimate business of the company and not otherwise. The directors shall be personally liable to make good the amount, if any capital is unlawfully disbursed. If the person receiving the money knows that he is receiving the payment of any ultravires act, then he should return the money back to the directors.
3. **Void ab initio:** The Ultravires acts by nature are null and void and the company is not bound by these acts. The company cannot sue or be sued upon such acts.
4. **Ultravires acquired property:** A company can protect its property acquired by the ultravires were cut and it has no power in the memorandum to put up the wires, it was held entitled to recover the damages for injury.
5. **Ultravires borrowing:** If a person lends money to a company and the company either has no borrowing power or had crossed the limit or the borrowing is for the purpose which is ultravires, then the contract will be declared to be void. For recovery of the lent money no action can be taken.

Exceptions:

1. If any act is ultravires the directors but intravires the company, the company can ratify it.
2. If the act is ultravires the article but intravires the company the articles may be altered to include the act within the power of the company.
3. If the act is ultravires the company but it has been done in good faith for the benefit of the company the person will be freed from his liability.
4. If the company has taken ultravires loan and uses it to pay intravires debts the company will be liable not the director. The outsiders can sue the company.

5. What is Articles of association?

According to section 2(2) of the companies act, 1956 'Articles' means the Articles of association of a company as originally framed and altered from time to time in pursuance of any previous companies law or of the present act. The articles of association are the rules and regulation of a company framed for the purpose of internal management of its affairs.

The Articles of association of a company are subordinate to and are controlled by the memorandum of association. The articles are framed mainly for carrying out the aims and objects of the Memorandum of Association.

They accept the Memorandum of Association as the charter of incorporation and so accepting if the articles proceed to define the duties, rights and powers of the governing body.

Companies required to file the articles with the Registrar of Companies:- The following are the companies, which are required to file the articles with Registrar of Companies.

1. Company limited by guarantee
2. Unlimited company
3. Private Company limited by shares

6. What are the content of Articles of association?

1. Exclusion wholly or in part of table A.
2. Adoption of preliminary contracts.
3. Number and the value of shares
4. Allotment of shares
5. Call on shares
6. Lien on shares
7. Transfer and transmission of shares
8. Forfeiture of shares
9. Alteration of capital
10. Share certificates
11. Conversion of shares into stock
12. Voting right and proxies
13. Meeting
14. Directors and their appointment
15. Borrowing powers
16. Dividend and reserves
17. Accounts and audit
18. Winding up

7. How is an Articles of association altered?

1. According to the provisions of the act and to the conditions contained in its Memorandum of Association, a company may by passing a special resolution alter or add to its Articles of association.
2. The company must file with the Registrar of Companies a copy of special resolution within 1 month from the date of its passing
3. The altered Articles of association will bind the member in the same form as the original articles.

Limitations to alteration: The alteration made in the articles will be valid, until they fall within any one of the following given below:

1. The alteration must not authorize anything expressly or impliedly forbidden by the companies Act.
2. The alteration must not extend or modify the Memorandum of Association.
3. The alteration must not contain anything illegal.
4. The alteration must not be inconsistent with any alteration made by Company Law Board.
5. The alteration must be bonafide for the benefit of the company as a whole.
6. The alteration must not make the Articles of association unaltered as it is regarded bad in law.
7. Retrospective operation of Articles of association.
8. The alteration must not constitute fraud on the minority by a majority.
9. An alteration of Articles of association to effect a conversion of a public company into a private company cannot be made without the approval of Central Government.

10. There cannot be alteration of the Articles of association so as to compel an existing member to take or subscribe for more shares or in any way extend liability to contribute to shares capital, unless he gives his consent in writing.
11. A company cannot justify breach of contract with third parties or avoid a contractual obligation by altering Articles of association.

8. What is the doctrine of Constructive Notice?

It is necessary for every company to get registered the Memorandum of Association and Articles of association with the Registrar of Companies. The registrar's office is public office and on registration the Memorandum of Association and Articles of association becomes the public documents. So they are open and accessible to all.

On the payment of the nominal fee the document can be inspected by any one. Those dealing with the company whether a shareholder or an outsider is presumed to have read the two documents and understood their in true meaning. This deemed knowledge of the two documents and their contents is known as the doctrine of Constructive Notice.

When a person deals with a company in a way, which is not in accordance with the provision of the Memorandum of Association or Articles of association or enters into a transaction which is beyond the scope of the power of the company he must take the consequences in respect of such dealing.

The doctrine of Constructive Notice is not a positive doctrine but a negative one. It acts like the doctrine of estoppel. It does not work against a company but only an outsider dealing with the company. It prevents him from alleging that he did not know that the Memorandum of Association and the articles rendered a particular act ultra vires the company.

9. What is the doctrine of indoor management?

The doctrine of indoor management is an exception to rules of constructive notice. As per the doctrine of indoor management, the person dealing with the company has right to assume that as far as the internal proceeding of the company are concerned everything has been done properly. It is necessary to read the registered documents and to see that the proposed dealing is not inconsistent therewith. They are not required to do anything more as per the regularity of the internal proceeding. This disadvantage of doctrine of constructive notice is called the doctrine of indoor management.

The doctrine of indoor management is based on the *maxim omnia praesumuntur rit esse acts* (all the things are presumed to have been done rightly). The doctrine seeks to protect outsiders against the company.

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

1. **Knowledge of irregularity:** Under the rule of indoor management the benefit cannot be claimed if a person dealing with a company has the knowledge of the irregularity in its internal management.
2. **Acts are void ab initio and forgery:** The doctrine of indoor management will not be used, where the acts done in the name of company are void ab initio. The doctrine is applicable only to those irregularities that otherwise might affect a genuine transaction. It does not apply to forgery. A company cannot be made liable for forgeries done by its officers.
3. **No knowledge:** A person having no knowledge of Articles of association cannot ask for protection under the indoor management.
4. **Negligence:** If the irregularities are discovered by the person dealing with a company, on making proper inquiries, he cannot claim the advantages of the rule of indoor management. No protection of the rule is possible, where the circumstances surrounding the contracts are so suspicious as to invite inquiry and the outsiders dealing with the company does not make proper inquiry.
5. **Act outside the scope of apparent authority:** If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound.

10. On registration of Memorandum of Association and Articles of association, what contractual relationship is established between different parties?

According to section 36(1) of the Companies Act, 1956 the Memorandum of Association and Articles of association when registered bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants by the company and each member to observe all the provisions of the Memorandum of Association and the Articles of association.

The object behind this section is to import contractual forces to the Memorandum of Association and Articles of association. A contract is constituted by the Memorandum of Association and Articles of association of the company by the effect of these provisions between each member and the company. As a result of this a number of legal relationships are developed between different parties and the company as explained below:-

1. Between the company and the members:

- (i) The Memorandum of Association and Articles of association develop a contract between the members and the company.
 - (ii) However, opinion varies on the questions as to whether and how far the Memorandum of Association and Articles of association bind the company to the members.
 - (iii) One of the opinions is that it binds in the same way its members are and another opinion is that the company is not wholly bound.
 - (iv) It is not correct to say that the company is wholly bound, so that any member can sue it so as to prevent any breach of the Articles of association which is liberally meant to affect his right as a member of the company.
 - (v) An individual member passes the power to file a suit against the company to enforce their individual, rights for example, right to get back his shares wrongfully forfeited, right to contest election for directorship of the company, right to receive a share certificate ect.
 - (vi) The members filling suit in these cases sues not in the right of a member but in his own right to safeguard himself from the invasion of his own individual right as member.
 - (vii) Moreover, the rights granted to a member must be in his capacity as a member and in any other capacity such as a solicitor.
2. Between the member inter-se: -
- (i) No express agreement is developed by the Memorandum of Association and Articles of association between the members of the company yet each and every member of the company is bound by the Memorandum of Association and Articles of association on the basis of an implied contract to other members.
 - (ii) In the case of *Welton V. Jaffrey App. Cas. 299* it was held that the Articles of association regulate the rights of the members inter se but such right can be enforced only through the company or through the liquidator representing the company.
 - (iii) The Articles of association cannot regulate rights arising out of a commercial contract in which other share holders have no interest.
 - (iv) Therefore, an arbitration clause in the Articles of association of a company could not be invoked where a number of a company had a commercial dispute of a private nature with another member of a company.

11. What is the difference between Articles of association and Memorandum of Association?

Basis	Memorandum of Association	Articles of association
Meaning	Memorandum of Association is the charter of the company and defines the scope of its activities	An article of association of the company is a document which regulates the internal management of the company. These are the rules made by the company carrying out the objects or purposes.
Relationship	Memorandum of Association defines the relation of the company with the outside world.	Articles of association deals with the rights of the members of the company inter se and also establishes the relationship of the company with the members.
Types of documents	Memorandum of Association is a supreme document	Articles of association are subordinate to the Memorandum of Association.
Alteration	Memorandum of Association cannot be altered except in the manner and to the extent provided by the act.	Articles of association being only the bye-laws of the company can be altered by the special resolution.
Provision if not followed	A company cannot depart fro the provisions contained in its memorandum. If it does, it would be ultravires the company.	Anything done against the provision of Articles of association but which is intravires the Memorandum of Association can be ratified.

DESCRIPTIVE QUESTIONS

1.The Articles of association of a private limited company contain provisions restricting the right to transfer shares and limiting the number of members to 50. What restrictions are generally incorporated in the Articles of association in restricting the right to transfer shares?

The right of transfer of shares and limiting the number of members to 50 in generally restricted in the following steps –

1. By stating the method for calculating the amount at which the shares may be sold from one member to another. In actual it is left to be determined either by the auditor of the company or by the company at general meeting.
2. By permitting the directors to refuse transfer of shares to person whom they do not approve or by forcing the shareholders to offer their shareholding to the existing shareholders first. In this right of sale is restricted. On this basis, the Articles of association usually provides that before selling or transferring his share by the shareholder, the directors must be informed in writing of such intention of the shareholder.
3. By providing that the shareholders who are employees of the company must offer their shares to a particular person or class if person when the leave the company service or from other sources in case of under subscribed issues within 60 days from the date of closure of the issue, the company shall refund the subscription amount in full without interest or with interest @ 15% p.a. if not paid within 10 days after the expiry of the said 60 days.
2. **VD company ltd. is registering in Tamil nadu within the jurisdiction of the Registrar of Companies, Chennai. The company proposes to shift its registered office to a place within the jurisdiction of Registrar of Companies, Coimbatore. State the steps to be taken by the company to give effect to the proposed shifting of its registered office.**

In this case registered office of VD ltd. is situated within the jurisdiction of Registrar of Companies, Chennai and not its wants to shift its registered office to place within the jurisdiction of Registrar of Companies, Coimbatore, though the registered office of the company is to be shifted within the state of Tamil Nadu but from one Registrar of Companies to another Registrar of Companies. In such cases provision of section 17A of the Companies Act, 1956 are applicable which are as follows:

1. Company can do so only if the regional director permits to it.
2. For getting the permission an application form is to be filled.
3. Within the time period of four weeks, the regional directors are required to confirm the company's application and must inform it.
4. After getting the permission, the company must file a copy of the same with the Registrar of Companies within two months from the date of getting the permission alongwith the a copy of the altered Memorandum of Association.
5. After going through the documents, the Registrar of Companies is required to register the same and inform the company within one month from the date of filing.
6. The certificate issued by the Registrar of Companies is conclusive evidence of the fact of alteration and of compliance with the requirement.
3. **The directors of a company registered and incorporated in the name "Mars Textile India Ltd" desire to change the name of the company entitled "National Textiles and Industries Ltd." Advice as to what procedure is required to be followed under the companies Act, 1956?**
1. The first step to be taken in the procedure by Mars Textiles Ltd. is that it should find out from the Registrar of Companies whether the proposed name National Textiles and industries Ltd. Is available or not.
2. The company should file the prescribed form no. 1A with the Registrar of Companies along with the fee of Rs. 500/- to collect the above information.
3. The Registrar of Companies after examining the register will inform whether the new name is available or not for registration.
4. In case the name is available, the company must pass a Special Resolution for getting approved the change of name to National Textile and Industries Ltd.
5. After this approval of Central Government must be obtained as per section 21 of the act.
6. The power of Central Government for this has been vested to the Registrar of Companies.
7. For this approval the company has to file an application along with the prescribed filing fee for change of name.
8. Only on the issue of the certificate of incorporation by the Registrar of Companies, the change of name of the company will be complete and effective.
9. On the issue of the certificate the Registrar of Companies shall enter the new name in the register in place of the old one.
10. The right and obligation of the company will not be affected by the change of name and it shall not render defection a legal proceeding by or against it.
4. **The Articles of Association of Mars company ltd. Provide that documents may be served upon the company only through Fax. Ramesh dispatches a document to the company by post, under certificate of posting. The company**

does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh Suffers loss. Examine with reference to the provisions of the companies Act, 1956.

- 1. What refusal of documents by the company is valid?**
- 2. Whether Ramesh can claim damages on this basis?**

The problem as asked in the question is based on the provisions of the companies Acts, as contained in section 51. As per the section, the documents must be served on a company or on its officer at the registered office. It must be sent either by post or by leaving it at its registered office. If sent through post, it should either be posted under the certificate of posting or by registered post. When a notice has been addressed to the company and served on the directors, it gives a good service. The Articles of Association of the company, which contains the provision against section 51 cannot be enforced nor can they limit the mode of service to only one of the modes provided by the statute.

The answers to the questions are

1. The refusal by the Mars Company Ltd. of the service of the documents is not valid.
2. The answer to second question is that Ramesh can claim damages on this account from the company.
5. **The Articles of Association of the limited company provided that "X" shall be the Law officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid?**

According to section 36(1) of the Companies Act, 1956 the Memorandum of Association and Articles of Association of a company bind upon the company and its members and they are bound to follow all the provisions of the Memorandum of Association and Articles of Association as if they have signed the same. However, the company and members are not bound to outsiders in respect of anything contained in the memorandum/articles. Thus on the basis of the general rule of law, a stranger to a contract cannot acquire any right under the contract. In the above given case, the articles conferred a right on 'X', the law officer that he will not be removed unless the ground of misconduct is proved. In view of the legal position explained above 'X' cannot enforce the right conferred on him by the Articles of Association against the company. Hence the action taken by the company is valid.

6. **M/s. ABC Ltd. a company registered in the state of West Bengal desires to shift its registered office to the state of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.**

Would it make a difference, if the registered office is transferred from the jurisdiction of one regional Registrar of Companies to the jurisdiction of another Registrar of Companies within the same state?

In order to transfer the registered office from the state of West Bengal to the state of Maharashtra, M/s. ABC Ltd. has to take the following steps:-

1. To pass a special resolution and then the same with the Registrar of Companies.
2. Under section 17, a petition is to be filed before the CLB or Central Government.
3. An advertisement is to be given in the newspaper once in English language and in local language indicating the change and if any member or creditor has objection, then they can write to the Central government or CLB.
4. A notice should be given to the state Government of West Bengal.
5. All the documents required must be submitted to the Central Government along with the fee prescribed.

The CLB after hearing the petition passes an order for confirming the alteration in the Memorandum of Association of the company regarding the shifting of the registered office. After getting the confirmation, the order should be filed by ABC Ltd. with both the Registrar of Companies West Bengal and Maharashtra. After the registration, the Registrar of Companies Maharashtra will issue a certificate, which shall be the conclusive proof that all formalities have been complied with.

Change of registered office from the jurisdiction of one Registrar to the other registrar within the same state: The procedure followed for this change is as follows:-

1. The company can do so only if the Regional director permits to it.
2. For getting the permission an application form is to be filed.
3. Within the time period of four weeks, the Regional Directors are required to confirm the company's Application and must inform it.
4. After getting the permission, the company must file a copy of the same with the Registrar of Companies within two months from the date of getting the permission along with a copy of the altered Memorandum of Association.
5. After going through the documents, the registrar is required to register the same and inform the company within one month from the date of filing.

6. The certificate issue by the Registrar is a conclusive evidence of the fact of alteration and of compliance with the requirement.
7. **The management of Ambitious Properties Ltd. has decided to take up the business of Food processing activity because of the downward trend in real estate business. There is no provision in the object clause of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause.**

Section 17 of the companies Act, 1956, empowers a company to alter its Articles of Association by passing a special resolution. A company may change its object clause in so far as it is necessary for any of the following purposes given below:-

- (vi) To carry on its business more economically or more efficiently [section 17(1)(a)]
- (vii) To attain its main purpose by new or improved means [section 17(1)(b)]
- (viii) To enlarge or change the local area of its operation [section 17(1)(c)]
- (ix) To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company [section 17(1)(d)]
- (x) To restrict or abandon any of the objects specified in the memorandum [section 17(1)(e)]
- (xi) To sell or dispose of the whole or any part of the undertaking to the company [section 17(1)(f)]
- (xii) To amalgamate with any other company or body of persons [section 17(1)(g)]

Procedure:

To alter the objects of the company, a special resolution is to be passed at a general meeting.

A printed or a typewritten copy of the special resolution is required to be filed with the Registrar of Companies within 30 days of the passing thereof.

The registrar will register the documents and issue within one month, a certificate which will be conclusive evidence that everything required has been done.

If the required documents are not filled within the specified time, the alteration will at the completion of such period, become void and inoperative.

8. **M/s. India Computers Ltd. was registered as a public company on 1st July, 2005 in the state of Maharashtra. Another company by name M/s. All India Computer Ltd. was registered in Delhi on 15th July, 2005. The promoters of India Computers Ltd. have failed to persuade the management of All India Computers Ltd. to change the company's name, as it closely resembles with the name of the first registered company.**

Advise the management of India Computers Ltd. about the remedies available to them under the provisions of the companies Act, 1956.

Where as the name of M/s. All India Computer Ltd. was registered on a later date that is 15th July, 2005; the name of M/s. India Computer Ltd. was registered previously on 1st July, 2005. Therefore the promoters have a right to ask the management of M/s. All India Computers Ltd. to change the name of its company as it closely resembles with that of a previously registered company. Since the management of M/s. All India Computer Ltd. has not agreed u/s. 22 of the companies Act, 1956, the promoters of India Computers Ltd. can approach the Central Government for the rectification of the name of the company registered subsequently. The Central Government can direct within 12 months from the date of registration on the later company to change the name of the company the said company within 3 months by changing its name suitably falling which penal provisions will become applicable. U/s. 22, the power of Central Government has been delegated to the Regional Director.

9. **The directors of "Sunrise Computer Ltd." desire to change the company's name to "Royal Computer Ltd." and seeks your advice. Explain the procedure to be followed, for the said purpose, under the companies Act, 1956.**
1. The first step to be taken in the procedure of Sunrise Computer Ltd. is that it should find out from the Registrar of Companies whether the proposed name Royal Computer Ltd. is available or not.
2. The company should file the prescribed form 1A with the Registrar of Companies along with the fee of Rs.500/- to collect the above information.
3. The registrar after examining the register will inform whether the new name is available or not for registration.
4. In case the name is available, the company must pass a special resolution for getting approved the change of name to Royal Computer Ltd.
5. After this approval of the Central Government must be obtained as per section 21 of the act.

6. The power of the Central Government for this has been delegated to the Registrar of Companies.
7. For this approval the company has to file an application along with the prescribed filling fee for change of name.
8. Only on the issue of a fresh certificate of incorporation by the registrar, the change of the name of the company will be complete and effective.
9. On the issue of the certificate the registrar will enter the new name in the register in place of the old one.
10. The right and obligation of the company will not be affected by the change of name and it shall not render defecting any legal proceeding by or against it.

10. Answer the following :

1. The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In course of transacting the business, the chairman of the Company acquired the knowledge of arranging finance for the development of land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 Lakhs for arranging the finance. The Memorandum of Association of the company authorizes the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC Ltd.

2. XY Ltd. has registered office at Mumbai in the state of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune. What formalities the company has to comply with under the provisions of the companies Act, 1956 for shifting its registered office as stated above?

(a) According to Clause (d) of the section 17(1) company may change its object clause to carry on some business which under existing circumstances may be conveniently or advantageously with the business of the company.

A company may start a new business which is wholly different from and bears no relation to the existing business of the company. All that is essential is that new business should be capable of being advantageously combined with existing business.

In the present case, XYZ company limited is engaged in the business of acquiring land to erect houses on it. Contract entered by XYZ company Ltd. with ABC Ltd. for arranging finance for the development of land by introducing a financier is consistent and is not destructive with the existing business. Therefore, the contract is valid.

(b) In order to change the registered office from one town to another town in the same state. XY Ltd. has to take following steps:-

- (i) A special resolution is required to be passed.
- (ii) A notice of such change shall be given to the Registrar of Companies within 30 days of the change.
- (iii) If the change of registered office is from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the state, in that case confirmation by the regional Director will be necessary.
- (iv) Company will make an application to the Regional Director in the prescribed form and the confirmation will be communicated within four weeks from the date of receipt of the application for such change.
- (v) XY Ltd. is required to file with the Registrar a copy of the confirmation by the Regional Director within 2 months from the date of confirmation, together with a printed copy of the Memorandum of Association as altered and the Registrar will register the same and certify the registration under his hand within one month from the date of filling of such documents u/s. 17A(4).

11. The secretary of a company issued a share certificate to "A" under the Company's Seal with his own signature and the signature of a Director forged by him. "A" borrowed money from "B" on the strength of this certificate. "B" wanted to realize the security and requested the company to register him as a holder of the shares. Explain whether "B" will succeed in getting the shares registered in his name.

In the instant problem the doctrine of Indoor management can apply only in case of irregularities which might otherwise affect the transaction but it cannot apply to forgery which must be regarded as nullity. Hence B will not succeed in getting the share registered in his name.

12. The Articles of association of a public company clearly stated that Mr. A will be the solicitor of the company. The company in its general meeting of the shareholders resolved unanimously to appoint B in place of A as the solicitor of the company by altering the Articles of association. Examine, whether the company can do so? State the reason clearly.

According to section 189 of the companies Act, 1956, the Memorandum of Association and Articles of association shall bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum of Association and of the Articles of association.

It means, that members can enforce their rights given in the Articles of association against the company. But at the same time it is clear that articles are internal rules and regulation for a company hence outsider can not take advantage of the provision of Articles of association.

Also as per section 31, articles may be changed by passing a special resolution.

In this present case, Articles of association says that Mr. A should be appointed as solicitor and let us assume that there is no separate contract between Mr. A and the company. Now if the Articles of association is change by passing an unanimous resolution to appoint B in place of A, it is valid. Mr. A can not take an objection against the action of the company.

13. The Articles of association of MSW Ltd. contained a provision that upto 4% of issue price of the shares as underwriting commission may be paid to the underwriters. The Board of Directors decided to pay 5% underwriting commission. Can the board of directors do so? State the provision of law in this regard as stated under the Indian companies Act, 1956.

According to section 76 of the companies Act, 1956, a company may pay commission if the following conditions are fulfilled.

- (i) The payment of the commission is authorized by the Articles of association.
- (ii) The commission paid or agreed to be paid does not exceed.
 - In the case of shares 5% of the price at which the shares are issued or the amount or rate authorized by the Articles of association, whichever is less
 - In the case of debentures, 2.5% of the price at which the debentures are issued or the amount or rate authorized by the Articles of association, whichever is less;
- (iii) The amount of the commission agreed to be paid is disclosed in the prospectus or statement in lieu of prospectus.
- (iv) The numbers of shares or debentures underwritten are also disclosed in the prospectus or statement in lieu of prospectus.
- (v) A copy of the contract for the payment of the commission is delivered to the Registrar of Companies at the time of delivery of the prospectus or the statement in lieu of prospectus for registration.

In the present case, Articles of association for payment of commission at the rate of 4% which is less than the limit of 5% given under section 76. Hence the company can not pay a commission more than 4% of the issue price. Therefore we can conclude that the Board of Directors is wrong.

PRELIMINARY CONTRACT

1. What is a Preliminary contract?

Preliminary or Pre-incorporation Contracts: When the contract is agreed, on behalf of the company before its incorporation they are called the preliminary Contract or pre-incorporation Contract. These contract may relate either to the property, which the promoter wants to purchase for the Company or the technical knowledge which is essential for the success of the company. These types of contracts cannot bind the company until it is incorporated.

The legal position in case of preliminary contracts can be studied under two heads:-

1. Position before passing of Specific Relief Act, 1963
2. Position after passing of Specific Relief Act, 1963
1. Position before 1963:
 - (i) The preliminary Contract made before passing of Specific Relief Act, 1963 cannot bind the company because it has not legal existence before incorporation.
 - (ii) The companies are not in a position to sue on a pre-incorporated contracts.
 - (iii) Ratification are not possible in the case of the preliminary contract, as the ostensible principal not exist at the time of the contract.
2. Position after 1963: the promoters found difficulties in carrying out the work before the Specific Relief Act, 1963, because the contracts prior to incorporation were void. The Specific Relief Act, 1963 came as a relief to the promoters. The Act provides that where the promoters of a public company have made a contract before its incorporation, for the purpose of the company and if the contract is warranted by the terms of its incorporation, the company may enforce it.

Effect of the Pre incorporation contract: The effect of the pre-incorporation contracts are as follows:-

1. The company cannot be sued on the preliminary Contracts even though when it comes into existence and takes the benefit thereof. The company cannot be sued for those expenses, which are incurred before its incorporation because it was not in existence when the expenses were actually incurred.
2. The company is also not a position to sue on the preliminary Contract.
3. The person who acts for the intended company will be presently liable to the vendor, even if the company purports to ratify the agreement, unless the agreement provides that:
 - a. His liability will come to an end if the company adopts the agreement.
 - b. Either party may cancel the agreement if the company does not adopt it within a specified time.
4. As per section 15 and 16 of the specific relief Act, 1963, a pre-incorporation contract can be enforced against the company, if it is warranted by the terms of incorporation and it is adopted by the company. In such a type of cases the director has no discretion in the matter.

2. What is a provisional Contract?

The contracts entered into by a public company after its incorporation but before it is entitled to commence business is called as provisional Contracts. These contracts are not binding on the company until it becomes entitled to commence the business.

Provisional Contracts are valid for only those acts are expressly given in the Memorandum of Association. Any act which is not authorized by Memorandum of Association are ultravires and thus null.

3. What is the difference between Preliminary Contract and Provisional Contract?

	Basis	Preliminary Contract	Provisional Contract
1.	Meaning	Preliminary contracts are the contracts, which are made before the formation of the company	The contracts which are entered by a company after incorporation but before it is entitled to commence business are provisional Contracts
2.	Enforcement of contract	Neither the company can sue nor can it be sued to enforce the preliminary contracts.	Can be enforced only on receiving certificate of Commencement of Business.
3.	Contracts related to	Preliminary contracts may relate to property which the promoters desire to purchase for the company or they may be made with the persons whose know-how is vital to the success of company.	It is not so with the provisional contracts
4.	Applicable for	Both private and public company	Only public company

PRACTICAL QUESTION

1. A company was incorporated on 6th October, 2003. The Certificate of incorporation of the company was issued by the Registrar of Companies on the 15th October, 2003. The company on 10th October 2003 entered into a contract which created its contractual liability. The company denies from the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the companies Act, 1956, whether the company can be exempted from the said contractual liability.

According to the companies Act, 1956, the company comes into formation only after getting the certificate of incorporation. The Registrar of Companies will issue certificate of Incorporation upon the registration of the documents and on the payments of the necessary fees (section 34)

Section 35 of the Act provides that a certificate of incorporation issued by the Registrar of Companies is conclusive evidence towards all the administration acts and as to date of incorporation. The facts as given in the problem are similar to those in case of Jubilee Cotton Mills V. Lewis (1924). Where it was decided that an allotment of shares made on the date after incorporation could not be declared void on the ground that it was made before the company was incorporated when the certificate of incorporation was issue on the later date.

If the same rule is applied to the above mentioned case, the intention of the company will not be tenable. It is of no matter when the certificate of incorporation was issued. The main thing which is important is the date of incorporation and it is quite legal for the company to enter into contract on the date or after.

Thus, the conclusion to the above case is that contract entered into by the company before the issue of the certificate of incorporation shall be binding upon the company.

PROMOTORS

1. Who is the Promoter?

As such promoter has not been defined anywhere in the companies Act, 1956. But in the normal defined sense promoters are the persons who come together to form a company with some object.

They take the necessary steps to carry that object into operation. Section 62 of the companies Act only refers to the liability of a promoter.

“The term promoter is a term not of law but of business usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence”. The promoters are the persons who bring a company into existence.

2. What is the position of a promoter?

1. Promoters are not the agent of the company.
2. Promoters are not the trustees of the company.
3. Promoters stand in a fiduciary relationship with the company and to its shareholders.
4. Promoter should not make an affair or unreasonable use of his position.

In the words of lords Cairns, the promoter of a company stands undoubtedly in a fiduciary relationship. They have in their hand the creation, and molding of a company. they have the power of defining how and when and in what shape and under what supervision, it shall start into existence and begins to act as a trading corporation.

3. What are the duties of a promoter?

1. To disclose all the material facts relating to the promotion of the company.
2. It is the duty of the promoter to disclose all the profit, otherwise the contract on which the profit stands will be cancelled.
3. All the material facts relating to the purchase of assets should be disclosed.
4. A promoter is not allowed to derive a profit from the sale of his own property, to the company unless all facts are disclosed.
5. It is the duty of the promoter to see that there is no untrue statement in prospectus or statement in lieu of prospectus.

4. What are the Rights of a promoter?

1. Right to receive preliminary expenses: promoters have the right to receive preliminary expenses, which they have incurred before the incorporation of the company. if there has been contract for it.
2. Right to receive remuneration: Promoters are usually the director of the company, so they possess the right to receive remuneration.
3. Right to receive the proportional amount from the co-promoter.

5. What is the provision related to remuneration of a promoter?

A promoter is not liable to have any remuneration for his work from the company unless there is a valid contract. Remuneration may be paid to a promoter in any of the following ways:-

1. The promoter may purchase the business or other property and sell the same at higher price to the company.
2. Selling his own property to the company at a profit.
3. Commission may be paid to the promoters on sale of the shares.
4. He may be paid a lump sum by the company.
5. Promoter may be give fully or partly paid shares in consideration of the services.

DESCRIPTIVE QUESTIONS

1. **Briefly discuss the provisions relating to constitution of National Company Law tribunal and National Company Law Appellate Tribunal.**

The National Company Law Appellate Tribunals have been constituted by Central Government by notification with official Gazette. Any person aggrieved by an order of the Tribunal, can within 45 days file an appeal before the National Company Law Appellate Tribunal, which will pass orders after giving opportunity of hearing to the aggrieved party.

Part VI-A has been introduced into the companies Act, 1956 by the Companies (2nd Amendment 2002). Its enforcement will mean repeal of the Sick Industrial Companies (Special Provisions) Act, 1985 and also abolition of the board of Industrial and Financial Reconstruction (BIFR). Such cases will go before the National Company Law Tribunal. Section 424A provides for such reference. The Board of Directors of a Sick Industrial Companies has to make a reference to the Tribunal. They have to prepare a scheme for its revival and rehabilitation and submit to the tribunal along with an application containing such particulars as may be preferred. The Tribunal is empowered to make suitable orders on completion of the Enquiry.

PRACTICAL QUESTIONS

1. **XYZ Company limited was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the supplier by the company after the incorporation.**

The company was incorporated and the furniture was used by it. Shortly after incorporation the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can be held liable for payment under the following situations:

1. **When the company has already adopted the contract after incorporation?**
2. **When the company makes a fresh contract with the suppliers in terms of pre-incorporation contract?**

If a contract is made by the promoter on behalf of the company which is not yet incorporated, then they will be personally liable for the contract because they have entered the contract personally.

Promoters will be made personally liable to pay all the damages for the failure to perform the promises made in the company's name, even though the contract makes clear that only the company shall be answerable for the performance. The promoters can be made personally responsible and liable for the contract because they are the person who signs the contract. A company is not in a position to ratify the contract entered into by the promoters on its behalf before its incorporation. Therefore, a company cannot by confirmation obtain the benefit of the contract, pretended to have been made on its behalf, before it came in to existence, as ratification by the company when formed is legally impossible. The doctrine of ratification is applicable only when an agent contracts for a principal, who is in existence and who is competent enough to contract at the time of contract by the agent.

After the incorporation the company if it desires it can enter into a new contract with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters.

If the company adopts the pre-incorporated contract, it will not create a contract between the company and the other party, even though the option of the contract is made as one of the objects of the company in its Memorandum of Association.

It is therefore better for the promoter acts on behalf of the company to be formed to provide in the contract that:-

- (a) The liability of the promoters will come to an end, if the company makes a fresh contract in terms of the pre-incorporation contract.
- (b) The parties may rescind the contract, if the company does not make a fresh contract within a limited time period.

Thus, by using the above principles, the answer to the question asked in as follows:

1. In the first case the promoters will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company.
2. In the second case, the liability of the promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporated contract.

PROSPECTUS

1. **What is the meaning and definition of Prospectus?**

Section 2(36) of the companies Act defines a prospectus.

“A prospectus means:-

Any documents described or issued as a prospectus and includes –

any notices, circular, advertisement, or other documents inviting deposit from the public or

documents inviting offer from the public for the subscription of shares or debentures in a company”

A prospectus is not merely an advertisement. A document shall be called a prospectus if it satisfy two things:

1. It invites subscription to shares or debentures or invites deposits.
2. The aforesaid invitation is made to the public.

Rules relating to Prospectus:

1. Prospectus should be in written form.
2. Prospectus must be dated
3. It must be registered
4. It must be issued within 90 days of registration, otherwise the registration is cancelled after 90 days of registration, if it is not issue during the 90 days.

2. What are the contents of a prospectus?

Part 1: Things mentioned in the first part of IInd Schedule.

Part 2: Things mentioned in the Second part of IInd Schedule.

Part 3 Explanation of certain terms and expressions used under Part I and Part II of the schedule.

Part1:

- (i) General information
- (ii) Capital structure
- (iii) Term of the present issue
- (iv) Particular of the issue
- (v) Company's management and project
- (vi) Particular in regard to any other listed company under the same management
- (vii) Pending litigation
- (viii) Management perception of risk factor.

Part 2:

- (i) General information
- (ii) Financial information
- (iii) Statutory and other information

Part 2:

It contains explanation of certain terms and expressions used under Part I and Part II of the schedule. It also requires a declaration that all relevant provisions of the act and the guidelines issued by the government have been complied with and nothing has been stated in the prospectus that is contrary to the provisions of the companies Act.

SEBI Guidelines: SEBI has directed the lead managers to ensure, proper disclosure to the investors by keeping in mind their increased responsibilities consequent upon the notification.

The lead manager should give adequate disclosure but also ensure due compliance to guideline for disclosure and investor protection issue by SEBI both in letter and in spirit. Following information should be included by the lead managers in the prospectus to be issued by the company:-

1. **Disclosure Clause:** The disclosure is to be printed in the bold in the offer of documents in Part I after issuing details under the head general information.
2. **Stock market date:** A clear information must be given of the stock market date alongwith the high; low and average prices of the company during the preceding three years.
3. Performance vis-à-vis promises relating to previous issues.
4. Reservation is done for NRI's overseas corporate bodies in public issue. When the amounts are paid in foreign currency then only NRI's application is to be accepted.
5. Buy-back arrangement for purchase of non-convertible portion or partly convertible debentures.
6. Development of proceed of the issue.
7. Manner of getting the stock investments and its disposal.
8. Statement relating to allotment and refund. The lead managers are to ensure themselves about it.

3. When is the issue of prospectus not needed?

When prospectus is not required to be issued u/s. 56:

1. Where the shares and debentures are not offered to public [section 56(3)(b)]
2. Where the offer is made in connection with a bonafide invitation to a person to enter into an undertaking agreement with respect to shares/debentures [section 56(3)(a)]
3. Where the offer is made to the existing members/debenture holders of the company [section 56(5)(a)]
4. In the case of issue of shares or debentures which in all respect similar required to specify the contents of the Memorandum of Association.

4. What are the statutory requirements in relation to a prospectus?

1. **Dating of prospectus:-** As per section 5s, a prospectus issued by or on behalf of a company or in relation to an intended company must be dated. The section further provides that the date on the prospectus shall, unless contrary is proved, be taken as the date of the publication of the prospectus.
2. **Registration of prospectus:-** section 60 of the Act deals with the registration of prospectus with the Registrar of Companies. it requires: -
 - 1) Delivery of a copy of the prospectus to the Registrar of Companies on or before the date of its issue. The copy of prospectus so delivered, should be signed by all the persons named therein as director or proposed director
 - 2) The prospectus so delivered should be accompanied by (a) consent of every expert referred to in section 58 of the Act; (b) prospectus, in case any of the contracts has not been reduced to writing, a Memorandum of Association setting out full particulars of the contract and (c) adjustment made in financial statements required to be included in the prospectus duly signed by the person(s) making the report thereon, with reasons.

Section 60(3) provides that the Registrar of Companies will not register a prospectus if

- (i) It is not dated
- (ii) It does not comply with the requirements of section 56 as to the matters and reports to be set out in it, viz, Schedule II requirements;
- (iii) It contains statements or reports of experts engaged or interested in the formation or promotion or management public the company [section 57];
- (iv) It includes a statement purported to be made by an expert without a statement that he has given and has not withdrawn his consent to the manner of its inclusion therein. [section 58];
- (v) A copy delivered to the Registrar of Companies is not signed by every persons who is named therein as a director or proposed director of the company or by his agent authorized in writing.

5. What is an abridged prospectus?

According to section 2(1) of the companies (amendment) Act, 2000 “Abridged prospectus means a memorandum containing such salient features of prospectus as may be prescribed.” As per the companies Act, the company was allowed to furnish an abridged form of prospectus alongwith the application for shares/debenture of information to the prospective investors, the government has revised the format of abridged prospectus so as to help them to take a correct decision regarding investment in shares and debentures.

The same printed number should be bearded by the abridged prospectus (in form 2A) and the shares application form. The investor may release the share application form along with the perforated line after he had an opportunity to study the contents of the abridged prospectus before submitting the same to the company.

6. What is Self Prospectus?

Meaning: “Shelf Prospectus” means a prospectus issued by any financial institute or bank for one or more issues of the securities or class of securities specified in that prospectus. [Section 60A]

Need: Raising funds from the public by means of various securities is a time consuming process. Negotiations with the various parties have to be finalized. Matters to be specified in the prospectus have also become quite large and highly informative, particularly under the SEBI Guidelines. Every time any such issue comes, a fresh prospectus is required to be filed. Although it is a repetitive matter, the procedural aspects take a lot of time. In order to minimize the Burdon on such institutions, it is now provided to introduce shelf prospectus, which will be valid, for a period of one year from the date of opening of the first offering of the shelf prospectus.

Provisions:[Section 60A]

1. A company filing a shelf prospectus with the Registrar of Companies shall not be required to file prospectus at every stage of offer of securities by it within a period of validity of such self prospectus.

2. An information memorandum shall be issued to the public alongwith shelf prospectus filed at the stage of the first offer of securities and this prospectus will be valid for a period of one year, from the date of opening of the first issue of securities under the prospectus.
3. Any public financial institution, public sector bank, or scheduled bank, whose main object is financing, shall file a shelf prospectus. "Financing" means making loans to or subscribing in the capital of a private industrial enterprise engaged in infrastructural financing or such other companies as the central government may notify in this behalf.
4. An update information memorandum should be filled every time when an offer for securities is made. Such memorandum together with the shelf prospectus shall constitute the prospectus.

7. What is Information Memorandum?

Information Memorandum means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed, by means of a notice, circular, advertisement or document [section 2(19B)]

Provision: [section 60B]

The provisions under section 60B, in this regard, may be noted as follows:

1. A public company making an issue of securities may circulate information Memorandum to the public prior to filing of prospectus.
2. The company is required to file a prospectus prior to the opening of the subscription list and the offer as a red-herring prospectus at least 3 days before opening of offer.
A red-herring prospectus is a prospectus, which does not have complete particulars on the price of securities offered and quantum of securities offered.
3. The information Memorandum and red-herring prospectus shall carry same obligation as are applicable in the case of a prospectus.
4. Every variation between the information Memorandum and the red-herring prospectus shall be highlighted by the issuing company and shall be individually intimated to the persons invited to subscribe to the issue of securities.
5. If the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated, cheques or stock-invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.
6. If a company or underwriter or banker to the issue acts contrary to the aforesaid stipulation, such action shall be void and the applicant shall be entitled to receive a refund of his post-dated cheques or stock-invests or subscription monies on cancellation of application. The applicants are entitled to receive back their original application money and interest at the rate of 15% p.a. from the date of encashment till payment of realization.
7. The applicant or proposed subscriber shall exercise his right to withdraw from the application on any information on any intimation of verification within 7 days from the date of such intimation and shall indicate such withdrawals in writing to the company and the underwriters.
8. 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 the Registrar of Companies as well as SEBI, in the case of listed public company and in any other case with Registrar of Companies only.

8. What is deemed prospectus?

Section 64(1) provides that where a company allots or agrees to allot any shares or debentures with a view to these being offered for sale to the public, 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.

Further, an allotment of, or an agreement to allot, shares or debentures shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public, if it is shown;

- (i) That the offer of the shares or debentures for sale to the public was made within six months after the allotment or agreement to allot;

(ii) That at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

Additional requirement relating to deemed prospectus

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

(ii) The place and time at which the contract under which in the said shares or debentures have been or are to be allotted may be inspected. Section 60, dealing with the registration of prospectus applies to the deemed prospectus in terms of section 64(4) and accordingly it renders the persons making the offer of sale to the public as deemed directors of the company.

Where the person making the offer is a company or a firm, the document (i.e. deemed prospectus) must be signed by at least two directors or one-half of the partners, as the case may be [section 64(5)]

9. What is a statement in lieu of prospectus?

Where a public company does not invite public to subscribe for its shares but arrange money from private sources, it needs not issue the prospectus to the public. But the company has to get its prospectus registered three days before the allotment of shares. Thus, the company not inviting public to subscribe, prepare a draft prospectus which contains the information given in schedule III of the act, such a draft prospectus is known as a statement in lieu of prospectus.

Provisions: Only public company which does not invite public for subscription can issue this prospectus. Responsibility will be same as that when actual prospectus is issued.

When issued: Section 70(1) requires a public company having a share capital to file with the Registrar of Companies a statement called "Statement in lieu of prospectus" in the following cases:

- (a) Where it does not issue a prospectus (because it feels that it can raise enough capital without inviting a subscription from the public); or
- (b) Where it issues a prospectus but has not proceeded to allot any of the shares offered to the public for subscription (because the issue has been a failure and the minimum subscription has not been received)

Statement in lieu of prospectus must be filed with Registrar of Companies at least three days before any allotment of shares or debenture is made.

Form of statement in lieu of prospectus: Schedule III contains a model form of a statement in lieu of prospectus in pursuance of section 70; Schedule IV contains a model form of a statement in lieu of prospectus when a private company is converted into a public company in pursuance of section 44.

Consequences/Penalty for misstatement in, or not filing of, statement in lieu of prospectus: If the allotment of shares or debenture is made without filing the statement in lieu of prospectus.

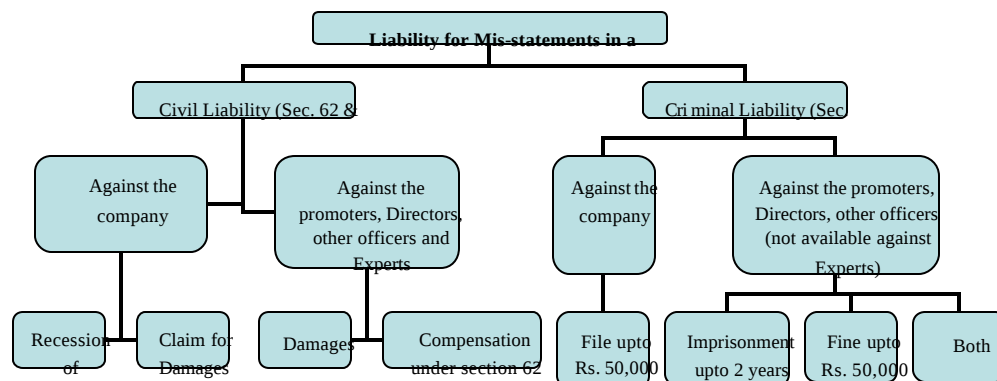
(i) The allottee may avoid the allotment within two months after the statutory meeting, or where no such meeting is held, within two months of the allotment [section 71(1)]

(ii) The person who authorized the delivery of SLP may be punished with imprisonment upto 2 years or with fine Rs. 50,000 or with both. [section 70(5)]

10. What is a Mis-statement? What are the provisions regarding the mis-statement?

According to section 65(1) of the Act:

- 1. 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 and
- 2. Where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission to be a prospectus in which untrue statement is included.



1. Civil Liability

An allottee of shares, who had applied for shares on the faith of a prospectus containing untrue statements has remedies available against different persons, i.e. the company (under the Indian contract Act, 1872), directors, promoters and experts.

(i) Remedies against the company:

Any person who, relying on a prospectus contain mis-statement or omission of material facts takes shares from the company may –

- Rescind the contract to take the shares
- Claim damages.

Rescission:

The shareholders give up the shares and get back his money with interest. He must however take action to rescind the contract:

- Within a reasonable time
- Before proceeding to wind up the company have commenced and
- Before he does anything (after he comes to know of the mis-statement in the prospectus); which is inconsistent with the right to repudiate e.g. to accept dividends.

The allottee can claim relief only if he can show that the mis-statement or omission was:

- One of fact and not of flow, nor an expression of opinion
- Material
- Acted upon by him

Suit for damages: In order to succeed, the allottee must, in addition to the three facts mentioned above (in connection with the rescission of contract), prove:

- That those acting on behalf of the company acted fraudulently;
- That those purporting to act on behalf of the company were authorized to act on its behalf
- That he suffered a loss or damages

It is important to remember that the allottee cannot both retain the shares and get damages from the company.

(ii) Remedies against Directors or promoters

A shareholders who had been induced to take shares may claim from the directors or promoters or from any one else responsible for untrue statement occurring in the prospectus :

- Damages for fraudulent misrepresentation
 - Compensation under section 62
 - Damages for non compliance with the requirement of section 56 regarding contents of the prospectus
- (a) Damages for Fraudulent misrepresentation:** An allottee of shares may bring an action for deceit i.e. fraudulent misrepresentation. There must be an intention to defraud and that is to be proved by him. The directors, etc, will not be liable for the tort or deceit if they honestly believed the statements to be true.

- (b) **Compensation for untrue statement (section 62):** An allottee of shares or debentures is entitled to claim compensation from directors, promoters and any other persons who authorized the issue of prospectus, for damages sustained by reason of any untrue statement in it.
- (c) **Liability under section 56:** An omission from prospectus of a matter required to be stated under section 56 may give rise to an action for damages at the instance of subscriber for shares, who has suffered loss thereby, even if the omission does not make the prospectus false or misleading. But the plaintiff must prove that he has sustained loss or damages by reason of the omission of a matter required to be stated in the prospectus.

Criminal Liability for Mis-leading in prospectus

According to section 63, where a prospectus contains an untrue statement, every person authorising its issue be punishable:

- (i) With imprisonment for a term upto 2 years; or
- (ii) With fine upto Rs. 50,000; or
- (iii) With both imprisonment and fine

However, an expert is not criminally liable in respect of mis -statement in the prospectus.

Liability under section 68

Section 68 provides that any person who, either knowingly or recklessly making any statement promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into or to offer to enter into any agreement for, or with a view to acquiring, depositing of, subscribing for, underwriting shares or debentures, shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to Rs. 1,00,000 or with both.

11. When is a Director or other person not liable for Mis-statement in prospectus?

The person responsible for the issue of prospectus containing untrue statement can be exonerated from such liability if he can prove that:

1. In a suit under Section 52 of the companies Act, 1956:-

- (i) He withdrew his consent to act as director before the issue of the prospectus and it was issued without his authority or consent; or
- (ii) He withdrew his consent after the issue of prospectus but before allotment and public notice was given; or
- (iii) The issue was made without his authority or consent and on becoming aware of the issue he gave reasonable public notice of the fact; or
- (iv) He had reasonable ground to believe that the statements were true and believed them to be true; or
- (v) The statement was correct and fair summary or copy of an expert's report; or
- (vi) The statement represented a fair copy or fair extract from an official document or from the statement made by an official person.

2. In a suit under section 56:-

A director or other person sued under section 56 may escape liability if he proves:-

- (i) That he has no knowledge of the matter not disclosed; or
- (ii) That the contravention arose out of an honest mistake of fact; or
- (iii) In the opinion of court, non-compliance or contravention was not material or that the person sued ought reasonably to be excused having regard to all the circumstances of the case.

12. Who is an Expert?

The word 'expert' includes an engineer, accountant, valuer or any other person whose profession gives an authority to a statement made by him. Section 59(2) of the companies Act, 1956 includes the provision of the experts. According to section 57, the report of an expert cannot be taken in consideration in a prospectus, if he is any way related with the formation or promotion of the company.

Expert's liability:

An expert becomes liable for an untrue statement in the prospectus if it is based and related to his report. If the expert is not concerned nor connected, than his report in this capacity cannot be taken:

- (i) Unless he has given a written consent to the issue of the prospectus and has not withdrawn the consent before the delivery of the copy of the prospectus to the Registrar of Companies.
- (ii) Till a statement as to his consent and non-withdrawal of it appears in the prospectus. (section 58)

The rule designed is very effective to protect a prospective investor by making a party responsible to the issue of prospectus and making them liable for untrue statement.

Penalty: section 59(1) of the companies Act, 1956 provides a penalty or fine extending Rs. 50,000 for the company and for any other person who is knowingly a party to the issue of prospectus.

When an expert is not liable: An expert will not be liable for the untrue statement, if he proves that:

- (i) After giving his permission to the issue of the prospectus, he withdraws in writing before the delivery of a copy of the of prospectus for registration; or
- (ii) He was competent to make the statement and he had reasonable conditions to believe that upto the time of allotment of shares , the statement was correct; or
- (iii) After the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the mis-statement withdraws his consent in writing and gave public notice & reason thereof.

An expert has the right to claim indemnity against those persons who inserted his name in the prospectus, in case where he has not given his written consent or he has withdrawn his consent before the issue of prospectus.

DESCRIPTIVE QUESTION

1. State the remedies available against a company to a subscriber for allotment of shares on the faith of a misleading prospectus. What conditions must be satisfied by such a subscriber before opting for the remedies?

Any person who by relying on a prospectus, containing mis-statement or omission of material facts takes share from the company may:-

- (a) Rescind the contract
- (b) Claim damages

Rescission of the contract: An application must be made to the court for the rescission of the contract, if statement discovers out to be fraudulent on the faith of which the shares were taken. The application should be made within a reasonable time and before the company goes into liquidation. The shares allotted to the person will have to be surrendered to the company. His name is then struck off from the register of members and he gets back the money paid by him to the company alongwith interest. If the following conditions are fulfilled then only the contract will be rescind:-

- (i) The statement must be untrue
- (ii) The statement must be material misrepresentation of facts
- (iii) The omission of material fact must be misleading before rescission is granted
- (iv) The statement must have forced the shareholders to take up the shares
- (v) The deceived share holder is an allottee and he must have relied on the statement in the prospectus.
- (vi) The proceeding for rescission must be started immediately as soon as the allottee comes to know of a misleading statement in the prospectus.

Rescission is available only if the aggrieved shareholder:

- (1) Acts within a reasonable time
- (2) Before the company goes into liquidation
- (3) Has not done any act indicating the upholding of the contract to take shares like:-
 - (i) Accepted dividend declared by the company; or
 - (ii) Having attended a meeting of the company.

Damages: An allottee of shares may bring an action for deceit. There must be an intention to defraud and that is to be proved by the allottee. The directors will not be responsible for the tort of deceit if they honestly believed statement to be true.

2. What is meant by 'Red-herring Prospectus'? State the circumstances under which such prospectus is required to be fled with the Registrar of Companies? What is the requirement relating to filing of final prospectus in such cases?

According to the explanation of sub section (4) of section 60B of the companies Act, 1956 "Red-herring Prospectus" means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.

For example if a company issuing its shares to the public through book building process then it will specify only the no. of shares to be issued but not the exact price at which the shares are to be issued. Rather than it can specify a price band within which investor can make subscription.

When to file Red-herring Prospectus :

A public company making an issue of securities may circulate information Memorandum to the public prior to filing a prospectus. [Subsection (1)]

A company inviting subscription by an information Memorandum shall be bound to file a prospectus prior to the opening of the subscription lists as a Red-herring Prospectus, at least three days before the opening of the offer. [Sub-section (2)]

The information Memorandum and Red-herring Prospectus shall carry same obligation as are applicable in the case of a prospectus [Sub-section (3)]

Requirements relating to filing of final prospectus:

Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised and the closing price of the securities and any other details as were not complete in the Red-herring Prospectus shall be filed in case of a listed company with the SEBI and Registrar of Companies, and in any other case with the Registrar of Companies only [Sub-section (9)]

PRACTICAL QUESTION

- 1. A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividend were not paid out of trading profit, but out of capital profit. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars. Decide.**

Any person who takes shares on the faith of statement of facts contained in a prospectus has the remedy to rescind the contract if those statements are false or untrue. The word 'untrue statement' is to be constructed as explained in section 65(1)(a) which must state that a statement included in the prospectus will be deemed to be untrue, if the statement is misleading in the form and context in which it is included.

According to section 65(1)(b) where the omission from a prospectus of any matter is calculated to mislead the prospectus is deemed, in respect of such omission to be a prospectus in which an untrue statement is included.

In the above problem, the fact that dividend were paid out of capital profit and not out of trading profit was not disclosed in the prospectus and till that extent the prospectus contained a material mis-representation of a fact giving a false impression that the company was a profitable one. Hence the allottee can avoid the contract of allotment of shares.

- 2. The directors of M/s. Reckless Investments Ltd. have allotted to shares to the investors of the company without issuing a prospectus or filling a statement in lieu of prospectus with the Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard.**

According to the provision of section 70 and 71 of the companies Act, 1956 any allotment of shares by a company without filing a prospectus or SLP will become regular allotment.

The effect of it is that the allotment made by M/s. Reckless investment Ltd. will become voidable at the instance of the allottee that is the applicant for shares within a period of two months from the date of allotment.

The allotment becomes voidable at the option of the investor applicant even if the company is in the course of winding up.

Further, the directors liable for the default are also liable to compensate the company and the allottee for loss to which the company have sustained or incurred. There is a time limit of 2 years which the investors have to claim the damages.

- 3. With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received a copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provision of the companies Act, 1956 examine whether X's claim for damages is justified.**

Where a person has purchased the shares of the company on the faith of the prospectus which contained untrue statement he can seek rescission of the contract or claim damages. But this remedy is available only to those persons who subscribed for any shares on the faith of the prospectus. Persons who have become shareholders by subsequent purchase to the Memorandum cannot avail this remedy.

In the present case, Mr. X did not apply for the allotment public any shares. After the completion of allotment few months later, he bought 2000 shares from stock exchange.

As per the provision of companies Act Mr. X neither has a remedy to rescind the contract nor can claim damages. Thus, X's claim for damages is not justified.

ACCEPTANCE OF DEPOSITS

1. What is a Deposit?

According to the explanation of section 58A(10) deposit means any deposit of money with and includes any amount borrowed by a company. Therefore, deposit also includes in it loan taken by a company. It does not include in it such amount as may be prescribed in consultation with RBI.

2. What are the rules relating to Invitation and Acceptance of Deposits?

Section 58A and Companies (acceptance of Deposits) Rules, 1975, imposed certain restriction and limitation on the invitation or acceptance of deposit by the companies. Some of the important rules made under this section are as follows:-

1. **Certain companies are prohibited to invite Deposits:** The companies which do not have net owned fund of Rs. 1 Crore are not allowed to invite or accept deposits.
2. Deposits are not allowed to be invited without issuing an advertisement
3. If there are default in repayment process than the companies were not allowed to invite deposits.
4. **Declaration by the depositor:** The Depositor should clearly declare in the form of application that money is not being deposited out of funds acquired by him by borrowing or accepting deposits out of funds acquired by him by borrowing or accepting deposits from any other person.
5. **Nomination:** The depositor should make the nomination as and when required as per section 109A and 109B.
6. **Deposits payable on demand:** A company should not accept or renew deposits which are payable on demand. Also, a company cannot accept deposits repayable before 6 months or after 36 months of receipt.
7. **Interest on deposits:** At present there is a ceiling of 12.5% per annum on rate of interest.
8. **Ceiling on deposits:** A company shall not accept deposits over and above the following limits:
 - (i) 10% of the paid-up capital and free reserves, in the case of deposits in the form of deposits against an unsecured debenture.
 - (ii) Any other deposit not exceeding 25% of the aggregate of the paid-up shares capital and free reserves of the company.
9. **Register of Deposits:** Every company should maintain a Register of Deposits for acceptance purpose. This register must be kept at the registered office of company. It must be preserved for minimum of 8 years, from the financial year on which the latest entry was made.
10. **Penalties for Contravention:** If the deposits are not made as per the act or rules, the amount collected should be paid back within 30 days from the date of acceptance of deposits. If still the default is contained then the company shall be subject to a fine, which shall not be less than twice the amount not repaid and in addition to this every officer who is in default shall be punishable with imprisonment for a term of 5 years.

Penalty for invitation of any deposits: Where default relates to the invitation of any deposits the company shall be punishable with a fine which may extend to Rs. 10 Lakhs but not less than Rs. 50,000.

3. Who is a Small Depositor?

Section 58A of the companies Act, 1956 defines a 'small depositor' as a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000 in a company and includes the successors, nominees and legal representatives. Small depositor does not include those depositors who renew their deposits and those depositors whose repayment is not made due to death or has been stayed by a competent court.

Acceptance, Repayment and Further deposits: -

1. Every company accepting deposits from the small depositor should inform the company law board within 50 days the name and address of each small depositors to whom it has defaulted in repayment of deposits or interest thereon. Thereafter the information should be given on a monthly basis.
2. On receiving the information the Company Law Board shall direct the company to repay the deposits and for this object the appropriate order is to be passed within 30 days, if it is delayed an opportunity to the small depositors must be given of being heard, for this purpose presence of the small depositor is not essential.
3. **Restriction on the company :**

- (i) No further deposits can be accepted from the small depositors unless the company repays all matured deposits alongwith interest due thereon.
- (ii) If in any case a company makes a default in repayment of small deposits, it shall state in all its future advertisement and application inviting deposits, the details regarding total number of small deposits and the amount due thereon.
- (iii) Where the interest accrued on small deposits has been dispensed this fact must be made clear in every future advertisement and application for inviting deposits.
- (iv) A statement must be their in every application from inviting deposits regarding the applicant that they had been appraised of every past default waiver of interest etc.
- (v) If the company avails any working capital from any bank subsequent to acceptance of small deposits. It shall first be utilized for repaying the principal and interest due to small depositors before using the fund for some other purpose.
- (vi) If the company fails to comply with the provision of section 58AA or order of Company Law Board, then it will be subject to a fine of Rs. 500 per day and imprisonment upto 3 years. The directors are also liable to be proceeded against. Under the Criminal Procedure Code such offence shall be cognizable.

Exemption: The provisions of section 58A do not apply to:

1. A banking company
2. Companies other than banking companies as the Central Government may after consulting with the RBI, specify in this behalf.

DESCRIPTIVE QUESTION

1. **State the consequences when a public limited company fails to repay matured deposits which it has accepted from the public. Can such a company continue to invite or accept deposits from the public?**

Repayment of Deposits: section 58(A) states that the repayment of deposits is very important. Every deposit accepted by a company shall unless renewed on accordance with rules made under section 58A(1) should be returned back in accordance with terms and conditions of such deposits.

When a company omits to repay any deposits or part thereof in reference with the terms and conditions of such deposit, the Company Law Board may, if it is satisfied either on its own virtue or on the application of the company, the depositors or the public, direct or order the company to make repayment of such deposits or part thereof within such time period and subject to such conditions as may be prescribed in the order. [section 58A(9)]

The depositor whose deposit has been matured and is not repaid must make an application (in triplicate) to the Company Law Board branch located at Delhi, Calcutta, Mumbai and Chennai depending upon the place of registered office of the company in the prescribed manner along with an application fee of Rs. 50.

If the orders of the Company Law Board are not followed under section 58A(9) it would attract penalty by way of imprisonment, which may extend to 3 years and shall also be liable to a fine of not less than Rs. 50/- for every day till such non-compliance continues.

Invitation after default: No company will invite or allow any other person to invite or cause to be invited on its behalf any deposits unless, the company is not in default in the repayment of any deposit or a part thereof as per the companies Amendment Act, 1996 and any interest there upon in reference with the terms and conditions of such deposits under section 58A(2). Therefore, the deposits are not allowed to be invited by the defaulting companies. This prohibition is only with regard to inviting deposits and it does not apply to the acceptance of deposits without invitation, provided the company has filed statement in lieu of advertisement with Registrar of Companies and all deposits accepted are in accordance with companies (acceptance of Deposits) Rules, 1975.

2. **Several small depositors of Overtrading company limited have made complains about non-refund of the deposits after due date. Explain briefly (1) the meaning of small depositor and (2) the duty of the company after the default has taken place in the matter of repayment of the deposits.**

Section 58AA of the companies Act, 1956 defines small depositors as a depositor who has deposited in any financial year a sum not exceeding of Rs. 50,000/- in a company and includes his successor, nominees and legal representatives.

Duty of company in case of default in repayment of deposits:-

1. The companies accepting deposits from small depositor should inform the Company Law Board/tribunal within 60 days of the default.
2. It becomes the duty of the companies to give the name and address of the small depositor to whom they have defaulted.
3. After this the company may give intimation to the Company Law Board on a monthly basis.

ALLOTMENT OF SHARES

1. What is meant by allotment of shares?

When a person intends to purchase shares he applies to the company in the prescribed format. When his application is accepted it is called the allotment of shares.

An allotment creates a binding contract between the parties.

2. How is Allotment defined?

The term allotment has not been defined in the companies Act, 1956.

Allotment of the shares means appropriation of the unappropriated shares. Allotment has been clearly defined in the case of Shri Gopal Jalan and company V. Calcutta Stock Exchange Association Ltd. as “the appropriation out of the previously unappropriated capital of the company of a certain number of shares to a person.”

3. What are the provisions as to the allotment of shares?

1. General provisions:

- (i) Allotment by proper authority i.e. board of directors
- (ii) Allotment against application only. This means allotment cannot be oral
- (iii) Allotment not to contravene any other provision of the law
- (iv) Reasonable time- 30 days from the close of issue the allotment should be done. If it is not allotted within 30 days the application money is to be returned with 15% of interest.
- (v) Commission of the allotment should be done to applicant.
- (vi) Allotment should be absolute and unconditional
- (vii) Revocation (forfeiture of shares is a mode of revocation of acceptance)

2. Statutory provision:

- (i) Registration of prospectus – prospectus can be registered on the day of issue or before issue.
- (ii) Application money (5% in 1956) (25% as per SEBI Guidelines 2000)
- (iii) The minimum number of shares for which application can be made is 200 shares of Rs. 10 each [as per SEBI guidelines]

In the case of discount and premium whatever be the number of shares amount will be Rs. 2000.

- (i) Money to be deposited in separate bank account until the minimum subscription is received and certificate of commencement of business (whichever is earlier)
- (ii) *Minimum Subscription:* As per the SEBI (90% of the public issue is the minimum subscription.
- (iii) *Opening of the subscription list:* Not until the beginning of the five days from the issue of prospectus. The date is known as day of opening of the subscription list.
- (iv) *Closing of the subscription list:* As per SEBI guideline 2000 provide the subscription list for public issue must be kept open for at least 3 days and maximum period of 10 working days. The infrastructure based company for maximum 21 days.
- (v) *Permission to deal on a stock exchange:* 10 Weeks from the date of closing of subscription list. After the completion of 10 weeks if company is not listed in stock exchange within 8 days. It has to return the full allotted money along with 15% interest.

Over subscription: Over subscribed money should be returned within 8 month with 15% interest. And still if the company is unable to return the board of director were penalized with Rs 50,000/- or 6 month to 1 year of imprisonment.

4. When is an irregular allotment? What are the provisions relating to it?

When the allotment of shares is made in contravention of the provision of the act then the allotment is termed as irregular. An allotment will be considered irregular in the following cases: -

- (i) Where minimum subscription is not received
- (ii) Where a copy of the prospectus has not been filed with the Registrar of Companies.
- (iii) Where a copy of the statement in lieu of prospectus has not been delivered to the Registrar of Companies at least 3 days before the allotment.
- (iv) Where application money has not been received, kept in a scheduled bank.
- (v) Where subscription list is opened before the beginning of the 5th day from the date of issue of prospectus.

(vi) Where application money to a minimum of 5% of the nominal value has not been received.

(vii) Where the shares are not listed on a recognised stock exchange or have been refused listing within 10 weeks.

Consequences of Irregular Allotment:

Sr.	Type of Irregularity	Under section	Consequence	Liability
1.	Prospectus not delivered to the Registrar of Companies	60	Allotment is valid	Company and every person knowingly a party to the issue of prospectus shall be fined upto Rs. 50,000/-
2.	Minimum subscription not subscribed	69(1)	Allotment is voidable	a. The entire application money is to be returned within 10 days or with interest @ 6% p.a. after 10 days. b. The directors who knowingly contravene the provisions are liable to the company as well as to the allottee.
3.	Application money less than 6% of nominal Value	69(3)	Allotment is voidable	a. Company and every office responsible shall be fined upto Rs. 5,000 b. The directors who knowingly contravene the provisions are liable to the company as well as to the allottee.
4.	Application money not deposited in a scheduled bank	69(4)	Allotment is voidable u/s. 71(1)	a. Company and every office responsible shall be fined upto Rs. 50,000 b. The directors who knowingly contravene the provisions are liable to the company as well as to the allottee.
5.	Statement is lieu of prospectus not delivered to the Registrar of Companies	70	Allotment is voidable u/s. 71(1)	a. Company and every office responsible shall be fined upto Rs. 10,000 b. The directors who knowingly contravene the provisions are liable to the company as well as to the allottee.
6.	Subscription list opened before 5 th day	72	Allotment is valid u/s. 71(1)	Company and every officer responsible shall be fined upto Rs. 50,000
7.	Shares not listed on stock exchange	73(1)	Allotment is void u/s. 73(1)	The entire money received on application shall become due and if not paid within 8 days, directors must repay with interest @ 15% p.a.

5. What are the provisions relating to returns as to allotments?

Returns as to Allotment: after the allotment of the shares by any company a return of Allotment in the prescribed form must be filed with the Registrar of Companies within 30 days of the allotment.

1. Where shares are allotted cash: Return must state the number of shares, nominal amt. of the share, address, occupation of the allottee, amt. paid or payable for each share.

2. Where shares other than bonus shares are allotted otherwise than in cash:

Return should contain:

- A written contract constituting title of the allottee of the share.
- The contract of sale or for service or other consideration for which the allotment was made.
- The number of such share than the nominal amount of the shares, amount paid or payable in form of consideration for such allotted shares.

3. Where the bonus shares have been issued, return must include:

- A copy of resolution authorizing the issue of such share.
- Number of shares, nominal value of shares, name and address and occupation of the allottee etc.

4. Where the shares have been issued at discount, return should include:

- (i) A copy of resolution authorising the issue of such shares.
- (ii) Copy of the order of Company Law Board.
- (iii) If the rate of discount exceeds 10% of the copy of document issued by the Central Government permitting such issue.

It is not done the penalty of Rs. 5000 per day for case 2, 3, 4 and in case 1 penalty upto Rs. 50,000.

5. Re-issue of forfeited shares: No need to file return of allotment to the Registrar of Companies.

6. What is Underwriting?

‘Underwriting’ is a contract entered into between the company and certain parties before the issue of the shares or debentures to the public for subscription. The contract entered into between the two is that if in case the whole or an agreed portion of the shares or debentures are not applied, then the underwriters themselves will take the unsubscribed share or debentures. They can also procure other person to apply for them. The company has no interest in knowing how the Underwriters procure the purchases. Thus, the underwriter exposes themselves to great risk, by placing the shares before the public. In return of this risk they get commission which is called Underwriting commission. Underwriting is on the nature of insurance against the possibility of inadequate subscription.

According to the SEBI guidelines 2000 Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or public do not subscribe to the securities offered to them.

Conditions: section 76 allows the payment of underwriting commission subject to the compliance of the following conditions:

- 1. The payment of commission must be authorized by the articles of the company.
- 2. The names and address of the underwriters should be disclosed.
- 3. A disclosure must be there about the Underwriting commission in the prospectus or statement in lieu of prospectus.
- 4. The amount of the Underwriting commission payable should not exceed 5% in case of shares and 2.5% in case of debentures. If the Articles permit the company can have lesser percent of commission.
- 5. The commission can be paid in cash or in kind as agreed between two parties.
- 6. A disclosure should also be there in relation to the number of shares or debentures which the person have agreed to subscribe absolutely or conditionally.
- 7. A copy of contract in relation to the payment of commission should be delivered to the Registrar of Companies.
- 8. Underwriting commission may be paid in respect of debentures offered to the members on a right basis.
- 9. The Underwriting commission will not be paid on the shares or debentures, which are not offered to public for subscription. But where a person has subscribed or agreed to subscribe under sub-section (1)
 - (a) For any issue in or debenture of the company and before the issue of the prospectus statement in lieu thereof of any other person or persons has or more subscribed for any or all those shares & debentures.
 - (b) The fact together with the aggregate amount of commission payable under this section in respect of such subscription is disclosed in the prospectus or statements then the company will pay commission to first mentioned persons [section 76(4A)]

7. What is Brokerage?

Brokerage [u/s. 76(3)] is a reward paid to the middleman or mediator who brings about a bargain between the seller and purchaser of shares and debentures.

Provisions relating to brokerage:

- 1. It is paid even if it is not authorized by the Articles of Association.
- 2. Brokerage is paid only on those shares, which are sold by the broker.
- 3. The rate of the brokerage is not fixed it depends upon the company.
- 4. Brokerage is paid for every share while it is issued to the public.
- 5. It is not necessary to disclose the name of contract and brokerage.

8. What is Minimum subscription?

The minimum subscription is the value which in the opinion of the Board of Directors of the company must be raised by the issue of those shares which are offered to the public for subscription [section 69(1)]. The significances of raising the minimum subscription are-

1. The purchase price of any property required by the company is to be paid out of the proceeds of the issue.
2. If the company borrowed money for purchase of property or for preliminary expenses, then the repayment is done by the subscribed money.
3. Any commission payable for sale of shares is paid out of the proceeds of issue.
4. It acts as a working capital of the company.
5. Other expenses are also met by this amount.

The reason behind the provision of minimum subscription is to protect the company from the disadvantages of starting the business without adequate financial resources. This also acts in the form of investor protection measure because if the company is unable to receive the minimum subscription, then it has to refund money collected from the application.

Time of opening the subscription list:

1. According to section 72(1) no allotment should be made until the beginning of the 5th day from the date of issue of prospectus.
2. The subscription list should be kept open for at least 3 days and the information should be mentioned in the prospectus.]
3. The maximum period of keeping the subscription list open is 21 days if the issue was underwritten and 10 days for any other case.
4. The main objective behind this provision is to give the application a sufficient time to study the prospectus and, to withdraw their offer if they are not satisfied with the prospectus.

Provision:

1. Section 69(1) of the companies Act, 1956, states the provision for the companies that the prospectus of every company must contain an indication as to the minimum amount which in the opinion of the Board of Directors must be raised.
2. The amount quoted in the prospectus must be of such nature which can be recovered easily; this amount is known as minimum subscription.
3. The amount payable on application of each share shall not be less than 5% of the nominal value of shares.
4. If the application shares for making the minimum subscription is not received within 120 days of the issue of prospectus all the money so received will be repaid without interest.
5. If such money is not returned within 130 days after the issue of prospectus; then it will be returned with interest @6% after the completion of 130 days

Provision as per SEBI guidelines:-

- (i) As per the SEBI guidelines, the minimum subscription in respect of public and right issue shall be 90% of the issue amount.
- (ii) In case of offer for sale of securities, the need for 90% minimum subscription will not be mandatory.
- (iii) In case of non-receipt by the company of 90% of the issued amount from public subscription plus accepted development or from other sources, within 60 days from the date of closure of the issue, the company must return the subscription amount in full without interest.
- (iv) And with interest @15% p.a. if it is not paid within 10 days after the expiry of the said 60 days.

9. What are the provisions relating to purchase or Buy-back of the own share by a Company?

A Company possesses the right to purchase its own shares or other specific securities. The funds that can be utilized by the company for purchasing its own share should be out of: -

1. Its free reserves
2. The security premium account
3. The proceeds of any shares or other specified securities.

According to section 77A(1), the buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the similar kind of shares or other specified securities.

Employees' stock option or other securities as may be noticed by the central government from time to time may be included in specified securities.

Requirement to be complied before buy-back: A company cannot purchase its own shares or other securities unless they fulfill the following conditions:-

1. There should be an authorization in the articles for the buy-back.
2. A special resolution must be passed in the general meeting for authorizing the buy-back.
3. The buy-back must be or less than 25% of the total paid up capital and free reserves of the company.
In any financial year, the buy-back of equity shares shall not exceed 25% of the total paid up equity share.
4. The ratio of the debt owed by the company must not be more than twice the capital and free reserves after such buy-back.
The central Government has the power to increase the ratio of the debt, than specified in the clause for the class or classes of companies.

All the amounts unsecured and secured debts are included in the term debt.

'Free reserves' includes in it the reserves which as per latest audited balance sheet of the company are free for distribution as dividend and it will also include in it the balance to the credit of the securities premium account.

5. The shares or other specified securities which are to be buy-back by the company must be listed on any recognized stock exchange in reference with the regulation made by SEBI in its behalf.
6. Buy-back must be done on the shares and securities which are fully paid up.
The notice of the meeting at which the special resolution is proposed to be passed should include with it the statement stating:-
 1. A full and complete disclosure of all material facts
 2. The reason behind the buy-back must be disclosed
 3. The types of securities which are to be purchased under buy-back.
 4. The amount to be involved under the buy-back.
 5. And lastly the time within which the buy-back will be completed [section 77A(3)]

Requirement to be complied after buy-back: section 77A and 77AA of the companies Act, 1956 deals with the requirement to be fulfilled after buy-back. They are as follows:

1. According to section 77A(7) the securities which are bought back should be extinguished and physically destroyed within 7 days after the completion of buy-back.
2. A company is not permitted to issue same kind of shares or securities which were brought back for a period of 24 months. However, the following are permitted:-
 - a. Bonus shares
 - b. Sweat equity
 - c. Stock option to employees
 - d. Issue of securities of a different class than is other than one which was earlier bought back
 - e. Subsisting obligation such as conversion of warrants
 - f. Conversion of preference or debentures into equity shares [section 77A(8)]
3. A register must be maintained by the company showing securities bought back, consideration paid for the buy-back, date of cancellation of securities, date of extinguishment and physical destruction of securities and other prescribed particulars [section 77A(a)]
4. After the buy-back is over, a return must be filed with the registrar of companies and SEBI, if the company is listed within 30 days giving details as prescribed [section 77A(10)]
5. According to section 77AA if the buy-back is done from the free reserves than a sum equal to the face value of share purchased will be transferred to capital redemption reserve account. Details of such transaction must be disclosed in Balance Sheet of the company.

DESCRIPTIVE QUESTIONS

1. In what way does the companies Act, 1956 regulate and restrict the following in respect of a company going for public issue of shares:
 - 1) Minimum subscription; and
 - 2) Application money payable on shares being issued?

Companies Act, 1956 contains provisions which regulate and restrict the minimum subscription and the application money payable on shares issued by a company going for public issue of shares. These provisions are contained under section 69(1) and 69(3) to (6) of the Act. The section has been explained as under:-

Minimum subscription [section 69(1):-

Any share capital of the company offered to the public for subscription will not be allotted unless:-

1. Any shares mentioned in the prospectus as the minimum amount has not been subscribed, provided that such amount should not be less than 5% of the face value of shares issued; and
2. The sum payable on application for such amount has been paid to and received by the company

If the application for minimum subscription is not received within 120 days after the issue of prospectus, then all the money so received from the application must be repaid without interest. If the money is not returned within 130 days after the issue of prospectus it will be repaid with interest at the rate of 6% from the expiry of 130 days.

Application Money: According to section 69(3) of the companies Act, 1956, the amount to be received on application of each share must not be less than 5% of the nominal value of shares. The money received by the application of shares should be deposited in a scheduled Bank:-

1. Till the company receives the certificate of commencement of Business [section 149]
2. Where the certificate is already obtained; then until the entire amount payable on application for shares in respect of the minimum subscription has been received by the company.

Where the amount is not so received by the company within the time prescribed, then the money received from the applicants are to be returned without interest. And if it is still delayed then the interest will also be added.

2. **DIA Company limited desirous of buying back of all its equity shares from the existing shareholders of the company seeks your advice. Examining the provisions of the companies Act, 1956. Advise whether the above buy-back of equity shares by the company is possible. Also state the sources out of which buy-back of shares can be financed.**

After introduction of section 77A under the companies Act, it is possible for a company to buy-back its own shares. But for this purpose the company will have to fulfill the following conditions mentioned in sub-section 2;

- (i) The buy-back is authorized by its Articles
- (ii) A special resolution has been passed in general meeting of the company authorising the buy-back;
Provided that instead of passing of a special resolution company will have to pass a resolution in the board only if :-
 - The buy-back is equal to or less than 10% if total paid up equity capital and free reserves of the company
 - An offer for another such buy-back is not made within a period of 365 days from the preceding offer.
- (iii) The buy-back is or less than 25% of the total paid up capital and free reserves of the company
Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year
- (iv) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.
Provided that the Central Government may prescribe a higher ratio of the debt than that of specified under this clause for a class or classes of companies.
Explanation:- For the purpose of this clause, the expression "debt" includes all amount of unsecured debts;
- (v) All the shares or other specified securities for buy-back are fully paid-up;
- (vi) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf;
- (vii) The buy-back in respect of shares other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Also before the buy-back a declaration of solvency should be filed with Registrar of Companies and the buy-back must be completed within 12 months from the date of passing of resolution. Also the shares bought back must be extinguished and physically destroyed within seven days of the last date of completion of buy back.

Sources out of which buyback of shares can be financed:

According to sub section 1 of the section 77A, a company may purchase its own shares or other specified securities out of –

- (i) Its free reserves
- (ii) The securities premium account

(iii) The proceeds of any shares or other specified securities

Provided that not buyback of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

PRACTICAL QUESTIONS

1. ABC Company limited at a general meeting of members of the company pass an ordinary resolution to buy back 30% of its equity share capital. The Articles of the company empower the company for buy back of shares. The company further decide that the payment for buy-back be made out of the proceeds of the company's earlier issue of equity shares. Explaining the provisions of the companies Act, 1956, and stating the sources through which the buy-back of companies own shares be executed. Examine

- a. **Whether company's proposal is in order?**
- b. **Would your answer be still the same in case the company instead of 30% decides to buy back only 20% of its equity share capital?**

Buy-back of own shares: Sources of Funds etc. when the company purchases its own shares and/or other specified securities. It is known as buy-back of own shares. The purchase should be made out of :-

- (i) The securities premium accounts
- (ii) Its free reserves
- (iii) The proceeds of any shares or other specified securities

As per Section 77A(i), the buy back of any kind of other specified securities is not allowed to be made out of proceeds of an earlier issue of the same kind of share or other security.

Section 77AA contains two provisions regarding the buy back of shares:-

- (i) A special resolution is to be passed by the company in general meeting who is deciding for the buy back of shares.
- (ii) Secondly, the buy-back is less than 25% of the total paid up capital & free reserves of the company.

By considering the above two provisions, the question asked in the problem can be answered as under:-

1. The company's proposal for buy back is not in order because it has passed only an ordinary resolution and 30% buy-back is in violation of the provisions.
 2. The answer of the second question is also the same because there also the resolution passed by the company is an ordinary resolution not the special resolution. Though the buy-back is not violative as the percentage is 20%.
- 1. After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 shares in favour of "X". The company deposited the said amount in the bank but withdrew 50% of the amount, before finalization of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the companies Act, 1956. Comment.**

Allotment of shares: The Company has received 80% of the minimum subscription as stated in the prospectus. Hence, the allotment made is in contravention of section 69(1) of the companies Act and the allotment is irregular which is attracting the provisions of section 71 of the companies Act, 1956.

The consequences of irregular allotment: At the option of the applicant, the allotment is rendered voidable. The opinion must be exercised:

- (i) Within 2 months after the holding of the statutory meeting of the company; or
- (ii) Within 2 months after the date of allotment where the company is not required to hold the meeting or the meeting is already held.[section 71(1)]

If the company goes into liquidation, than also the irregular allotment is voidable. [Section 71(2)]

As per above provisions, refusal of "X" to accept the allotment of shares on the ground that the allotment is violative of the provisions of the companies Act is valid provided he has exercised his option to avoid the allotment within the period mentioned in section 71(1) of the companies Act.

The company has also violated the provision of section 69(4) of the companies Act in withdrawing 50% of the amount with the bank before receiving the entire amount payable on application for shares in respect of the minimum subscription.

2. The Board of Directors of the company decides to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permits only 3% commissions. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the companies Act, 1956?

Underwriting Commission: According to section 76 of the companies Act, 1956:

- (i) The payment of commission should be authorized by the Articles.
- (ii) The amount to be paid as commission should not exceed 5% in case of share and 2.5% in case of debentures.

Answer to the problem:

Thus, by the consideration of the above provision it is concluded that the Board of Directors, decision to pay 5% is incorrect, since the payment will not exceed 3% as given in the Articles of the company.

Whereas, the second decision of the board is correct, since the commission can be paid out of capital and out of profit both.

3. Mars India limited owed to Sunil Rs. 1,000. On becoming this debt payable, the company offered Sunil 10 shares of Rs. 100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of this allotment in the light of the provisions of the companies Act, 1956.

The allotment of shares by Mars India limited to Sunil is valid subject to the following provisions of the companies Act, 1956.

According to section 81 of the companies Act, 1956, a company may issue shares to its lenders who have been given the option to convert their loans into shares. For this the conversion has to be approved, before the raising of loan, by a special resolution and also by the Central Government.

Thus the allotment will be valid if-

1. An option had been given by the company to Sunil for conversion of loan into share before the loan was raised.
2. Such a conversion was approved by a special resolution and by Central Government before the loan was raised.

MEMBERSHIP, INVESTMENT AND SERVICE OF DOCUMENTS

1. Who is a Member of Company?

The members of a company are the persons who collectively constitute the company as a corporate entity.

Section 41 of the companies Act, 1956 defines a member as:-

1. The subscription to MOA of a company shall be deemed to have agreed to become members of the company and on its registration, shall be entered as members in its register of members.
2. Every other person who agrees in writing to become a member of a company and whose name is entered in the register of members shall be a member.
3. Every person holding equity share of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be the member of the company.

2. Who can become a member?

Any person who is competent to contract may become the member of the company as per the provision of Memorandum and Articles of Association of the company.

Certain person cannot be the member of the company:

1. Minor
2. Persons of unsound mind
3. Insolvent
4. Partnership firm N/P but partners individually can become a member.
5. Company (may or may not as per the MOA and AOA)
6. Subsidiary Company cannot become member of holding company.

3. What is the difference between a member and shareholder?

The persons who collectively constitute the separate entity are the 'members' or 'shareholder' of a company. These words are used interchangeably. In case of a company limited by shares, a company limited by guarantee and having share capital and an unlimited company whose capital is held in definite shares these words are synonymous. Whereas in case of an unlimited company or a company limited by guarantee having no share capital a member may not be a shareholder.

Distinction between a member and a shareholder

Sr.	Basis	Member	Shareholder
1.	Registration	A registered shareholder is a member	A registered member may not be a shareholder

2.	On the Death of member	A legal representative may not be a member until he applies for registration	The legal representative remains a shareholder though his name does not appear on the register
3.	Share warrant	Holder of share warrant is not a member his name is struck off	A person who owns a share warrant is a shareholder
4.	On subscription	A person who subscribes to the MOA immediately become the member	When the shares are allotted to the subscriber they become shareholder.
5.	On the transfer	On the transfer of share the person remains the member till the time the transfer is registered in the name of the transferee	A person who transfers his shares ceases to be a holder of shares from the date of transfer.

4. What are the modes of acquiring the Membership?

A person may become a member or shareholder of the company in any one of the following ways:-

1. **By subscribing to the Memorandum of Association:** The subscriber to the Memorandum of a company are deemed to have agreed to become a member of the company and on the registration of the company their names are entered as members on the register of members
2. **By agreeing to take qualification Shares:** According to the section 266 directors of the company on delivering to registrar a written undertaking to take their qualification shares and to pay for them become the members of the company and they are in same position as if they were subscribers to the Memorandum.
3. **By transfer of shares:** Shares in a company are movable property and are transferable in the same way as provided in the Articles of the company. Thus one person possesses the right to transfer his shares to another person. On the registration of transfer the transferee becomes the member of the company.
4. **By application and allotment of shares:** A person may become a member of a company by an application for shares to the formal acceptance by the company. On valid allotment, the name of the shareholder is entered in the register of members
5. **By succession:** On the basis of the succession certificate the legal heirs of the deceased member/shareholder get the right to be a member of the company. The company on this basis enters their name in the register of members.

5. Can a public limited company be a member of another public limited Company?

If the Memorandum of Association of the company authorizes then only a company can become the member of another company. But there are some cases in which a company may not become the member of its holding company. Section 77(1) lays down that a company cannot become a member of itself, that is it cannot purchase its own shares. Any allotment or transfer of shares will be void in a company to its subsidiary or a nominee for its subsidiary.

Section 42(1) will not apply in the following conditions that are:-

1. Where the subsidiary is concerned as the legal representative of a trustee, or
2. Where the subsidiary is concerned as trustee, unless the holding company or a subsidiary of it is interested in the trust and is not so interested only by way of security for the purpose of a transaction entered into by in the ordinary course of business [section 42(2)]

All the commencement of the Act, a subsidiary which was a member of its holding company will continue to become member before becoming a subsidiary of a holding company. But it shall not except in two cases mentioned above in section 42(2) have any voting right at the holding company meetings.

Section 42 increase the restriction contained in sub-section (1) to the cases where a public company which is a subsidiary is not holding any shares in the holding company in its own name but through its nominee.

However, the prohibitions contained in sub-section (10) is applicable in the case of subsidiary having membership interest in the holding company which is either a company limited by guarantee or unlimited company having share capital or not.

6. How is Membership terminated?

Termination of the membership: it can take place in two ways:-

1. Voluntary termination (by act of the parties)
2. Compulsory termination (by operation of law)

1. Voluntary/by act of the parties termination:-

- (i) By transfer of shares
- (ii) By forfeiture of shares
- (iii) By surrender of shares
- (iv) By exercising lien by the company.
- (v) By issue of share warrants
- (vi) By redemption of shares
- (vii) By the buy back of shares by the company
- (viii) By irregularity in allotment

2. Compulsory/By operation of law termination:-

- (i) By termination of shares
- (ii) By insolvency
- (iii) By the order of court on acquiring shares
- (iv) By dissolution

7. What are the rights of a Member?

Right of the member of a company: A member of the company has the following right against the company:-

1. Right to have his name registered on the register of members.
2. Right to have the certificate of shares held or the certificate of stock issued to him within the prescribed time.
3. Right to transfer shares subject to any restriction imposed by the articles of the company.
4. Right to receive a copy of the statutory report.
5. Right to attend meeting of shareholders, receive proper notice and to vote at the meeting.
6. Right to have notice on any resolution requiring special notice.
7. Right to associate in the declaration of dividends and to apply to the court for an injunction.
8. Right to obtain request minutes of proceeding at general meeting.
9. Right to obtain copy of Memorandum of Association and Articles of Association on request and on payment of the fees.
10. Right to remove directors by joining with others.
11. Right to inspect the registers, indexes returns and copies of certificate etc. kept by the company and to obtain extracts and copy thereof.
12. Right to apply to the court to have any variation or abrogation to his right set aside by the court.
13. Right to have first option in case of further & new issue of shares.
14. Right to participate in the appointment of an auditor at the AGM.
15. Right to obtain a copy of P&L A/c. and Balance sheet with the audit report.
16. Right to inspect the auditor's report at the AGM of the company.
17. Right to apply for the appointment of one or more competent inspectors by the Government to investigate into the affairs of the company.
18. Right to participate in passing of the Special Resolution.
19. Right to receive a share in the capital of the company and in the surplus assets, if any on the company's liquidation.
20. Right to take part in the appointment and in fixation of remuneration of one or more liquidators in case of a Members Voluntary winding up & to fill any vacancy in the office of a liquidators so appointed by him.

8. What are the liabilities of a Member?

1. In case of company limited by shares, liability will be limited only to the extent unpaid.
2. In case of company limited by guarantee, liability will be limited to the amount guaranteed.
3. In case of company with unlimited liability, the members are liable in full for all the debts of the company.

9. Can a Member be expelled?

A member cannot be expelled even by altering the Articles. (Dept. of Company affairs in Bajaj Auto Ltd. V. N.K. Tarodia) such an alteration will be opposed to the fundamental principles of the company's jurisdiction and is ultravires the company.

10. Can a Member be suspended?

A member can be suspended but temporarily provided the power to suspend is contained in the Articles and the same is exercised, bonafide by the managing director of the company

11. What is Investment?

In simple language, investment includes any type of the property or rights in which money or capital is, invested. But in the case of company, we take the word investment to a limited sense that is investing of money in shares, stock, debentures or other securities.

12. Which investments can be held by a company in its own name?

Under section 49(a) , investments made by a company (other than an investment company) on it's name on behalf shall be made and held by it in its own name. Theaforesaid section is subject to the following exception:-

- (i) **Investment exercisable in trust:-** When the company make s investment on behalf on someone else, then such investment need not be held in its own name. Thus, where the company is a trustee, the investment is assumed to be made on behalf of the beneficiaries of the trust and not on its own behalf. Thus, no objections are made in such cases in which the investment are being made by the company as a trustee but held in the name of the beneficiary.
- (ii) **Qualification shares in respect of nominee director or nominee holders[section 49(2)]:-** Where a company is in a position to appoint a director or directors on the board of another company and the Articles of that company provide for share qualification, it will be open to the appointing company to hold the shares (i) jointly in its own name and the name of appointee director (ii) in its own name.
- (iii) **Holding shares in a subsidiary in the name of the nominee[section 49(3)]:-** According to section 49(3) a company may hold any shares or shares in its subsidiary through the name or names of nominee of the company if it is required to ensure that the number of members of the subsidiary does not fall below the minimum number prescribed under the act for private and public companies.
- (iv) **Investment companies [section 49(4)]:-** When the principal business of the company is to buy and sell shares and securities, they are expected from the requirement of holding shares or securities on its own behalf.
- (v) **Other Section [section 49(5)]:-** Section 49 does not restrict a company :-
 - (a) From depositing 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;
 - (b) From depositing with the bank being the bankers of the company, any shares or securities for collecting dividend or interest payable thereon;
 - (c) Form holding investments are in the form of securities held by the company as a benefits owner.
 - (d) From depositing with or transferring to or holding in the name of the SBI or scheduled bank, being the banker of the company shares or securities in order to facilitate the transfer. If no transfer of such shares or securities taken place within the period of six months from the date from which the shares or securities are transferred by the company to, or are first held by the company in the name of SBI or scheduled bank as aforesaid shall as soon as practicable, after the expiry of the period re-transfer those shares or securities in its own name.

If the shares of securities are not held by the company in its own name, they should maintain a register in which they must record the nature, value and other particulars as may be important to identify the shares, securities in question. It must also mention the bank or person in whose name of custody the shares or securities are held. [Section 49(7)]

13. How are Documents served ?

Section 51 of the companies Act, 1956 explains the law relating to service of documents on company. the section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post or by leaving it at its registered office.

Service of documents or Registrar of Companies [section 52]:

A document may be served on Registrar of Companies by sending it to him at his office by post under a certificate of posting or by registered post or by delivering it to, or leaving it for him at his office.

Service of documents on members by a company [section 53]

1. According to section 53(1) a company may serve documents to its member either personally or by sending it by post to him to his registered address in India or to the address if any within India supplied by him to the company for giving notices to him.
2. Where a document is sent by post, the service thereof shall be effective if the letter containing the document is properly addressed and is sent by ordinary post. But when a request is made by any member, the notice should be served by

registered post or under a certificate of posting provided the member has deposited sufficient money to meet the expenses [section 53(2)(a)]

These services shall be deemed to have been effected:

- (a) In the case of a notice of a meeting, at the completion of forty-eight hours after the letter containing the same is posted out.
 - (b) In any other case, at the time at which the letter would be delivered in the ordinary course of post.
3. Under section 53(3), if a person residing abroad has not supplied an address to the company within India for the purpose of giving notice to him, then a document advertised in a newspaper circulating in the neighborhood of the registered office shall be deemed to be duly served on him on the day on which the advertisement was made.
 4. As per section 53(4), joint holder of a share will be served notice on the joint holder named first in the holder.
 5. In the case of the death of the shareholder, it becomes the duty of the legal representatives to furnish their address for a notice to be sent and if they fail to do so, the company will serve the notice at the earlier recorded address. In case of the insolvent members the same rule applies when the assignee fails to provide their address [section 53(5)]

DESCRIPTIVE QUESTIONS

1. How far can a minor become a member of a company under the companies Act, 1956?

A person who gives approval in writing to become a member of a company and whose name is entered in the register of members will be the member of the company [section 41(2) of the companies Act, 1956]. An agreement is very important for membership. It has been held in *Mohri Bibi Vs. Dharmadas Ghose* that an agreement with a minor is wholly void because he has no contractual capacity. Hence a minor or lunatic cannot enter into an agreement.

If a minor makes an application for shares, and directors allot shares to a minor without knowing that he was a minor and enters his name on the register of members, as soon as the company comes to know the fact, it has the right to cancel the allotment and strike the name of the minor from the register. On this, it becomes the duty of the company to return the entire money to the minor, which is obtained in relation to the allotment.

The CLB has laid down in *Nandita Jain Vs. Bennet Coleman & Co. Ltd.* that a minor can become a member, if the following conditions are fulfilled:-

- (a) If the shares are fully paid up
- (b) Company must be a company limited by shares.
- (c) The transfer is mainly for the benefit of the minor
- (d) Application for the transfer is made on behalf of minor by lawful guardian.

The Punjab High Court in the case of *Diwan Singh Vs. Minerva Film Ltd.* held that there is no legal restriction on a minor becoming the member of a company, if they acquire shares which are fully paid up and no further liability or obligation is attracted to it.

By transfer and transmission also a minor can become a member.

PRACTICE QUESTION

1. Describe the ways to become a member of the company.

A company issued 20 partly paid equity shares and registered them in the name of a minor describing him as a minor. The father of the minor signed the application on the minor's behalf. After some time the company went into liquidation. The company filed a suit against the father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advise.

Modes of acquiring membership: A person may become a member of a shareholder of the company in any one of the following ways:-

1. **By subscribing to the Memorandum of Association:** The subscribers to the Memorandum of a company are deemed to have agreed to become a member of the company and on the registration of the company their names are entered as members on the register of members
2. **By agreeing to take qualification shares:** According to section 266 directors of the company on delivering to the registrar a written undertaking to take their qualification shares and to pay for them become the members of the company and they are in the same position as if they were subscribers to the Memorandum.

3. **By transfer of shares:** Shares in a company are movable property and are transferable in the same way as provided in the Articles of the company. Thus one person possesses the right to transfer his shares to another person. On the registration of transfer the transferee becomes the member of the company.
4. **By application and allotment of shares:** A person may become a member of a company by an application for shares to the formal acceptance by the company. On valid allotment, the name of the shareholder is entered in the register of members
5. **By succession:** On the basis of the succession certificate the legal heirs of the deceased member/shareholder get the right to be a member of the company. The company on this basis enters their name in the register of members.

Answer to Problem: The person who is a competent enough to enter into a contract is liable to become a member. A minor and a person of unsound mind cannot be the member of the company, as they are incompetent to contract. It has been contractual capacity, so the agreement with the minor is void-ab-initio.

No qualification has been prescribed by the companies Act, 1956 for membership. Therefore, in India a minor can be allotted share. His name will be appeared on a company's register of members, but at the time of minority no liability is incurred by minor.

In the given question the company issued 20 partly paid up shares and registered it in the minor's name. The transaction was void and the father who signed the application on the minor's name could not be treated as having contracted for shares. Therefore, he could not be placed on the list of contribution when the company goes into liquidation. The facts to the case of **(Palaniappa V. official Liquidator AIR 1942 Mod. 740)**

2. **M/s. Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of Rs. 10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to the Balak by way of transfer.**

The companies Act, 1956 does not lays down a qualification for membership. An agreement enforceable in a court of law makes important the membership.

Therefore, the contractual capacity stated by the Indian contract act, 1872 should be taken into consideration. It was held in the case of Mohri Bibi Vs. Dharmadas Ghose that since the minor does not have contractual capacity, thus, agreement with minor will be void. Therefore, a lunatic or minor cannot enter into an agreement to become the member of the company. Further, in the case of Diwan Singh Vs. Minerva Films Ltd., the Punjab High Court held that there is no legal restriction on a minor becoming the member of a company by taking up the shares by way of transfer provided the shares are fully paid up and no obligation should be related to it.

In view of the above case, M/s. Honest Cycle Ltd. can give membership to Balak through 1000 shares, received by way of transfer in favour of Mr. Balak a minor because the shares are fully paid up and no further obligation or liability is attached to these.

3. **X had applied for the allotment of 1000 shares in a company. No allotment of shares was made to him by the company, later on, without any further application from X, the company transferred 1000 partly paid up shares to him and placed his name in the register of members. X, knowing that his name was placed in the register of members, took no step to get his name removed from the register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the companies Act, 1956, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.**

According to section 41(2) that deals with membership by application and allotment – an application for shares is an offer to take shares; allotment is acceptance of that offer by the company creates a binding contract between the applicant and the company.

Further more as per section 111 the tribunal may order for the rectification of the register where there is no valid allotment of shares i.e. where there is allotment of shares without observing provisions of the Articles of Association.

In the present case, shares applied by X were not allotted by the company. Later on company places his name on register of members by transferring partly paid 1000 shares which are not applied for. Moreover, X knowing that his name was placed in register of members did not applied for the rectification of register where his name was entered without sufficient cause will be liable for the call made on such shares.

Thus, X cannot refuse to pay for the call money as he has taken no steps to get his name removed from the register of members. Therefore, he cannot escape himself from the liability as a member of the company.

SHARE CAPITAL

1. What is a Share?

According to section 2(46) of the companies Act, 1956, “A share is a share in the capital of a company, and includes stock except where a distinction between stock and share is expressed or implied”.

The Supreme Court of India in the Commissioner of Income-tax V. Standard Vacuum Oil. Co. observed “By a share in a company is meant not any sum of money by an interest measured by a sum of money and made up of diverse rights conferred on its holders by the Articles of Association of the company which constitute a contract between him and the company.”

In another case Supreme Court defined a share as “a right to participate in the profits made by the company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound up.”

2. What is the nature of Share?

1. A share is not a sum of money but is the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of Mutual ‘covenants’ entered by all the shareholders inter se.
2. A share is a chose-in-action implies the existence of some person entitled to the rights, which are rights in action as distinct from right in possession, and until the share is issued no such person exists.
3. In India, a share is registered as ‘goods’. Section 2(7) of the sale of goods act, 1930 defines ‘goods’ to mean any kind of movable property other than actionable claims and money includes stock and shares. However, section 82 of the companies Act, while recognizing share as movable property, suggests that they shall be transferable only in the manner provided by the Articles of Association of the company.

4. A share is not a negotiable instrument

Again in Shree Gopal Paper Mills Ltd. Vs. CIT, the learned judge observed that the share when it becomes associated with a member becomes a movable property. It is, however, not a movable property whose transfer is solely regulated by the sale of goods act. Its transfer is also governed by the companies Act, and/or Articles of Association of the company. Each share again bears a distinguishing number. It is, however, not a tangible property for it is not the share certificate; it only consists of a bundle of rights and obligations.

3. What is the concept of capital?

There are many concepts of the capital such as –

1. **Authorised or registered capital:-** it is the amount of share capital which a company is authorized to issue.
2. **Issued capital:** It is that part of authorized capital which is actually issued by the company for public subscription.
3. **Subscribed capital:** It is the total amount of the nominal value of shares which have been actually taken up by the public.
4. **Called up capital:** it is that amount of the nominal value of shares subscribed for, which the company has asked its shareholders to pay by means of calls or otherwise.
5. **Paid up capital:** It is that part of the issued capital which has been paid up by the shareholders.
6. **Uncalled capital:** It is the amount which remains uncalled on shares.
7. **Reserve capital:** A company may resolve by special resolution that the whole of the uncalled capital shall not be called upon except in the event of winding up. This amount is called the reserve capital.

4. What are the various kinds of share capital?

Section 86 provides two kinds of share capital:-

1. Preference share capital
2. Equity share capital

According to section 85 of the companies Act, 1956, preference share capital means that part of the share capital, which fulfills both the following requirements:-

1. On the winding up or the liquidation of the company it carries or will carry a preferential right to be paid that amount paid on the preference shares must be paid back before anything is paid to equity shareholders.
2. During the life of the company, it must be assured of preference dividend. The preferential dividend may consist of a fixed amount payable to preference shareholder before anything else is paid to the equity shareholders. Alternatively, the amount so payable as preferential dividend may be calculated at fixed rate.

Types of preference share which a company can issue: a public company is allowed to issue following types of preference shares:-

1. Participating preference shares
2. Non-participating preference shares
3. Cumulative preference shares
4. Non-cumulative preference shares
5. Convertible preference shares
6. Non-convertible preference shares
7. Redeemable preference shares
8. Irredeemable preference shares

Explanation:

1. **Participating preference shares:** such shares are entitled to a fixed preferential dividend and along with it, carry a right to participate in surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders.
2. **Non-participating preference shares:** These shares are entitled to the fixed dividend and do not have the right to further participate in the surplus profit.
3. **Cumulative preference shares:** These shares confer a right on its holder to claim fixed dividend of the past and current year out of future profits. The fixed dividend keeps on accumulating until it is fully paid.
4. **Non cumulative preference shares:** These shares give right to its holder to a fixed amount or a fixed percentage of dividends out of the profits every year. If no profits are available in any year the shareholders get nothing, nor can they claim unpaid in any subsequent year.
5. **Convertible preference shares:** The holder of such shares is given the right of conversion. With the help of such right the preference shares can be converted into equity shares at future date.
6. **Non convertible preference shares:** The holder of such shares does not get a right to convert such shares into equity shares at later date.
7. **Redeemable preference shares:** These shares are redeemable even before the winding up of the company. The paying back of capital is called redemption. After the commencement of the companies act, no company limited by shares shall issue any preference share, which is irredeemable or is redeemable after the completion of a period of twenty year from the date of issue.
8. **Irredeemable preference shares:** These shares are not redeemable until the happening of a certain specified event such as winding up of the company. These shares are not to be issued after the commencement of companies (amendment) Act, 2000.

Equity shares [section 85(2)]

The equity shares are those shares which are not preference shares. In other words, shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital are known as equity shares. After satisfying the rights of preference shares, the equity shares shall be entitled to shares in the remaining amount of distributable net profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available. The rate of dividend is recommended by the Board of directors of the company and declared by shareholders in the annual general meeting.

Equity shareholders have a right to vote on every resolution placed in the meeting and the voting rights shall be in proportion to the paid-up equity capital. As compared to this, the holders of preference shares can vote only on such resolution which directly affects the rights attached to the preference shares. However, if the preference dividend is not paid fully for more than two years, the preference shareholders shall also get voting right on every resolution placed before the company [section 87].

5. Can share capital be altered?

Alteration of the share capital [section 94]: A company limited by share through a general meeting if permitted by its Articles, alter the terms of Memorandum relating to share capital in order to:-

1. Increase its share capital by the issue of new shares.

2. Consolidating and sub-dividing all or any of its share capital into shares of large amount than its existing shares.
3. Converting the fully paid up shares into stock and stock into fully paid shares.
4. Sub-dividing the shares into the shares of smaller amount.

Procedure for the alteration of the share capital is:

1. There should be provision in Memorandum of Association and Articles of Association for the alteration of share capital.
2. Ordinary resolution should be passed for it.
3. The registrar should be informed about it within 30 days.
4. If the information is not given than penalty of Rs. 500 per day of default is charged.

6. How is share capital reduced?

According to section 81 of the companies Act, 1956 if the issue of share capital is being made before the completion of 2 years from the date of incorporation of the company or before the expiry of one year from the first allotment of shares then the shares are to be offered to the existing equity shareholders. This further allotment will increase the subscribed capital.

Further, after the expiry of said period, the new shares of the company may be offered to the person other than the existing equity shareholder in following circumstances:-

1. If the company passes a special resolution to that effect in general meeting authorising the Board to allot shares to outsiders [section 81(1A)(a)]
2. If an ordinary resolution is passed and the approval of the Central Government is obtained. The Central Government will give its approval only if it is satisfied the proposal is most beneficial to the company [section 81(1A)(b)]
3. If any of the shareholder declines to accept the share offered to him by the company, in that case Board of Directors may place the shares in such a way as they think most beneficial to the company [section 81(1A)(c)]
4. Where the convertible debentures are issued by the company the same may be converted into the equity to persons and the shares can further be allotted to persons other than existing equity shareholders.
5. If the company has taken any loan from the Central Government by issuing debentures and other wise the government may if in the public interest change such debentures or loan into shares in the company [section 81(4)]. These shares can further be issued for increasing the subscribed capital.
6. Where the existing shareholder renounces his right for the shares can be issued only to the equity shareholders, unless procedure as stated above has been adopted for issue of these shares to outsiders , etc. Thus, in general the share cannot be offered to preference shareholders.
7. **What is the difference between reduction of capital and Diminution of Capital?**

Reduction of Capital and Diminution of Capital:-

Reduction of capital related to issued capital whereas diminution of capital is done of authorized and non-issued capital.

Sr.	Basis	Reduction	Diminution
1.	Meaning	Reduction of capital involves reduction of subscribed capital of paid up capital.	Diminution of capital is the cancellation of the subscribed part of the issues of capital.
2.	Nature of resolution	It is affected by special resolution.	It is affected by ordinary resolution.
3.	Notice to Registrar of Companies	No time for notice to Registrar of Companies.	A notice is to be sent to the Registrar of Companies within 30 days from the date of cancellation.
4.	Confirmation of court	It requires confirmation of court.	It does not require confirmation of court.
5.	The word reduced	Court may give order to add the word 'and reduced'	No such order is given.

8. What is Sweat equity share?

Sweat equity shares means the equity shares issued by the company to its employees or directors at a discount or for consideration other than cash. These shares may be issued for providing know-how or making available rights in the nature of intellectual property rights or value addition by whatever name called.

Conditions to be fulfilled by a company for issuing sweat equity shares: Section 79A permits company to issue sweat equity shares if the following condition are satisfied:-

1. Sweat equity shares must be of a class of shares already issued by the company.
2. The issue should be authorized by a special resolution passed by the company in general meeting.
3. Not less than one year must have at the date of the issue elapsed since the date on which the company was entitled to commence the business.
4. The resolution must specify number of shares, current market price, consideration, if any and class or classes of directors or employees to whom the sweat equity shares may be issued.
5. 'Sweat equity' shares can be issued as per regulation made by SEBI if the company is listed on stock market. If the company is not listed on the stock exchange 'sweat equity shares' will be issued in reference with guidelines of Central Government. [section 79(1)]
6. Limitation, restriction and provision available to sweat equity shares are similar to other equity shares [section 79A(2)]

Steps for issue of sweat equity shares:- Following are the steps which must be taken by the company for the issue of sweat equity shares:-

1. A special resolution must be passed to authorize the issue of sweat equity shares.
2. The special resolution must contain the number of shares, current market price, consideration, if any and the class of directors or employees.
3. Company can issue sweat equity shares only after the completion of one year of its commencement.
4. Sweat equity shares in case of a listed company will ne issued in reference with the regulation made by the SEBI in this behalf.
5. In the case of unlisted company, the shares are to be issued in accordance with the guidelines as may be prescribed.

9. What are the provisions relating to Bonus Shares?

Provisions related to Bonus Shares:-

1. It is allotted to the equity shareholders of the company only.
2. Since it is capitalization of company, it should have undistributed profit left with the company.
3. It should be mentioned in the Articles.
4. Special resolution in general meeting should be filed.
5. Return should be filed within 30 days to the Registrar of Co mpanies.

Guidelines to the SEBI for the Bonus Shares:

1. Application for the listed company should be made.
2. If the bonus shares are issued after the issue of right share, the company should keep in mind that it should not affect the right of debenture holder.
3. If can be issued from free reserves and shares premium account.
4. Bonus share cannot be issued in place of dividend.
5. To issue of bonus shares within 6 months of declaration & it should be the provision under AOA.

10. What are the provisions relating to issue of Shares at premium?

Section 78 of the companies Act, 1956 contains the provision regarding the issue of shares at premium by a public company. This section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the value of the premium on those shares should be transferred to an account called the "Security Premium Account".

Purpose for which the money received as share premium may be issued by the company:- The share premium may be applied by the company forfollowing purposes:-

1. In writing off the preliminary expenses of the company or
2. In issuing to the members of the company fully paid bonus shares; or
3. In writing off the expenses or the commission paid or discount allowed on any issue of shares or debentures of the company.
4. In providing for the premium payable on redemption of any redeemable preference share or any debenture of the company. Issue of the securities at differential premium is allowed. The value which the acquirer of securities may pay in

excess of the par value for acquiring the shares depends upon the contract between the company and acquirer of such securities.

Issue of share at a premium for consideration other than cash: It is possible for the company to issue shares at a premium for consideration other than cash. In such a case, a sum equal to the amount of the premium must be transferred to the share premium account.

11. What are the provisions relating to the issue of shares at discount?

The issue of shares at a discount is regulated by law and section 79 provides that subject to certain conditions, the shares can be issued at discount. The conditions are as follows:

1. The issue must be a class or classes of shares already issued. The shares of the class issued for the first time are not allowed to be issued at a discount.
2. Not less than 1 year, has at the date of issue, elapsed since the date for which the company became entitled to commence business.
3. The issue of shares at a discount must have been authorized by a resolution passed by the company in general meeting and sanctioned by the Company Law Board/Central Government.
4. Specification must be made in the resolution about the maximum rate of discount, at which the share are to be issued. By virtue of the provision added to section 79 by the amendment Act, 1974, no such resolution should be passed by Company Law Board, if the maximum rate of discount specified in the resolution exceeds 10% unless the Company Law Board is of the opinion that a higher percentage of discount may be allowed in the special circumstances of the case [section (ii)]
5. After the date of the sanction, the shares to be issued at the discount must be issued within 2 months, the time period can be extended if Company Law Board permits.
6. Each and every prospectus relating to the issue of the shares must have the particular of the discount allowed on the issue of the shares or so must of that discount as has not been written off at the date issue of the prospectus.
7. On default the company and every officer of the company who is in default shall be punishable with a fine which may extend to Rs. 500.

Directors' liability in respect of improper issue of shares at a discount:

1. The directors will then be liable if they have improperly issued the shares at a discount. The extent of compensation will be to the amount of discount.
2. The holders of such shares will have to pay back to the company the amount of discount.
3. If before the commencement of winding up the allottee discovers the illegality of discount allowed, he may avoid liability to take the shares and may get his name removed as a shareholder provided he has not otherwise agreed to keep the shares.

12. What are the conditions under which shareholders' right can be varied?

Variation of shareholder's right [section 106]: there are two types of the shares in a company equity shares and/or preference shares. Different classes of shares possess different rights of a class of shares. The right of these shares is determined by the Memorandum, the Articles the terms of issue of shares or a special resolution. Subject to the fulfillment of the following condition, these rights may be varied:-

1. A provision should be there in the Memorandum or the Articles of the company in respect of such variation
2. A written consent should be given by the shareholders of at least $\frac{3}{4}$ th of the issued shares of the class whose right are to be varied or a special resolution must be passed at a separate meeting of the holders in that effect.
3. If there are no such provisions in the Memorandum or Articles, such variation must not be prohibited by the terms of issue of the shares of that class.

Rights of dissentient shareholder: Following are the right of the dissentient shareholders:-

1. The holder of not less than ten percent of the issued shares of a class who did not give their consent or have not voted in the favour of the resolution for the variations have the right to apply to the court to have the variation cancelled.
2. Application to the court should be made within 21 days after the date on which the consent was given or the resolution was passed.
3. The court grants a hearing to the application and to any other person who may apply to the court to be heard and appears to the court if interested in the application.

4. If the court gets satisfied having regard to all the circumstances of the case, that the variation would unfairly prejudice the shareholders of the class represented by applicants, then the court disallows the variation and if the court does not get satisfied, it confirms the variation.
5. On such application, the decision of the court is final.
6. It is the duty of the company to forward a copy of order to the Registrar of Companies within 30 days.
7. If the compliance of the provision is not followed then the company & every officer of the company who is in default shall be punishable with a fine which may extend to Rs. 50. [section 107]

OBJECTIVE QUESTION

1. **Reserve capital to a public company may be called at any time.**

False: According to section 99 of the companies Act, 1956 once the uncalled capital is converted into reserve capital by passing a special resolution it can be called only at the time of winding up of the company. Also it can not be converted back into normal uncalled capital.

DESCRIPTIVE QUESTIONS

1. **A public limited company wants to increase its subscribed share capital by offering the new shares to the persons who are not the members of the company. Referring to the provisions of the companies Act, 1956, advice the company about the procedure the company has to adopt to give effect to the above proposal. OR**

When can a public company offer the new shares (further issue of shares) to persons other than the existing shareholders of the company? can these shares be offered to the preference shareholders?

According to section 81 of the companies Act, 1956, if the issue of share capital is being made before the completion of 2 years from the date of incorporation of the company or before the expiry of one year from the first allotment of shares then the shares are to be offered to the existing equity shareholders. This further allotment will increase the subscribed capital.

Further, after the expiry of said period, the new shares of the company may be offered to the persons other than the existing equity shareholders in following circumstances:-

1. If the company passes a special resolution to that effect in general meeting authorising the board to allot shares to outsiders [section 81(1A)(a)]
2. If an ordinary resolution is passed and approval of the Central Government is obtained. The Central Government will give its approval only if it is satisfied that the proposal is most beneficial to the company [section 81(1A)(b)]
3. If any of the shareholder declines to accept the share offered to him by the company, in that case Board of Directors may place the shares in such a way as they think most beneficial to the company [section 81(1A)(d)]
4. Where the convertible debentures are issued by the company the same may be converted into equity shares to persons and the shares can further be allotted to persons other than existing equity shareholders.
5. If the company has taken a loan from the Central Government by issuing debentures and otherwise the government may if in the public interest change such debenture or loan into shares in the company [section 81(4)]. These shares can further be issued for increasing the subscribed capital.
6. Where the existing shareholder renounces his right for the shares offered to him to any other person, who may not be the existing shareholder.

Preference shareholders –whether (Further issue of capital) be offered to: According to section 81, is quite clear that these shares can be issued only to the equity shareholders, unless procedure as stated above has been adopted for issue of these shares to outsiders, etc. thus, in general the share cannot be offered to preference shareholders.

PRACTICAL QUESTION

1. **DJA Company limited is holding 40% of total equity shares in MR Company limited. The Board of Directors of MR Company Limited (incorporated on 1.1.98) decided to raise the paid-up equity share capital by issuing further shares and also decided not to offer any shares to DJA Company Limited on the ground that it was already holding a high percentage of shares in the MR Company Limited. Articles of Association of MR Company Limited provides that the new shares be offered to the existing shareholders of company. On 1.3.2001 new shares were offered to all the shareholders excepting DJA Company Limited. Referring to the provisions of the companies Act, 1956 examine the validity of decision of Board of Directors of MR Company Limited of not offering any further shares to DJA Company Limited.**

The question asked above is based on the application of the provision of the companies Act, 1956 as contained in section 81 and ruling given as GAS Meter Co. Ltd Vs. Diaphragm & General Leather Co. Ltd.

As per provision contained in section 81 if at any time after the completion of 2 years from the incorporation of the company or after the completion of 1 year from the first allotment of further shares, it should be offered to the existing equity shareholders of the company in proportion to the capital paid up on those shares.

In case of GAS meter Co. Ltd V. Diaphragm & general leather Co. ltd, the fact of case were same as given in the problem stated in the question, the Articles of Diaphragm Co. provided that the new shares will be first offered to the existing shareholders. The company offered new shares to all the existing shareholders except the GAS Meter Co ltd which held its controlling shares. It was held that company could be restrained from doing this:-.

- (i) If the case is applied to the question we find that, MR Ltd's decision for not offering any further shares to DJA co. ltd on the ground the DJA Company already holds a high percentage of shareholding in MR Company ltd. is not valid for the reasons that it violates the provision of section 81.
- (ii) Secondly the offer for issue of shares was made on 1.3.2001 that is after the expiry of 2 years of the formation of the company.
- (iii) Thus, board of MR Company ltd. cannot take a decision regarding non-allotment shares to DJA Co. ltd. unless the same is approved in the general meeting by means of special resolution [section 81(1A)]

SHARE CERTIFICATE AND SHARE WARRANT

1. What is a Share Certificate?

Share certificate (section 113): It is a document which certifies that the allottee is the holder of specified number of shares in the company. It is a document of title also. It is not a negotiable instrument because it is not transferable.

2. What is the object and effect of share certificate?

According to section 84, a share certificate shall be prima facie evidence of the title of the member to such shares.

Estoppel as to title: company cannot deny the fact that the person is not holder of the shares.

Estoppel as to payment: company cannot deny the fact that the shares are not paid up if in share certificate the shares are fully paid up.

3. How is a Share certificate issued?

No share certificate shall be issued except:-

- (i) In pursuance of a resolution of the Board of Directors.
- (ii) On surrender to the company of the letter of allotment, except in case of issue against letter of acceptance or of remuneration, or in case of issue of bonus shares.

Procedure: The Company undertakes the following procedure for issue of share certificate.

1. The Board of Directors before issuing a share certificate must pass a resolution to its effect the letter of allotment or fractional coupons of required values should be surrendered to the company. when such type of documentary evidence are not available due to the same having been lost or destroyed, the board should prescribe such conditions as regards to indemnity & payment of incidental expenses which is important for the company to incur in finding out the evidence for the purpose of proving the title of the shares.
2. A share certificate will not be issued in exchange of consolidated or sub-divided shares or in place of torn, defaced old shares or where cases in the reverse for recording in lieu of which unless the certificate of which it is issued has been surrendered to the company.
3. In every certificate the name of person should be mentioned who is the owner of the share to which the certificate relate and the amount paid up.
4. The duplicate share certificate must not be issued in place of the lost or destroyed share without the consent of the board.
5. Where a certificate has been issued in the place of old certificate, this fact must be shown on the face of the certificate.
6. All the books and documents relating to the issue of share certificate must be under the safe custody of the managing Director and the other directors of the company.
7. All the forms required for the purpose of the issue of share certificate must be printed under the authority of the Board and person appointed by the board should have the custody of all blocks and other equipment of printing.
8. The issued share certificate must possess the common seal of the company which must be affixed in the presence of director or any other person appointed for the purpose by the Board. Share certificate should be signed by the persons mentioned above. One of the two directors must be a person other than the managing or whole time director.

9. When a certificate is issued in lieu of one lost or destroyed, it must contain the statement "Duplicate issued in lieu of certificate No...." In addition to the duplicate shall be stamped or punched in bold letter across the face of the share certificate.
10. Matter relating to the certificate issued under rule 4(1) must be entered on the Register of members against the name of persons and in whose favour the certificate have been issued, also mentioned the date of issue. In the same way entries relating to Rule 4(2) and (3) must be mentioned in the register. Both these categories should be approved either by the secretary or by a person appointed by the Board (Rule 7)

4. What is the time for issue of Share certificate?

1. In case of allotment, within 3 months of the allotment.
2. In case of transfer, within 2 months.

In both the above cases the time limit can be increased to up to 9 months by get it sanctioned from the Company Law Board.

If still certificate is not issued within 9 months then the allottee may lodge a complain to the Company Law Board. Then Company Law Board gives a notice to the company for getting the allotment done within 10 days of the notice. If it is not done then the company is at default and a penalty of Rs. 5,000 per day is charged till the default continues.

5. What are the provisions to the Lost Certificate?

1. Duplicate share certificate will be issued provided it is proved that it is lost or destroyed.
2. If the share certificate is mutilated or torn then the company may issue share certificate if such mutilated certificate is surrendered to the company.

[If the person is caught for doing fraud, the penalty is Rs. 10,000 to Rs. 1,00,000 and 6 months to 3 years of imprisonment]

6. What are the provisions relating to the Duplicate share certificate?

According to section 84(2) a company can issue or renew a duplicate certificate only on the happening of two cases.

1. If it is proved that original certificate has been lost or destroyed, or
2. Having been faced or mutilated or torn is surrendered to the company.

Section 84(4) makes necessary for the companies to apply or follow the rules prescribed by the government in regard to the following matters:-

1. The way of issue of renewal of a certificate or issue of a duplicate thereof.
2. The form of a certificate (original or duplicate or renewed)
3. The matters to be entered in the register of members or the register or renewed or duplicate certificate.
4. The form of such registers.
5. The fee or charge on payment of which the terms and condition if any including terms and conditions as proof or evidence and indemnity and reimbursement for expenses incurred in connection with investing evidence on which a certificate may be renewed or duplicate thereof may be issued.

7. What is a Share warrant?

Share warrant is a document issued by the company limited by shares, if so authorized by its Articles. The warrant is issued under the common seal of the company and states the owner of the warrant is entitled to the certain number of shares specified therein. As it is a bearer document, it can be transferred by mere delivery.

According to section 114 of the companies Act, the share warrant can be issued only after getting permission from the Central Government. The share warrants are issued only in respect of the shares, which are fully paid up. For the payment of the future dividend the dividend Coupons are attached with share warrant. When the Share warrant is issued by the company, the company immediately will strike out from its register of members, the name of the member in whose name the share warrant has been issued.

According to section 115, the following points should be recorded in the register of members upon the issue of the share warrant:-

1. The date on which the share warrant has been issued.
2. The reason for the issue of the share warrant.
3. A statement of the shares specified in the warrant, distinguishing each share by its number.

8. What is the difference between share certificate and share warrant?

Difference between share certificate and share warrant

Sr.	Basis	Share certificate	Share warrant
1.	Time of issue	A share certificate can be issued at any stage without the shares being fully paid up	A share warrant can be issued on when the shares are fully paid up.
2.	Transfer	A share certificate cannot be transferred	A share warrant can be transferred by the mere delivery.
3.	Membership	The holder of the share certificate is a member of company.	The holder of the share warrant is not the member of the company unless the Articles otherwise provided.
4.	Which company can issue	A share certificate can be issued by public and private company both.	A share warrant can be issued by a public company only.
5.	Approval of Central Government	The issue of share certificate does not require the approval of Central Government.	A share warrant can be issued only if the Articles
6.	Petition	A petition on winding up can be presented by the holder of share certificate.	The holder of share warrant cannot do so.
7.	Stamp duty	Stamp duty is payable on the transfer of shares in a share certificate.	No stamp duty is payable.
8.	Coupons	No coupons of dividend are attached to a share certificate.	A coupon for dividend may be attached to share warrant.

9. Is the bearer of share warrant a member of the company?

The bearer of a share warrant is not a member of the company [section 2(27)]. However, if company's Articles of Association so provide, he may be treated as a member of the company for any purpose defined in the Articles [section 115(5)]. Thus, the Articles may provide that the bearer of a share warrant shall be allowed to exercise the rights of a member, such as attending meetings, approving annual accounts, appointing directors, etc. But, having regard to the express provisions of section 270(4), the Articles of Association of a company cannot provide that the shares specified in a share warrant may be considered as qualification share for the office of a director.

10. What are the provisions relating to Reconversion of Warrant into shares?

A share warrant may, at any time be surrendered by the holder to the company for cancellation, and his name can again be entered into the register of members, provided the Articles do not prohibit such conversion and the fee prescribed by the Board of Directors for the purpose is paid [section 115(2)]

In the event of such conversion, if the company enters the name of a bearer of a share warrant in respect of shares therein specified, without the warrant being surrendered and cancelled, the company shall be responsible for any loss that may be occasioned to any person in this regard [section 115(3)]

On surrender of the share warrant, the date of the surrender shall be entered in the register of members. [section 115(4)].

11. What are the provisions in relation to calls on Shares?

Calls on shares: When shares are issued, the terms of issue may specify that installment by which the issue price shall be payable. Installment other than those payable by way of application and allotment money are generally referred to as calls. A call, in the strict sense, is a demand by the company for payment of part of the issue price of shares or debenture which has not been paid, and the date on which payment was made was not specified in the terms of the issue.

Requisites of a valid call:

In making a call, care must be taken that:

1. *Resolution at a meeting of the board [section 292(1)(a)]*

- (i) The directors making it are duly appointed and duly qualified;
- (ii) The meeting of the Board of directors has been duly convened;
- (iii) The proper quorum is present;
- (iv) The resolution making the call is duly passed and specifies the amount of the call, and the time and place of payment;

(v) A proper entry is made in the minutes.

2. *Calls on shares of same class must be made on uniform basis [section 91]:* For the purpose of this section, shares of the same nominal value on which different amounts have been paid up shall not be deemed to fall under the same class.
3. *Call to be made bona fide in the interest of the company:* The amount called up has to be used for the benefit of the company, and it should also be called only in the interest of the company.
4. *Time within which shares are to be made fully paid up:* Any company offering shares to the public must ensure that the shares issued are made fully paid up within 12 months of the date of allotment, where the size of the issue is upto Rs. 500 crores, the amount to be called up on application, allotment and on various calls should not in each case exceed 25% of the total quantum of issue.
5. *Notice of call:* A call must be made serving members a notice of payment in accordance with the provisions of section 53. It should be a formal notice and not mere a demand or request for payment. It must specify the exact amount and time of payment.

12. What are the provisions in relation to payment on Calls?

Shares may be paid in cash or in kind or in any manner that has the effect of actual cash being received by the company.

A debt due and owing by a banking company to a shareholder can be set off against outstanding calls so long as banking company is a going concern.

Payment of calls in advance

Section 92 of the act provides that the directors may, if authorized by the articles, allow shareholders to pay the whole or a part of the amount remaining unpaid on any shares held by them, although no part of that amount has been called up. On the amount so received the company may pay interest at such a rate as may be agreed upon between the Board and the members paying this sum in advance. The rate of interest specified under regulation 18 of Table A is 6 % per annum.

According to section 92(2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the money so paid in advance by him until the same becomes payable.

However, section 93 provides that dividends may be paid on advance call, if so authorized by the articles.

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 A provides for interest at the rate of 5% per annum.

13. What are the rights and liabilities of a shareholder which arises on payment of calls made in Advance?

The right and liabilities of the shareholders when a company receives payment in advance of calls are as follows:-

1. The liability of the shareholders to the company in respect of the calls for which the amount paid is finished.
2. The amount received in advance of calls is non-refundable
3. The shareholder's voting right ends in respect of the money so paid by him till the same would, but for such repayment, become presently payable [sec. 92(2)]
4. The shareholder is in a position to claim interest on the amount of the call to the extent payable according to AOA. If there are no profits, it must be paid out of capital of the company.
5. The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.
6. In the event of winding up the shareholder's position is after the creditor but they must be paid his amount with interest, if any before the other shareholders are paid off.

PRACTICAL QUESTION

1. **“Sunrise Ltd” is authorized by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. ‘X’, a shareholder of the Sunrise Ltd., deposits in advance the remaining amount due on his shares without any calls made by “Sunrise Ltd”.**

One of the shareholders of ‘Sunrise Ltd.’, ‘Mr. X’ deposited in advance the leftover amount due on his shares without any calls made by ‘Sunrise Ltd.’ The company was authorized to accept the unpaid calls by its articles. As per section 92(1), a company if permitted by its articles can accept from any member the whole or part of amount remaining unpaid of any shares by him although no part of that amount has been called up. Such type of amount received or accepted is described as payment in advance of calls as follows:-

- (i) The liability of the shareholders to the company in respect of the calls for which the amount is paid is finished.

- (ii) The amount received in advance of calls is not refundable.
- (iii) The shareholder voting right ends in respect of the money's so paid by him till the same would, but for such payment becomes presently payable.
- (iv) The shareholder is in a position to claim interest on the amount of the call to the extent payable according to AOA. If there are no profits, it must be paid out of capital of the company.
- (v) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.
- (vi) In the event of winding up the shareholder position is after the creditor but they must be paid his amount with interest, if any before the other shareholders are paid off.

TRANSFER AND TRANSMISSION OF SHARES

1. What is transfer of shares?

Transferability of shares is an absolute right of the shareholder which cannot be denied even by the articles.

Section 82 empowers every shareholder to transfer his shares in the manner laid down in the articles and in accordance with the various provisions of the law.

Transfer of share in Private Company

A private company is statutorily under obligation to place certain restrictions on the right of its members to transfer shares. One of the restrictions on transfer of shares in a private company is the "Pre-emption Clause" which states that the transferor must offer his shares to the existing members of the company, before offering them to non-members, so long as a member is willing to purchase them at a fair price to be determined in accordance with the articles.

Transfer of shares in Public Company

In the case of public company also, there are some restrictions on the right of members to transfer shares. Regulation 21(Table A) provides that the board of directors may refuse to register the transfer to partly paid shares to a person of whom they do not approve. The board of directors may also refuse to register the transfer of any shares on which the company has a lien.

2. What are the provisions regarding transfer of shares?

Provisions regarding transfer of shares are:

- 1. It should be in accordance with the articles
- 2. The transfer deed to be presented before the registrar for the notification of date on the blank form
- 3. Form should be duly filled up as per form 7B.
- 4. It should be duly stamped.
- 5. And after this share certificate is to be attached and then sent to the company.

3. What are the time required within which the transfer must be registered?

- 1. In case where the shares are dealt in stock exchange, 12 months from the date mentioned in the deed or before the closure of the register whichever is later.
- 2. In any other case within 2 months from the date specified in the deed. Time period for the registration can be extended with the help of Form 7C by applying to the register.

Notice of refusal: Where a company refuses to register the transfer, whether in pursuance of any power of the company under its articles or otherwise, it shall within two months send notice of refusal to the transferee and the transferor giving reason for such refusal.

4. What is Blank Transfer?

When a share transfer form is signed by the shareholder without filing in the name of the transferee and date of transfer and hands it over along with share certificate to the transferee thereby enabling him to deal with shares, it is called a transfer in 'Blank' or 'Blank Transfer'. The ownership of shares in a company is generally transferred from one person to another by producing of a document from the seller to the buyer. This document is described as a 'transfer instrument' or 'transfer deed' or merely 'transfer'. Because of the convenience associated with the blank transfer, the shares are usually sold and produced through blank transfer. Blank transfer results in saving of stamp duty. It is to be affixed only by the last transferee who lodges the shares with the company for the purpose of registration of transfer. The title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor.

A transfer in blank, when accompanied by a share certificate, brings to the transferee both the legal and equitable rights to the shares and also the rights to call upon the company to register the transfer.

5. What is Forged Transfer?

An instrument on which the signature of the transferor is forged is called forged transfer. It is a null transfer and does not confer any title. It is so because in case of forgery there is not merely an absence of free consent but there is no consent at all. Hence, this transfer will never confer an ownership upon the transferee, however important the transaction may appear to be. If the company registers any forged transfer, the real owner can apply to the company for the rectification and get his name placed back in the register.

6. What are the rights of the aggrieved party against refusal to transfer the shares?

Rights of the aggrieved party against refusal to transfer the shares:

1. **Right to make an appeal to the company law board:** The transferor or the transferee has the right to make an appeal to the Company Law Board against any refusal by the company to register the transfer or against any failure on its part within two months of the receipt of the notice of such refusal. Or where no notice has been sent by the company, within four months from the date on which the instrument of transfer was delivered to the company.
2. **Right to apply to the Company Law Board for rectification of the register:** The person aggrieved or any member of the company may apply to the CLB for rectification of the register if the name in register of member without any sufficient cause or default is made or unnecessary delay take place in entering in the register the fact of any person having become or ceased to be a member.

7. What is the procedure of Transfer?

Section 108 provides that the transfer to be done in a proper instrument of transfer known as share transfer form.

This form shall be presented to the registrar who shall stamp it. The registrar shall not register a transfer share unless the transfer takes place in a duly stamped transfer form which is presented along with the share certificate.

8. How are partly paid up shares transferred?

For Partly paid up shares a company serves a notice to the transferee regarding any objection towards the payment. If transferee has any objection he should notify within 2 weeks from the date of notice otherwise his name will be entered.

9. What is Certification of Transfer?

Where a shareholder desires to transfer only some of the shares represented by a share certificate or desires to sell the shares to different person then the transferor is required to hand over the share certificate to be lodged along with the share transfer from the company. Where the transferor has already lodged with the company the required share certificate, along with an instrument of transfer for part of the shares, he may request the company to certify on the instrument of the transfer, that the share certificate for the shares covered by the instrument of transfer has been lodged with the company. This is called as certification.

According to section 112(3) (a) an instrument of transfer shall be deemed to be certificate, if it possess the word 'Certificate lodged' or the words to the same effect. Therefore, certification is the act of noting by the secretary etc. specifying that the share certificate has been lodged with the company.

When the transferor transfers only a portion of his shares, the company usually issues him tickets for the balance of shares which have not been transferred. These tickets are called "Balance Ticket".

Section 112 provides that certification is simply a representation by a company to any person acting on the faith of it that there has been a prima facie title in the transfer.

The company will be liable for the certification only if:-

- (i) The instrument of transfer is certified with the words 'Certificate Lodged' or words to the same effect.
- (ii) An authorized person issues the certification instrument on behalf of the company.
- (iii) The certificate is signed by any officer or servant of the company or any other person authorized to certify transfer on the company's behalf.

10. What is a Transmission of shares?

When the shares are transferred under the operation of law it is called transmission of shares:

Transmission of shares takes place: -

- (i) When the registered shareholder dies.
- (ii) When he is declared insolvent.

(iii) In case where the shareholder is the company, it goes into liquidation.

In case of the death of registered shareholders, his legal representative becomes the care taker of the shares. The legal representative if he can sell the shares without being registered, if he does not want to become the member of the company. In case he wants to become the member of the company, he should send a written and signed notice to the company disclosing his decision.

In case of the insolvency, the official assigner has the power to take the decision regarding selling of the shares, transferring of the shares or getting himself registered as a member.

In case where a shareholding company goes into liquidation then the liquidator of the company may sell and transfer the shares.

11. What is the difference between transfer of shares and transmission of shares?

Sr.	Basis	Transfer of shares	Transmission of shares
1.	Nature	Transfer of shares takes place by a voluntary a deliberate act if the transferor.	Transmission is the result of the operation of law.
2.	Instrument used	In case of transfer, the transferor and transferee have to execute an instrument of transfer	The shares are transmitted on the death of member and instrument of transfer is not required only a proof of his death to the shares is required.
3.	Method	Transfer is the normal method of transferring property in the shares	Transmission of share takes place only on death or insolvency or liquidation.
4.	Stamp duty	In case of transfer stamp duty is payable on the amount of the market value of shares	No stamp duty is payable in case of transmission.

DESCRIPTIVE QUESTIONS

1. States the procedure to be followed by a person nominated by a shareholder to get the shares registered in his name or transfer the shares in the event of death of the nominator. Are there any restrictions on the nominee receiving dividends and exercising voting rights in respect of such shares in the event of death of the nominator?
OR

Examine the provisions of the companies Act, 1956 regarding 'nomination' in case of transmission of shares.

Procedure for registration of shares in the name of nominee: By the virtue of nomination, a nominee is entitled to any shares. For this he will have to apply to the company along with proof of death of holder or joint holders. A nominee can either request the board of directors to register himself and the shareholder or he can transfer the shares of deceased shareholder [section 109B(1) of the companies Act, 1956]

A written notice is to be sent to the company by the nominee stating that he elects to be the registered holder of share. The notice should be accompanied by death of deceased shareholder [section 109B(2)]

Section 109B(3) states all the limitation, restrictions and provisions of the company act relating to the right to transfer and registration of transfer. It will apply as if the death of the member had not occurred and the notice of transfer were signed by the shareholder.

Nominee's right to receive dividend etc.:-

- (i) All the rights of deceased member like dividend and bonus etc. are entitled to the nominee.
- (ii) The nominee will not be eligible for voting right or other right as a member unless he makes an application in writing and is registered as a member in respect of the shares [section 109B(4)]
- (iii) If the nominee does nothing the company empowers him a notice to elect either to become a member or transfer the shares.
- (iv) Board of Directors of the company can withhold the payment of dividends, bonus or other money payable, if the nominee does not elect either to become a member or transfer the shares within 90 days of the notice. [section 109B(4)]

PRACTICAL QUESTION

1. A company refuses to register transfer of shares made by X to Y. the company does not send a notice of refusal to X or Y within the prescribed period. Has the aggrieved party any right(s) against the company for such a refusal? Advice.

The question asked above is based on section 111 of the companies Act which deals with refusal to register the transfer and appeal against refusal.

If the company refuses to register transfer or transmission of shares by operation of law, it has to send or dispatch a notice of refusal giving cause to the transferee or the transferor or to the person giving intimation of such transmission or on delivery of transfer deed to the company as the case may be within two month from the date of delivery of the transfer deed to company.

In the question above the company has failed to give a notice of refusal to the aggrieved party within the time period of two month. Thus, this failure makes available the right/remedies to the aggrieved parties.

Right/Remedies to aggrieved party: The party who at the default may apply to the Company Law Board under sub-section (2) or (4) of section 111 against refusal or for rectification of the register of members, if his name is entered in the register without much or optimum reason, or for omission of his name from the register or default in making an entry of his name in the register. The time period for filing such appeal is four months from the date of lodgment of transfer application. According to Sub-section (4) there is no limitation period for making an application for rectification of register of member. A fine of Rs. 500 is charged per day under sub-section (12).

2. "A" commits forgery and thereby obtains a certificate of transfer of shares from a company and transfer the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B'.

Problem relating to forged Transfer: A's forged transfer is illegal, it does not give the transferee concerned any title to the shares. Since the forgery is null, it cannot be a source of a valid transfer of title. Although, the innocent buyer acting in good faith could validly and reasonably assume the person named in the certificate is the owner of shares. At this also illegally cannot be changed into legality.

Hence in this case the company has the right to refuse to do the transfer of the shares in the name of the transferee B.

The liability of A against B is that he does not stand directly responsible as per the provision of the Company Law as he has already done a forgery which is illegal. Therefore in this case, A will be liable to compensate the company as he has ledged a forged transfer because of which the company has suffered a loss.

The company has issued a certificate of transfer, so it is liable to compensate B. further A the company has refused to register him as a shareholder, company has to compensate B. thus, from this the interest of the original or real shareholder is protected.

FORFEITURE OF SHARE

1. What is meant by Forfeiture of share?

When the shareholder fails to pay the amount due on call, the directors may, if so authorized by the articles take back his shares. This is called forfeiture of shares. Regulation 29 to 35 of Table A is followed with regard to the forfeiture of shares.

2. What are the grounds on which the shares can be forfeited?

The grounds on which the shares can be forfeited are as follows:

1. If permitted by the Articles, the shares can be forfeited only for non-payment of calls and installments and not for non-payment of other debts. In any provision is contained in the Articles to forfeit shares for non-payment of other debts than it will be invalid as an authorized reduction of capital.
 2. The company may by its Articles provide the ground for forfeiture other than non-payment of calls, subject to the qualification that such Articles are not against the general law of the land and the companies Act and the public policy. The forfeiture done should not effect in the reduction of the capital of the company.
 3. The power to forfeit shares must be in a goods faith and for the benefit of the company. a power to forfeit share on payment to a person of the full market value of his shares and if in case he commences and/or threatens an action against the company or directors, it will be invalid because it infringes shareholder's legal right.
 4. The Articles of the company must impose an obligation against the company that they should dispose of such type of shares, which amounts to reduction of the share capital.
3. What are the conditions to be satisfied for forfeiture?

1. **As per Articles:** In the Articles of the company an authorization for forfeiture of share could be there. It should be to the benefit of the company.
2. **Good faith:** The directors of the company must exercise the power to forfeit share in good faith.
3. **Proper notice:** Before forfeiting the shares, notice must be served to the company on the defaulting shareholders in account of the unpaid call along with the interest which has been accrued.
4. A clear notice of 14 days must be given for the payment of the unpaid call.
5. If the payments of the amount are not made within the period mentioned in the notice, the share against the call will be in the position to be forfeited.
6. **Resolution of the Board:** The directors have the power to pass resolution for forfeiting shares, if the defaulting shareholder is unable to pay the amount due within the specified time. The forfeiture becomes invalid if resolution is not passed.

4. What is the procedure for forfeiture?

Procedure for effecting forfeiture:

For the forfeiture of shares following procedures are followed:

1. There should be a clear authorization in the Articles of Association of the company for the forfeiture of shares.
2. Share must be forfeited for the non-payment of calls due to the company. The Articles may also permit other grounds also for forfeiture of shares.
3. A notice should be served on the defaulting members for the unpaid calls before the shares can be forfeited. A clear notice of 14 days must be given otherwise the notice will become invalid.
4. To show that the directors possess the power to forfeit the shares an extra notice must be served to the defaulting members.
5. Forfeiture of shares will become invalid, if the call in respect of which the forfeiture is made is invalidly done or the notice is inaccurate.
6. Calls should be validly made, if the forfeiture is for non-payment of calls.
7. If the requirement of the notice is not complied with the shares in respect of which the notice has been passed, it may be forfeited by a resolution of the Board to that effect.
8. The power to forfeit the shares must be exercised bona fide and in good faith.

5. What is the effect of forfeiture?

1. **Liability as past Member:** If the liquidation of the company takes place within one year of forfeiture, the member whose shares have been forfeited cannot be held liable as a contributory.
2. **Cessation of liability:** The liability of the members whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares.
3. **Forfeited shares become the property of the company:** The forfeited shares become the property of the company on forfeiture and may be reissued or otherwise disposed of on such terms and in such way as the board thinks correct.

6. Can the forfeited shares be reissued?

After forfeiture the shares may be reissued or disposed of on such terms and conditions as the board thinks fit.

However, the board is not bound to sell the forfeited shares and this reduction in capital due to non-issue of forfeited shares does not require sanction of the court.

The forfeited shares may be re-issued at any price provided the sum paid by the former holder and the sum received on re-issue does not fall below the face value. This price may however be more than the face value. In such case the excess value so received will be treated as premium and will be transferred to the securities premium A/c, provided it is the Articles say so.

7. Can the forfeiture be annulled?

If the former holder requests any time before the re-issue of the forfeited shares, the board if it thinks fit may cancel or annul the forfeiture as per the provisions as given in regulation 32 of Table A.

On cancellation of such forfeiture, the former holder is required to pay all calls due with interest. On payment his name is re-entered in the register of members.

8. What is surrendered of shares? What are the provisions relating to it?

Surrendered of shares is the voluntary return of shares by a shareholder for its cancellation.

There is no provision as such for surrendered of shares. This is because surrender would result in reduction of capital. Surrender of shares therefore requires sanction of court and can be done only when it is mentioned in the Articles. The surrendered share may be re-issued and the procedure and provision is similar to that followed in forfeiture of share.

DEBENTURES

1. What is debenture?

Meaning: Debenture means a document which acknowledges the loan made to the company and providing for the payment of interest on the sum borrowed, until the debenture is redeemed, that is repayment of the principal sum.

Definition: section 2(12) of the companies Act defines it as “Debenture includes debenture stock, bonds and may other securities of a company whether constituting a charge on the company’s assets or not.

The definition given above does not explain the term clearly. So, the correct definition of debenture is given by Gower L.C.B. according to him “debenture is a name applied to a certain types of documents evidencing an indebtedness which is normally but not necessarily secured by a charge over property.”

Thus, a debenture is a document which is drawn under the seal of the company, it binds the company to pay a sum money at a fixed time with the interest.

Characteristics of debentures:

1. Debenture is a movable property.
2. It is issued by the company.
3. It is in the form of certificate certifying indebtedness.
4. It usually satisfies the date of redemption.
5. It generally creates a charge on the undertaking of the company.

2. What are the various types of debenture?

Debentures may be of the following kinds:-

1. Secured debenture
 2. Unsecured debenture
 3. Redeemable debenture
 4. Perpetual debenture
 5. Bearer debenture
 6. Registered debenture
1. **Secured Debenture:** The debenture which are secured by a mortgage of the whole or part of the assets of the company are called secured debenture.
 2. **Unsecured or Naked Debenture:** Debentures which are issued without any charge on the assets of the company are called unsecured debentures. The holders of these debentures do not have any security for the repayment of principal or interest thereon.
 3. **Redeemable Debenture:** The debentures which are issued for a specified period of time are redeemable debentures.

On expiry of the specified time the company has the right to pay back the debenture holders and have its properties release from mortgage or charge.
 4. **Perpetual Debenture:** A debenture which has no clause as to the payment of which contains a clause that it shall not be paid back is called perpetual debentures.
 5. **Bearer debenture:** The debentures which are transferred by mere delivery and no stamp duty is payable on the transfer is called bearer debentures.
 6. **Registered Debenture:** The debenture which are payable to the person whose names appear in the register of Debenture holder is called registered debentures.

3. What is a Debenture Stock?

A company, instead of issuing individual debentures, which evidence separate and distinct debts, may create one loan fund known as “debenture-stock” divisible among a class of lenders each of whom is given a debenture stock certificate indicating the parts of the whole loan to which he is entitled.

However, for the purpose of the companies Act, ‘debenture’ includes ‘debenture stock’.

4. What is the difference between a share and a debenture?

Distinction between a share and a debenture

Sr.	Basis	Shares	Debentures
1	Ownership	Shareholders are the owner of the company.	Debentures holders are creditors.
2	Part of capital	Shares are a part of the capital of the company.	Debenture constitutes a loan.
3	Voting right	Shareholder generally enjoys the voting right.	Debenture holders do not have voting right.
4	Charge	Shareholders do not carry any charge.	Debentures have a charge on the assets of the company.
5	Interest or dividend	Dividend can be paid to shareholders only out of the profits of the company.	Interest on debenture is to be paid out even if there is no profit.
6	Rate of dividend	On equity shares the dividend may vary from year to year.	The rate of dividend is fixed in case of debentures.
7	Priority	In the event of liquidation of the company the shareholders are payable at the last.	Debentures get priority over the shares.

5. How is a Debenture issued?

1. Company can issue debentures only when it is authorized by the Memorandum of Association and Articles of Association.
2. Debentures can be issued at discount by passing resolution.
3. The company has to get debentures rating by CRISIA and CARC.
4. To get is applicated in the stock exchange list.
5. To notify the register.
6. Register of debenture holder is to be maintained.

6. What are the SEBI guidelines for protection of interest of debenture Holders?

SEBI guidelines of the protection of the interest of debenture holders are as follows:-

1. For protecting the interest of debenture holders, the trustee to the debenture issue shall be vested with the required power such as a right to appoint a nominee director on Board of the company is consultation with institutional debenture holder.
2. For the proper utilization of the funds the institutional debenture holder should obtain a certificate from the company's auditor.
3. Supervision of the trustee and the debenture redemption reserve and for the creation of security.
4. Investment institution will look after the progress in respect of debentures for project finance, modification etc. Debentures raised for working capital funds will be monitored by the lead bank.
5. Debenture issued by companies belonging to the groups for financing/replenishing funds or acquired share holding in other company will not be permitted.
6. Along with the application the company has to file with SEBI, certificate from the bankers or the solicitors that the assets on which security is to be created are free from any charge, or no objection has been taken making second charge where assets are already encumbered.
7. The security is to be created in 6 months or up to 12 months for any special reason. If it is failed to do so 2% per month interest is payable.
8. A meeting of debenture holder is to be called if security is not created after 18 months and the reason for the delay is to be explained.

7. What are the rights of debenture holders?

Rights of debenture holders:-

1. Rights and remedies of unsecured debenture holder:-
 - (i) They can file a suit against the company for the principal as well as for the interest.
 - (ii) They can file an application to the court regarding compulsory dissolution of the company.
 - (iii) If the company is under the process of winding up, they can claim their principal.
2. Rights and remedies of secured debenture holder:-
 - (i) They can file a suit against the company for the principal as well as for the interest.
 - (ii) They can file an application to the court regarding compulsory dissolution of the company.

- (iii) If the company is under the process of winding up, the can claim their principal.
- (iv) These debenture holders can file a suit against the companies for its compulsory dissolution through the debenture trustee.
- (v) They can file a suit against the company for the sale of property.
- (vi) It can get injunction from the court to restrict the right of the company to sell its property for redemption of the debenture.
- (vii) If the trustee is so authorized, the debenture holder may appoint liquidator, through the trustee and get the charge sold for the purpose of repayment.
- (viii) If the charged assets are unable to make the full payment, it can file a suit against the company for the balance payment.

8. What is meant by Redemption of Debenture?

Discharging or extinguishing the liability on account of debenture and in reference with the terms of redemption states in the debenture trust deed is called redemption of debentures. A company has to keep in mind the following three aspects regarding redemption that it:-

- (i) The time of redemption.
- (ii) The amount to be paid.
- (iii) The source from which redemption will have to be carried out.

Remedies to debenture holders:-

- (i) **When the debentures are not secured by any mortgage or charge:-** the remedies available to the holder when the debentures are not secured by any mortgage or charge are either: -
 - a. To sue the company for the recovery of the money secured by the debenture and execute the decree against the company's property; or
 - b. To present a petition for the winding up of the company under section 433(e) of the companies Act, 1956 on the ground of the company inability to pay its debts. If winding up is already in progress, than the holder has to prove in which winding up the amount due to him like any other unsecured creditors.
- (ii) **Where the debentures are secured by a mortgage or charge:** When the debentures are secured by a mortgage or charge the holder who wants to realize his security and recover the money due to him may apply to all or any of the following remedies: -
 - a. If the condition of issue permits a receiver may be appointed.
 - b. He may sue on his own behalf and on behalf of other debenture holders of the same class to obtain payment or enforce his security by sale.
 - c. An application for the winding up may be presented in the capacity of creditor for the principal and interest thereon.
 - d. The property can be sold by the trustee, if the debenture trust deed permits the sale.
 - e. An application can be made to the court for the closure of the company's right to redeem the debentures. But in such an action all debenture holders of the company in contradiction to those of a class as well as the company should be joined as parties.
 - f. After the date of the liquidation of the company the debenture holder will not be entitled for payment of interest, only the value of security will be raised, and debt for the balance is proved. He is not entitled to recover the interest out of his security when arriving at a balance for which he can prove in the winding up.

9. What is the provision in relation to issue of Redeemed Debenture?

Power to issue redeemed debenture: Section 121(2) of the companies Act, 1956 provides that if there is no provision to the contrary in the Articles or in the condition of the issue or if there is no resolution showing an intention to cancel the redeemed debentures, the company should have the power to keep the debentures alive for the purpose of re-issue. The company may re-issue either the same debentures or other debentures in their place.

In case of such re-issue the persons entitled to the debentures shall have the same right and priorities as if the debentures had never been redeemed. [Section 121(2)]

With the object of keeping the debentures alive for the purpose of re-issue, if they have been transferred to a nominee, a transfer from that nominee shall be deemed to be a reissue for the purpose of section 121 [section 121(3)]

The aim of keeping debentures that have been issued alive is that formalities for issue of debentures need not be complied with again and the issue can be made without delay. Stamp duty is to be paid.

The power to reissue debentures does not authorize the issue in the place of the redeemed debentures different in their terms from those which have been redeemed.

10. What is a Debenture Certificate?

Debenture Certificates are issued under the common seal of the company. The debenture certificate is a document, which certifies that the holder is the creditor of the company to the limit of a number of debentures multiplied by the face value of each debenture. For eg: if the certificate states 100 debentures of Rs. 100/- each, then holder having the certificate is entitled to get Rs. 10,000/- from the company at the time of redemption of such debentures by the company.

Thus, with the help of this certificate the holder gets the repayment of principal sum at the fixed date and the payment of interest at the fixed rate.

Time of issuing a certificate: The certificate is to be issued to the holder within three months of the allotment of debentures or debenture stock and within two months after the application for the registration of the transfer of any such debenture or debentures stock. The certificate is to be delivered in accordance with the procedure laid in section 53 of the companies Act, 1956.

The Company Law Board has the power to extend the period within which the debentures certificate may be delivered to a further period not exceeding nine months if it is satisfied that it is not possible for the company to deliver the certificate within the said period.

Penalty: if default is made in the delivery of debenture certificate within the said time then every officer of the company who is in default shall be punishable with a fine which may extend to Rs. 500/- per day and imprisonment for a term which may extend to two years.

A notice may be served to a company for making good the default. If it fails to do so within 10 days of the service of the notice, the Company Law Board may on an application made by the aggrieved person, will make an order directing the company and any officer of the company to deliver the securities within the period mentioned in the order. The order contains the information regarding all the costs incidental to the application shall be borne by the company or by the officer of the company who is in default.

11. What is the provision in relation to Appointment of “Debenture trustee”?

Appointment of Debenture Trustee: - The appointment and duties of debenture trustee are dealt under section 117B of the companies Act, 1956. A company before issuing of prospectus or letter of offer for the debenture is required to fulfill the following two conditions:

1. To appoint one or more debenture trustee for such debentures.
2. To disclose on the face of prospectus or letter of offer that debenture trustee or trustees have given their consent to be appointed.

A person cannot be appointed as a debenture trustee, if he:

1. Holds the shares, beneficially
2. Is the creditors
3. Has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

Thus on the basis of above provision answer to the question are as follows:

1. A shareholder who has no beneficial interest can be appointed as a debenture trustee.
2. A creditor whom company owes Rs. 499 cannot be so appointed because the amount owed is immaterial.
3. A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

12. What is the provision in relation to Conversion of Debenture into share?

- (i) According to section 81 of the companies Act, 1956 where any debentures or loan have been obtained from the Govt. by a company whether before or after the commencement of the companies Act, the Central Government is in opinion directs to convert those debentures or loans into the shares in the company on such terms and conditions as it thinks reasonable even when there is no provision for such conversion.
- (ii) Following are the circumstances on which Central Government pays due regard in determining the terms and conditions of such conversion:-

- (i) Company's financial position.
- (ii) The terms of issue of debenture loans.
- (iii) The capital of the company, its loan liability, its reserves, its profit during the preceding 5 years.
- (iv) Interest rates payable on debenture and loans.
- (v) The current market price of the shares in the company.

A copy of every order passed by the Central Government must be drafted before each house of parliament.

(iii) Remedies open to the company :-

If the terms and conditions of such conversion are not acceptable to the company, the company may, within 30 days from having knowledge of such order or within such further time, as may be given by the court make an appeal to the court in reference to such terms and conditions. The decision of the court on such appeal will be final and conclusive.

DESCRIPTIVE QUESTIONS

1. Explain the meaning and significance of the 'Pari Passu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debenture secured by a charge on certain assets of the company.

Pari Passu: One of the clauses used in debenture is pari passu. The clause means that all the debentures of the series are to be paid ratably. The amount of debentures is insufficient to meet the whole debts secured by the series of debentures. If the pari passu clause is not made use of then the debenture's rank in reference with the date of issue and if their issuing date is same as they are payable in their numerical order. A new series of debentures cannot be issued so as to rank pari passu with the prior series unless given in the debenture deed of the previous series.

Registration: Following are the particulars which are required to be filed with the Registrar of Companies in the event of the 'pari passu' clause being included in the debentures secured by the charge. This should be done within 30 days after the execution of the deed containing the charge and if there are no such deeds than after execution of debenture of the series: -

- 1. The total amount secured by the whole series.
- 2. The date of the resolution authorising the issue the series.
- 3. The date of deed by which security is created.
- 4. A detail description of the property charged.
- 5. The name of the trustee for debenture holder alongwith the deed containing the charge or a certified copy of the deed and if there is no deed than a one of debenture of the series. [section 128]

If the debentures in the series are issued more than one, then the date and the amount of each issued must be filed with the Registrar of Companies. If it is omitted to do so will not affect the validity of debenture issued.

2. What are the provisions of the companies Act, 1956 relating to the appointment of 'Debenture Trustee' by a company? whether the following can be appointed as 'Debenture Trustees':

- (i) A shareholder who has no beneficial interest.
- (ii) A creditor whom the company owes Rs. 499 only.
- (iii) A person who has given a guarantee for repayment of amount of debenture issued by the company.

Appointment of Debenture Trustee: The appointment and duties of debenture trustee are dealt under section 117B of the companies Act, 1956. A company before issuing of prospectus or letter of offer for the debentures is required to fulfill the following two conditions:

- 1. To appoint one or more debenture trustees for such debentures.
- 2. To disclose on the face of prospectus or letter of offer that debenture trustee or trustees has given their consent to be appointed.

A person cannot be appointed as a debenture trustee, if he:

- 1. Holds the shares, beneficially.
- 2. Is the creditors
- 3. Has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

Thus on the basis of above provision answer to the question are as follows:

- 1. A shareholder who has no beneficial interest can be appointed as a debenture trustee.
- 2. A creditor who company owes Rs. 499 cannot be so appointed because the amount owed is immaterial.

3. A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.
3. **Write a note on the powers of the Central Government in regard to conversion of debentures and loans into shares of the company under the following head:**
- (i) **When terms of issue of such debenture or terms of loan do not include term providing for an option of conversion.**
 - (ii) **Matters considered in determining the terms and conditions of such conversion.**
 - (iii) **Remedy available to the company if conversion or terms of conversion is not acceptable to it.**
- (i) According to section 81 where any debenture or loan have been obtained from the Govt. by a company whether before or after the commencement of company's amendment Act, 1963, the Central Government in its opinion directs to convert those debentures or loan into the shares in the company on such terms and condition as it thinks reasonable even when there is no provision for such conversion.
- (ii) Following are the circumstances on which Central Government pays due regard in determining the terms and conditions of such conversion:-
- 1. Company's financial position
 - 2. The terms of issue of debenture loans.
 - 3. The capital of the company, its loan liability its reserves its profit during the preceding 5 years.
 - 4. Interest rates payable on debenture and loans.
 - 5. The current market price of the shares in the company.

A copy of every order passed by the Central Government must be drafted before each house of parliament.

- (iii) Remedies open to company :-

If the terms and conditions of such conversion are not acceptable to the company, the company may, within 30 days from having knowledge of such order or within such further time, as may be given by the court make an appeal to the court in reference to such terms and conditions. The decision of the court on such appeal will be final and conclusive.

CHARGE

1. What is a charge under the companies Act, 1956?

Section 124 of the companies act, 1956 provides that for the purpose of registration under the companies Act “charge include mortgage”. The charge may be divided into two types: -

1. Fixed charge
2. Floating charge

2. What is a fixed Charge?

Fixed charge means a charge which is made particularly to cover definite and ascertained assets of fixed nature such as land, building etc. A legal title is passed in the case of fixed charge on the specific assets and the right to dispose of the property is lost by the company.

3. What is a Floating charge?

Floating charge: - The floating charge, as a kind of securities, is peculiar to companies as borrowers. An equitable charge which is created on some assets which are constantly changing is called floating charge. For example book debts, charge on stock in trade etc. The company can deal in such assets in its normal course of business unless the charge becomes fixed on the happening of an event. A floating charge is created by the debenture on the assets of the company.

Characteristics of floating charges:-

1. Floating charge is a charge on a class of assets of the company, both present and future.
2. The class is one which in the normal course of the business of the company would be changing from time to time.
3. It is found that unless some steps are taken by or on behalf of those interested in the charge, the company may carry on its business in the same way as it carried earlier.

Crystallization of a floating charge:- Crystallization means conversion of a floating charge into a fixed charge on the assets in the class charged. A floating charge crystallizes when:-

- (i) The company discontinues carrying on business.
- (ii) The company goes into liquidation
- (iii) A receiver is appointed for.
- (iv) A default is made in paying the principal on interest and the holder or the charge brings an action to enforce his security specified in the deed.

4. How is a Charge registered?

Registration of Charges (section 125):- The company which possess the power to borrow money should have the power to create a charge on its assets, but all this can be done only when it is mentioned in the Memorandum and Articles of Association.

Registration of Charge: - The course of rule of the charge together with instrument, if any by which the charge is to be created, or proved or a copy thereof shall be filed with the Registrar of Companies within the limit of 30 days after the date of the creation of charge. [section 125(1)]

However, the Registrar of Companies is in a position and has the power to extend the period of 30 days by another 30 days with the payment of an additional fee not exceeding 10 times the amount of fee given in schedule X.

Types of Charge to be registered:- Section 125 of the Companies Act, 1956 requires the companies to get registered the following charges with the Registrar of Companies within 30 days of their creation:-

1. A charge on uncalled share capital of the company.
2. A charge on calls made but not paid.
3. A charge for the purpose of securing any issue of debentures.
4. A charge on any debt of the company.
5. A charge on any immovable property, wherever situate or any interest therein.
6. A charge not being a pledge, on any movable property of the company.
7. A charge on a ship or any share in a ship.
8. A floating charge on the undertaking or any property of the company.
9. A charge on goodwill, on a patent or licence under a patent, on a trademark or a copyright or a licence under a copyright.
10. A charge created in India comprising property outside India with the instrument creating a charge or a verified copy.

Effect of Non-registration of Charge – Consequences of Non-registration of a Charge:-

1. **The money secured becomes immediately payable:** According to company 125 if the charge becomes valid then the money secured thereby shall become immediately payable. [section 125(3)]
Further nothing in section 125(1) shall prejudice any contract or obligation for payment of the money secured by the charge. [section 125(2)]
2. **The charges is void:-** the charge becomes void, if they are not registered with the Registrar of Companies. It shall be void as against the subsequent encumbrances as well as against the liquidator and the creditors [section 125(1)]
3. **No right of lien on the document of title:** If a charge becomes void for non-registration then no right of lien can be claimed on the documents of title as they are only ancillary to and were delivered pursuant to charge.
4. **Penalties:-** if any default is committed in filing the Registrar of Companies for the registration the particulars:-
 - (i) Of any charge created by the company.
 - (ii) Or of the payment of satisfaction of a debt in respect of which a charge has been registered.
 - (iii) Or of the issue of debenture of a series, requiring registration with the registrar.

Then till the registration has been effected on the application of some other person. Then the company and every officer who is in default shall be punishable with fine which may extend to Rs. 5,000 for every year.

If a company conducts a default in complying with any other requirement to registration with the Registrar of Companies of any charge created by the company, then the company and every officer who is in default will be punishable with a fine of Rs. 10,000.

PRACTICAL QUESTION

1. **ABC Limited realized on 2nd May, 2001 that particulars of charge created on 12th March, 2001 in favour of a Bank were not filed with the Registrar of Companies for registration. What procedure should the company followed to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 12th February, 2001 instead on 12th March, 2001? Explain with reference to the relevant provisions of the companies Act, 1956.**

Registration of charge: The course of rule of the charge together with the instrument, if any by which the charge is to be created, or proved or a copy thereof shall be filed with the Registrar of Companies within the limit of 30 days after the date of the creation of charge [section 125(1)]. The particulars of charge have been filed in this case within the prescribed period of 30 days.

However, the Registrar of Companies is in a position and has the power to extend the period of 30 days by another 30 days with the payment of an additional fee not exceeding 10 times the amount of fee given in schedule X. after going through the benefits of this provision, ABC limited should immediately file the particulars of charge within 30 days of creation of charge.

The company has to apply to the Company Law Board under section 141 and seek extension of time for filing the particulars for registration, if the charge was created on 12th February, 2001. It becomes duty of the company to satisfy the Company Law Board that the omission was accidental or due to inadvertence and it is just and equitable to grant relief on the other grounds. On this basis the Company Law Board may grant extension on the terms which it may think fit.

The moment the times is extended, the company is bound to get the charge registered.

2. **A charge requiring registration with Registrar of Companies was created on 1st February, 2008 by XYZ limited. The secretary of the company realized on 15th March, 2008 that the charge was not filed with the Registrar of Companies. State the steps to be taken by the secretary to get the charge registered with the Registrar of Companies.**

The course of rule of the charge together with the instrument, if any by which the charge is to be created, or proved or a copy thereof shall be filed with the Registrar of Companies within the limit of 30 days after the date of the creation of charge [section 125(1)]. The particulars of charge have been filed in this case within the prescribed period of 30 days.

However, the Registrar of Companies is in a position and has the power to extend the period of 30 days by another 30 days with the payment of an additional fee not exceeding 10 times the amount of fee given in schedule X.

Case: Looking at the above provision we can say that if the charge was created by XYZ limited on 1st February, 2008 it must be registered with the Registrar of Companies latest by 2nd March, 2008. But secretary of the company realized the same on 15th March, 2008, i.e. after passing of statutory time limit of 30 days. Thus secretary of the company should immediately apply for the late registration to the Registrar of Companies. To get the charge registered with Registrar of Companies, the

company must show a reasonable cause for delay in filing the particulars of charge and must also be a reasonable cause for delay in filing the particulars of charges and must also be ready to pay additional fees, which may be upto 10 times of the regular fees.

MEETINGS

1. What is a meeting?

A meeting is generally a gathering of a number of persons for some purpose or object.

In the same sense, a company meeting is the gathering of Board of Directors, members, shareholders for discussing any matter of the company.

There must be at least two persons to constitute a valid meeting. However, in some cases, even one person may constitute a valid meeting.

2. What are the requisites of a valid meeting?

1. The meeting must have been convened by the proper authority. The proper authorities are: -
 - (i) Board of Directors:- General Meeting
 - (ii) Shareholders :- Extra ordinary General Meeting
 - (iii) The Company Law Board:- For AGM and EGM on petition from the directors or shareholders.
2. Proper and adequate notice must have been served to all those entitled to attend the meeting.
3. For a valid meeting the provision given in the Articles as to the quorum is to be followed.
4. For a meeting to precede a 'chairman' is to be elected as per the provision of the Articles.
5. Proper minutes of the meeting are to be kept by the proper authority.

3. What are the provisions relating to notice?

1. Length of Notice:

- (i) 21 days clear notice
- (ii) A shorter notice is valid for AGM if all the members entitled to vote at the meeting consent.
- (iii) For other meeting a shorter notice is valid even if members holding 95% of voting right consent.

2. Notice to whom: Notice must be sent to

- (i) Every member of the company.
- (ii) Legal representative of a deceased member.
- (iii) Official assignee of an insolvent member.
- (iv) Auditor of the company.

3. Content of notice

- (i) Place of meeting
- (ii) Day of meeting
- (iii) Time of meeting
- (iv) Agenda of meeting
- (v) Right to appoint proxy.

4. Document to accompany notice

- (i) For AGM: -
 - a Audited financial statement of accounts
 - b. Director's report
 - c Auditor's report
 - d. Proxy form etc.
- (ii) For statutory meeting:-
 - a Statutory report
 - b. Proxy form etc.
- (iii) For EGM: -
 - a Explanatory statement
 - b. Proxy form etc.

5. **Omission to give notice:-** [u/s. 172(3)] Deliberate omission to give notice of the meeting to the members or to a single member will make the meeting invalid. But an accidental omission to give notice to or non-receipt of the notice by any member shall not invalidate the proceedings at the meeting.

The expression accidental implies absence of intention or deliberate design.

4. What is a Quorum? What are the provisions relating to it?

1. **Meaning:** A quorum is the minimum number of members who must be present at a meeting as required by law.

2. **Quorum for General meeting:** In absence of any provision in the Articles –

For public company – any 5 person personally present.

For private company – any 2 person personally present.

Note: Articles may provide for larger quorum but not for shorter quorum.

3. **Rules relating to Quorum:**

(i) Only members present in person are counted not the proxies.

(ii) Preference shares holders are not counted.

(iii) Joint holders are treated as single members.

(iv) A member present in two capacities as an individual member and as a trustee may be counted as two members.

(v) In case a company is the member of another company then the representative shall be treated as a member not as a proxy.

(vi) In case the president of India or Governor of state is member and sends representatives, such representative shall be treated as a member and not as a proxy.

4. **Course of action in case of quorum not being present at the general meeting [section 174]:**

(i) If within ½ hour from the time appointed for holding the meeting the quorum is not present, the meeting if called upon the requisition of members, shall stand dissolve.

(ii) In any other case the meeting shall be adjourned to the same day in the next week, at the same time and place or to such other day, time and place as the Board of Directors may determine and notify accordingly.

(iii) If at the adjourned meeting also, quorum is not present within ½ hour from the appointed time, the member present shall be quorum, even if the number of member be one.

5. Who is a Proxy?

Meaning: A proxy is a person, being a representative of a shareholder at a meeting of the company who, may be described as his agent to carry out which the shareholder has himself decided upon.

Who can appoint a proxy?

The shareholder and member of a company.

Who can be appointed as proxy?

Any person whether he is a member of the company or not.

How to appoint a proxy?

Proxy is always appointed in written form and should be signed by the member and duly stamped.

Time for lodging the proxy form: Before forty eight hours of the meeting

Right of the proxy:

1. Attending the meeting
2. Right to vote in the meeting.

Proxy of the company board corporate: in this case proxy takes part in the discussion and gives opinion on behalf of the company in the meeting.

Proxy in the case of the company is appointed by the president and then only he is given the right to take part in the opinion of the meeting.

Can proxy be revoked?

Yes, proxy can be revoked, only the person who has appointed the proxy can revoke him.

Type of proxy: There are two types of proxies.

One the general proxy and the other is the special proxy.

6. Who is a 'Chairman'?

Chairman is the person who is elected to preside over the meeting and conduct the proceeding of the meeting.

According to section 175, a meeting cannot proceed to transact any business without electing a chairman.

Who shall be the chairman?

A chairman is usually a member of the body over which he is to preside.

In case of a company: the Articles usually name the chairman of the board of directors to preside over the general meetings.

If the article is silent, then a chairman is elected from among the members present.

Procedure of election: u/s. 175(1) a chairman may be elected by show of hands.

Section 175(2) provides that if a poll is demanded then, the chairman shall be elected by poll.

Function:

1. The chairman presides over the meeting
2. He conducts the proceeding of the meeting
3. He must decide questions arising out of the meeting
4. He gives reasonable chance to the members to discuss any proposed resolution.

7. What are the provisions relating to Minutes?

Minutes are the written record of the meeting. It is an official record and is the summary of business transacted and decisions arrived at the meeting.

Section 193 makes it compulsory for every company to maintain the minute book recording all the proceeding of every type of meeting conducted.

Provisions:

1. The minute has to be written in a minute book.
2. The minute book has to be bound and its page consecutively numbered.
3. The minute book has to be written within 30 days of the conclusion of the meeting.
4. Every page of the minute book must be initiated or signed by the chairman. On the last page the chairman shall sign and put the date.
5. The chairman has to sign the minute book within 30 days of the conclusion of the meeting.
6. If the chairman dies or is unable to sign the minute book then one of the directors duly authorized by the board must sign the minute book.
7. The minute book shall be kept at the registered office of the company and shall remain open during business hours for members to inspect it without charge.
8. The members are also entitled to a copy of the minutes, however on payment of prescribed fees.

8. What is the procedure for inspection of Minutes Book by a member?

Procedure for inspection of minutes book of G.M. of a company by the member: -

A member has the right to inspect, free of cost, during business hours at the registered office of the company the books containing the minutes of GM of the company:-

1. to see whether the book is bound and its page consecutively numbered.
2. to see whether the every page of the minute book has been initiated or signed by the chairman last page of the minute book must be signed & dated.
3. to see whether the book has been kept at Registered office of the company.

The provision pertaining to the procedure for inspecting the minutes book of general meeting of a company by the members are as follows:-

1. The book constituting the minutes of the proceeding of any general meeting of a company shall:-
 - a. Be kept at the registered office of the company.
 - b. Be open, during business hours, for the inspection of any member without charge, subject to such reasonable restriction as the company may impose by its Articles or in general meeting, so however that not less than 2 hours in each day are allowed for inspection.
2. Any member shall be entitled to be provided, within 7 days, with a copy of any minutes under sub-section (1) on payment of such sum as may be prescribed for every hundred or fractional part thereof required to be copied.

3. If any inspection required under sub-section (2) is not provided within the specified time, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 5,000 in respect of each offence.
4. For any such refusal or default, the Central Government may by order compel immediate inspection of Minutes Book or direct that the copy required shall be immediately sent to the person requiring it.

9. What are the various kinds of General Body Meeting?

1. Statutory meeting
2. Annual General Meeting
3. Extra Ordinary General Meeting
4. Class Meeting.

10. What are the provisions of Statutory Meeting?

Statutory meeting is the first meeting of the company and is conducted once during the life time of the company.

Companies which can hold such meeting: A company limited by shares and a company limited by guarantee & having share capital are the companies which can hold statutory meeting.

Companies which need not hold the meeting:-

1. Private company whether independent or subsidiary of a public company.
2. A public company not having share capital
3. An unlimited public company.
4. A public company limited by guarantee and not having share capital
5. A Government company.

Time limit for the meeting:- A statutory meeting may be held within a period of

1. Not less than one month.
2. Not more than 6 months.

From the date of receiving the certificate of commencement of business.

Notice of the meeting: A minimum of 21 clear days notice is to be given.

Object: The main purpose of the meeting is to enable the members of the company to know at an early date the financial position and the prospects of the company and also to provide them an opportunity to discuss on various matters arising out of promotion and formation of the company.

Importance: this meeting is held only once during the life time of the company and is the first meeting of the company.

What is a statutory meeting and its content: A statutory meeting is a report which is sent to each member along with the notice of the meeting.

Content of statutory report:-

1. It sets out the total number of shares allotted and the mode of allotment.
2. The total amount of the cash received by the company in respect of the shares allotted.
3. An abstract of receipt and payment of the company. This report has to be duly certified by at least two directors. Out of which one shall be a managing director along with auditor of the company.
4. Agenda of the meeting regarding the formation and prospects of the company.
5. Particulars of directors, auditors, etc.
6. Particulars of contract.
7. Under writing contract.
8. Arrears of call.
9. Commission or brokerage.

Adjournment of Statutory meeting: The statutory meeting may be adjourned from time to time according to the provision of the companies Act, 1956 and the power to adjourn vests in the hand of the shareholders.

Penalties:

1. If default is made complying the requirement of section 165, every person responsible shall be punishable with a fine extended to Rs. 5,000/-.
2. If the company fails to call a statutory meeting then it becomes a sound ground for the winding up of the company.

Can the court demand a statutory meeting?

Yes, where the company fails to conduct a statutory meeting within a stipulated time, then the court may call for meeting.

11. What are the provisions relating to Annual General meeting?

Annual general meeting of the company is an annual meeting of the body of the member held every year.

Companies to hold AGM: Every company can hold annual general meeting whether having shares capital or not, whether limited or unlimited.

Time limit:**First Annual general meeting:**

A company may hold its first annual general meeting within a period of 18 month from the date of incorporation. However this should not be more than 9 months from close of financial years.

Subsequent meeting:-

1. There must be one meeting held in each year.
2. The gap between two annual general meetings must not be more than 15 years.
3. Meeting must be held not later than 6 months from close of financial year.

Extension of time: the registrar has the power to extend the time of 15 months by 3 more months in special cases.

Day, hour and place of meeting: The meeting can be held at any working place, on any working day and working hours.

If the day scheduled for meeting is declared by the Central Government to be a public holiday after the issue of the notice, it shall not be deemed as a holiday.

Notice of the meeting: 21 clear days notice or any shorter notice if agreed by all shareholders must be given.

Business to be transacted**(1) Ordinary business: -**

- (a) To present the balance sheet, report of Board of Directors, etc.
- (b) To declare dividends.
- (c) To appoint directors.
- (d) To appoint auditors and fixation of their remuneration

(2) Special Business:-

Any other business which is not an ordinary business

Default in holding Annual general meeting

The Company Law Board on petition from member shall call or direct the calling of the general meeting of the company.

Penalty:

If default is made in holding AGM, the company and every officer in default shall be punishable with fine which may extend to RS. 50,000/- . In case the default continues, a further fine upto Rs. 2,500/- per day may be levied till such default continues.

12. What is the provision relating to procedure to be followed for transacting business at AGM through postal Ballot?

1. Where a company decides to pass any resolution by postal ballot, it must inform about it to all the shareholders by sending notice, alongwith a draft resolution explaining the reason and requesting them to send their assent within a period of 30 days from the date of posting of the letter.
2. The notice should sent through the registered post and a postage pre-paid envelope for facilitating the communication of assent or dissent of the shareholder to the resolution with the said period should be annexed.
3. The board of directors may appoint one scrutinizer. He must not be in the employment of the company. He must be a retired judge or any person of repute who is in the position to conduct the postal ballot voting process.
4. The scrutinizer will remain at his position for 35 days leaving holidays from the date of the issue of the notice for annual general meeting. He is required to submit his final report on or before the said period.
5. If resolution is towards a majority of the shareholders by means of postal ballot, It shall be deemed to have been issued at a general meeting.
6. If a shareholder sends his assent or dissent in writing on a postal Ballot and thereafter any person fraudulently defences or destroys, the ballot paper or declaration of the identity of shareholder such person shall be punishable with imprisonment for a term which may extend to 6 months or with fine or both.

7. The scrutinizer will maintain a register to record the consent received, including electronic media, mentioning the particulars of name, address, folio no. nominal value of shares, number of shares, etc, he shall also maintain record for postal ballot which are received in defaced or mutilated form.
8. The postal ballot and all other paper relating to postal ballot will be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes of the meeting.
9. Thereafter, the scrutinizer shall return the ballot paper and other related materials to the company so as to preserve such ballot papers and other related papers safely till the resolution is given, effect to.
10. Voting by electronic mode is part of postal ballot.

13. What is the provision in relation to Resolution?

There are three kinds of resolutions:-

1. Ordinary resolution
2. Special resolution.
3. Resolution requiring special notice.

1. Ordinary Resolution [section 189(1)]

When a motion is passed by simple majority of the members voting at a general meeting, it is said to have been passed by an ordinary resolution. All matters which are not required by the companies Act, 1956 or the company's Articles to be done by a special resolution can be done by means of an ordinary resolution. Some of the cases in which only ordinary resolution is required are:

- (i) Alteration of authorized capital
- (ii) Declaration of dividend
- (iii) Appointment of auditors (other than the appointment cover by Section 224A)
- (iv) Fixation of their remuneration, election of directors.

2. Special resolution [section 189(2)]

According to section 189(2), a resolution is a special resolution when –

- (i) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members
- (ii) The notice required under the companies Act has been duly given of the general meeting;
- (iii) The votes cast in favour of the resolution by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution. Abstentions, if any, are not to be taken into account.

Some of the matters for which special resolution is required to be passed are:

- (i) To alter object clause of Memorandum;
- (ii) To change the registered office of the company from one state to another
- (iii) To reduce share capital of the company; and
- (iv) To alter Articles of Association.

3. Resolution Requiring Special notice: According to section 190, a resolution requiring special notice is not actually an independent class of resolution. Such a resolution may be an ordinary or special resolution.

It is a different kind of an ordinary resolution of which notice of the intention of move a resolution has to be given to the company by proposer.

The notice shall be given not less than 14 days before the meeting at which resolution is to be moved exclusive of the day on which the notice is served or deemed to be served and the day of the meeting. The object of special notice is to give the members sufficient time to consider proposed resolution and to give Board of Directors an opportunity to indicate their views on resolution.

A special resolution is required for a resolution in following cases:-

1. Appointment of auditor other than retiring one
2. Provision that a retiring auditor shall not be re-appointed.
3. Removal of director in place of one who is removed
4. Appointment of a director in place of one who is removed

The Articles of the company may provide for additional matters in respect of which special resolution is to be passed.

14. What is an extra ordinary general meeting?

Clause 47 of the table A (schedule 1) provides that all general meeting other than the annual general meeting shall be called as extra ordinary general meeting. An extra ordinary general meeting in convened for transacting some special business or urgent business that may arise in between two AGMs, for instance change in the object or sif of registered office or alteration of capital or removal of a director/auditor. Companies Act containing the following provisions with respect to extra ordinary general meetings:

1. **Business to be transacted:** All business transacted at such meetings called special business.
2. **Who may call** – An EGM may be called:
 - (i) By the Board of Directors of its own accord: (clause 48 of Table A to the Act.)
 - (ii) By the Directors on requisition.
 - (iii) By the requisitionists themselves
 - (iv) By the Company Law Board
- (i) **By the Directors:** The Board of Directors may call a General Meeting of the members at any time by giving not less than 21 days' notice [Section 171(1)]. A shorted notice may, however, be held valid if consent in accorded thereto by members of the company holding 95% or more of the voting rights [section 171 (2) (ii)].

In exceptional cases of urgency any director (in the absence from India of requisite number of directors to form quorum in the board meeting) or any two members of the company may convene an extra ordinary General meeting.
- (ii) **By the Directors on Requisition [section 169]-** The Board of Directors must convene a general meeting upon the request or requisition if the following conditions are satisfied:
 - (a) The requisitionists must be such numbers who, at the date of the deposit of the requisition, are the holders of 1/10th of total voting power. Thus, in case of a company having share capital they should hold at least 1/10th of such of the paid up capital that carries right to vote in regard to that matter [section 169(4)(a)]. Preference shareholders having voting right only as regards matters relating to the preference shareholders. They have no general voting right and, therefore, no right to requisition in respect of other matters, if the company does not have a share capital, they should at least hold 1/10th of total voting right of the company in regard to that matter [section 169(4)(b)]
 - (b) The requisition must state the objects of the meeting i.e. it must set out the matters for the consideration of which the meeting is to be called [section 169(2)].

However, the requisitionists are under no obligation to attach the explanatory statement to the requisition. It is for the Board of directors, on receipt of the requisition, to include in the notice convening the meeting the necessary explanatory statement.
 - (c) Requisition must have been deposited at the registered office of the company [section 169(3)].
 - (d) Requisition must be signed by the requisitionists [section 169(2)]. In case all the aforesaid conditions are satisfied, i.e. a valid requisition has been received; the Board of Directors must within 21 clear days of the receipt of the requisition call the meeting giving at least 21 days' notice fixing the meeting. Within 45 days of the receipt of the requisition [section 169(6)].
 - (e) Where two or more distinct matters are specified in the requisition, the validity of each such matter shall be determined independent of each other before convening the meeting. Where the resolution proposed is a special resolution, requirements of section 189(2) must be complied with, viz, it should be so described and explanatory statement be annexed.
- (iii) **By the requisitionists themselves [section 169(6)]** – If the board of Directors does not or fails to call the meeting as aforesaid (i.e. within 21 days fixing the date of the meeting within 45 days of the deposit of a valid requisition) the meeting may be called:
 - (a) By the requisitionists themselves.
 - (b) In case of company having share capital, by one or more requisitionists as represent:
 - A majority in value of the paid up share capital held by all the requisitionists; or
 - At least 1/10th of the paid up share capital carrying voting rights in respect of that matter, whichever is less.
 - (c) In cas e of a company not having share capital, by one or more requisitionists who represent at least 1/10th of total voting power in the company in regard to the matter of the requisition.
 - (d) Meeting must be held within 3 months of the date of the deposits of the requisition [section 169(7)].

- (e) Where two or more person hold any shares or interest in a company jointly, a requisition, or a notice calling a meeting, signed by one or some of them shall, for the purposes of this sec, have the same force and effect as if it had been signed by all of them [section 169(8)].

Meeting by the requisitionists must be held in the same manner, as nearly as possible, in which the meetings are to be called by the Board of Directors [section 169(7)]. However, where the registered office is not made available to them for holding the meeting, they may hold the meeting elsewhere.

(iv) By the Company Law Board [section 186]:If for any reason it is impracticable to call a meeting of the company, other than an Annual general meeting, the Company Law Board may direct the calling of the meeting:

- (a) On its own motion
- (b) On an application of any director
- (c) On an application of any member entitled to vote at that meeting.

For the aforesaid meeting, the Company Law Board may give directions in respect of the place, date and the manner in which the meeting is held and conducted. It may also give such ancillary or consequential directions as it thinks expedient, including a direction that one member present in person or proxy shall be deemed to constitute a meeting.

15. What is class meeting?

Section 106 provide that where the share capital of a company is divided into different classes shares, the right attached to the shares of any class may 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:

- (a) If provision with respect to such variation is contained in the Memorandum or Articles of the company; or
- (b) In the absence of any such provision in the Memorandum or Articles, if such variation is not prohibited by the terms of issue of the shares of that class.

PRACTICAL QUESTION

1. **Dinesh, a director in a company gave in writing to the company that notice for any general meeting and the Board of directors meetings be sent to him at his address in India only be registered Main and for which he paid sufficient money. The company sent two notice to him, of such meeting, by ordinary mail, under the certificate of posting, Dinesh did not receive the said notice and could not attend the meeting and the proceeding thereof on the ground of improper notice. Decide in the light of the provisions of the companies Act, 1956.**

(i) **Whether the contention of Dinesh is Valid?**

(ii) **Would your answer be same in case Dinesh remained outside India for two month (when such notice were given and meeting held).**

Problem on notice and validity of proceeding of the meeting: the question asked is based on the provision of section 172 along with section 53 of the companies Act, 1956. As per the section, the notice may be served either personally or sent through post to the registered address of the members and in the absence of any registered address in India, to the address, if any within India is given by the members to the company for the purpose of sewing notice. The service through post shall be deemed to be effective only when they are correctly addressed, prepared and posted. When a member wants the notice to be served on him under a certificate or by registered post with or without the acknowledgement due and has deposited money with the company to defray the incidental changes, then the notice should be served accordingly, otherwise service will not be treated to be effective.

The answer to the question asked is as follows:-

- (i) The contention of Dinesh shall be defended for the reason that the notice was not properly served and meeting held by the company shall be invalid.
- (ii) According to section 172 of the companies Act, 1956, the comp any is not bound to send notice to Dinesh at the address outside. Thus the answer in second case shall differ from the first one.

2. **M/s. Low Esteem Infotech Ltd. was incorporated on 1.4.2003. No general meeting of the company has been held so far. Explain the provision of the companies Act, 1956 regarding the time limit for holding the first Annual general meeting of the company and power of the Registrar of Companies to grant extension of time for the first Annual general meeting?**

The provision contained in section 166 of the act states that company shall hold its first Annual general meeting within a period of 18 months from the date of incorporation. Since M/s. Low Esteem Infotech Ltd. Was incorporated on 1.4.2003, the

first Annual general meeting of the company should be held on or before 30th September 2004. Further the Registrar of Companies of has the power of grant extension of time for a period of not exceeding 3 months for holding the Annual general meeting. This power of the Registrar of Companies is not applicable in case of first Annual general meeting. if the Annual general meeting of the company was held after the 30th September,2004, then the company and its directors will be responsible for the default.

- 3. Annual General Meeting of a private company was schedule to be held on 15.12.2003. Mr. A, a shareholder, issued two proxies in respect of the shares held by the company in favour of Mr. X and Mr. Y. The proxy in favour of Y was ledged on 12.12.2003 and the one in favour of X was ledged on 15.12.2003. The company rejected the proxy in favour of Y as the proxy in favour of Y was of dated 12.12.2003 and thus in favour of X was of dated 13.12.2003. is the rejection by the company in order.**

If a member appoints more than one proxy in respect of the same meeting, then the one which has been appointed later time shall prevail and one which has been appointed earlier shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of X being later in time shall be upheld as valid. According to section 176 of the companies Act, 1956 a proxy should be deposited 48 hours before the time of meeting. In the given case, the proxies should have therefore been deposited on or before 13.12.2003. X deposited the proxy on 15.12.2003. Hence, the proxy in favour of X has become invalid. Thus, the proxy in favour of Y is valid as it is deposited in time.

- 4. The minutes of the meeting must contain fair and correct summary of the proceeding threat. Can the Chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a Director of the company. The chairman declines to do so. State how the matter can be resolved?**

As per section 193(5), any matter which:

- (i) Is or could reasonably be regarded as defamatory of any person;
- (ii) Is irrelevant or immaterial to the proceeding; or
- (iii) Is detrimental to the interest of the company.

The Chairman shall exercise an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified above. Since the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes, the insistence of the shareholders will be of no avail.

- 5. Dev limited issued a notice for holding of its Annual General Meeting on 7th November, 2005. The notice was posted on the members on 16.10.2005. Some members of the company alleged that the company had not complied with the provisions of the companies Act, 1956 with regard to the period of notice and as such the meeting was not validly called. Referring to the provisions of the Act, decide:**

- (i) Whether the meeting has been validly called?
 - (ii) If there is a short fall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?
 - (iii) Can the short fall, if any, be condoned?
- (i) For general meeting of any kind, at least 21 clear days notice must be given. In this case the notice of meeting was sent by post. In case the notice is sent by post the provision is as follows:-

It must be posted at such time as to give 21 clear days notice as required by section 171 plus 48 hours in addition. Each of the 21 days must be a full calendar day excluding the day on which notice is issued. Therefore notice of general meeting must be sent at least 25 days before the date of meeting.

In the question,

The date of meeting = 7th Nov. 2005.

Date of posting = 16th October 2005.

So, 25th day from 16th Oct. 2005 = 9th November.

The meeting has not been validly called as the notice falls short of 2 days.

- (ii) The notice falls short of 2 days as explained above.

- (iii) A shorter notice will be valid in case of AGM if all members entitled to vote at the meeting give their consent.

I case of any other meeting a shorter period will be valid if consent is given by members holding at least 95% of the paid up capita carrying voting rights or representing at least 95% of voting power (section 171)

6. The Articles of Association of X Ltd. requires the personal presence of 7 members to constitute the quorum of General Meeting. The following persons were present in the EGM to consider the appointment of Managing Director:

- (i) A, the representative of Governor of Madhya Pradesh.**
- (ii) B and C, shareholders of preference share.**
- (iii) D, representing Y Ltd. and Z Ltd.**
- (iv) E, F, G and H as proxies of shareholders.**

Can it be said that quorum was present in the meeting?

As per Articles of Association of the company the quorum for a general meeting is 7 members personally present. But the quorum is not complete, so the meeting cannot be held. It is so because: -

- (i) For the purpose of ascertaining quorum, only members present in person and not by proxies are to be counted. Even the Articles of Association cannot provide for counting of proxies for the purpose of quorum. However, exception to this rule is contained in section 167 and 186.
- (ii) Preference shareholders present in the meeting are not to be counted for the purpose of quorum except where the proposed business includes any item directly affecting preference shareholders.

Hence there is no proper quorum.

7. A company served a notice of General meeting upon its members. The notice stated that a resolution to increase the share capital of the company would be considered at such meeting. A shareholder complains that the amount of the proposed increase was not specified in the notice. Is the notice valid?

As per the contents of the notice, the notice should contain a statement of the business to be transacted at the meeting (called agenda). If special business is to be transacted (such as increase in the share capital of the company) , an explanatory statement should also be attached to the notice of the meeting. The statement must state all material facts concerning each item of special business.

Hence the notice is not valid.

8. MN limited held its Annual general meeting on 27th March, 2008. M the chairman of the said meeting dies on 1st April, 2008, when minutes of the annual general meeting were not yet recorded and signed. How would you deal with the situation? Would your answer be different in case the meeting held on 27th March, 2008 was a Board meeting?

According to section 193(1) of the companies Act, 1956, every company shall within 30 days of conclusion of the following meeting prepare minutes:

- Meetings of shareholders
- Meeting of Board of directors
- Meeting of committee of board of Directors

And the pages of minute book should be consecutively numbered.

And as per section 193(1A), each page of minute shall be initialed or signed and last page of the record of proceeding of each meeting shall be dated and signed –

- (a) In the case of minutes of proceeding of a meeting of the board or of a committee thereof, by the chairman of such meeting or the chairman of the next meeting;
- (b) In the case of minutes of proceeding of a general meeting by the chairman of the same meeting within the aforesaid period of 30 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.

Case: AGM of MN limited was held on 27th march hence the minutes should be signed by M latest by 26th April but he dies on 1st April, without signing minutes. In this circumstances MN limited should call and hold a board meeting and authorize a person to sign the minutes of AGM.

In case the above meeting had been a board meeting then in case of death of chairman of the meeting , minutes can be signed by chairman of the next board meeting.

MISCELLANEOUS

1. What is Dividend?

The earning and profit of the company which is not retained in the business but is distributed among the members is known as dividend.

In case of a company which is a going concern, it ordinary means the portion of the company which is allocated to the holders of shares in the company.

In case of winding up it means a division of the realized assets among the contributories and creditors according to their respective rights.

2. What is Interim Dividend?

Interim dividend is a dividend paid between two annual general meetings of the company,

Provisions:-

1. The BOD may declare interim dividend from time to time.
2. The amount of dividend including interim dividend shall be deposited in a separate Bank account within five days from the date of declaration of such dividend.
3. The amount of dividend so deposited above shall be used for payment of interim dividend.
4. Since, interim dividend does not constitute a statutory debt and therefore directors can rescind it by passing a resolution.

3. Dividend is payable to whom?

According to section 206, dividend is payable to:-

1. The registered share holders or to their bankers.
2. The bearer of share warrants.

In case of sale of shares:

As per section 206(A) companies Amendment Act, 1988, in case of shares the transfer deed in respect of which has been lodged with the company and is pending registration at the time of payment of dividend, the dividend shall be paid to the transferee only in case the transferor has given a written mandate to that effect.

4. Can a dividend once declared be revoked?

A dividend creates a debt towards the shareholders. Hence, once declared a dividend can not be revoked.

Exception:-

- (1) It can be revoked with the consent of the shareholders.
- (2) It can be revoked where it has been declared illegally.
- (3) It can be revoked in the event of outbreak of war, imposition of taxes, etc where it is better to conserve assets.

5. What are the sources out of which dividends may be paid?

According to section 205, dividends are declared out of the following:-

1. Current profit after providing for depreciation.
2. Past reserves created out of profit or credit balance in the P & L A/c. brought forward.
3. Moneys provided by central Government or state Government in pursuance of a guarantee given by that Government.

6. What is the mode of payment of dividend?

According to section 205(3) the dividend is paid in cash and cash only.

According to section 205(5)(b) the dividend payable in cash may be paid by cheque or warrant.

7. What is the time within which dividend is to be paid?

According to section 207, it is obligatory for a company to pay dividend within 30 days of its declaration.

The term 'to pay' means posting of the dividend cheque or warrant. On default, every director who is knowingly a party to default is punishable with imprisonment which may extend to 3 years and with fine of Rs. 1,000 for every day if the default continues.

Default when excused:-

According to section 207, the default, is excused in the following cases:-

1. Where dividend could not be paid due to operation of any law.

2. Where the shareholder has given certain direction to the company regarding the payment of dividend which cannot be complied with.
3. Where there is a dispute as to the recipient of dividend.
4. Where the dividend has been lawfully adjusted against any sum due to the company.
5. Where the failure to pay dividend or post the warrant within 30 days was not due to any default on the part of the company.

8. What is the provision relating to unpaid and unclaimed dividend?

According to section 205(A), where a company has declared a dividend but not paid or is not claimed within 30 days then the company shall transfer the total amount so unpaid or unclaimed to a special account called unpaid dividend A/c. to be opened by the company in that behalf, within 7 days from the date of expiry of said 30 days.

Section 205(a)(5) further provides that money transferred to the unpaid dividend account if remains unclaimed for a period of 7 years from the date of such transfer, must be transferred to Investor Education and Protection Fund.

If the above provision is not complied with the company and every officer responsible shall be punishable with a fine which may extend to Rs. 5,000/- for every day during which the failure continues.

DESCRIPTIVE QUESTIONS

1. Explain the provisions of the companies Act, 1956 relating to establishment of an “Investor Education and Protection Fund”.

Under section 205(i) of the companies Act, 1956 a fund is established by the Central Government called Investor Education and Protection fund. This fund will be used for the purpose of promotion of investors awareness and protection of investors [section 205C (3)].

The sources from which the fund will be collected are as follows [section 205(2)]: -

1. Matured and unpaid deposits with companies.
2. Amount of unpaid dividends.
3. Matured debentures with the companies.
4. Application money received by company for the purpose of allotment of any securities and due for refund.
5. Interest accrued on the amount referred above.
6. Interest or other income received out of investment from the fund.
7. Grants and donations from the Central Government, State Government, companies or any other institutions. The amount due for payment by company will not become the part of the fund for 7 years. If investors/shareholders do not claim the amount within 7 years, then the company is in the position to transfer the prescribed amount to the authority of the fund. The liability of the company ends as soon as the funds are transferred.

An authority or a committee is formed by the Central Government for the administration of the fund. It is the duty of the authority to see that the money is spent in carrying out the objects for which the fund has been established.

2. Advise the Board of Directors of a public company in relation to following matters, under the provisions of the companies Act, 1956:

(i) Sources out of which the company can declare dividend.

(ii) Transfer of profit to reserves before declaring dividend for a particular financial year.

Sources of Dividend Declaration and Transfer of Profit:-

The company can declare dividend out of the following sources for any financial year:-

1. Out of the profit of the company for that year arrived at after providing for depreciation in the manner laid down in the act; or
2. Out of profits of the company for any previous financial year or years arrived at after providing for depreciation and remaining undistributed; or
3. Out of both; or
4. Money provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that government.

If any thing is for the public interest, than the Central Government may allow the company to declare or pay dividend for any financial year out of the profit of the company for that year or any previous financial year or years, without providing for depreciation [section 205(i)]

Transfer to reserves up to 10% of the profits.

Central Government may prescribe certain, percentage of profit not exceeding 10 percent to be transferred to the reserves of the company, before any dividend is declared or paid by a company for any financial year out of the profits of the company. The company has the power to transfer a higher percentage of its profit to the reserves.

The companies (transfer of profits to reserves) rules 1975 has prescribed the percentage of profit which have to be compulsorily transferred to the reserves of the company before declaration of dividend. They are as follows:-

Rate of proposed dividend as to paid up capital	Maximum amount to be transferred to reserves out of current profits
1. Where it exceeds 10% but does not exceed 12.5%	(a) 2.5% of current profits.
2. Where it exceeds 12.5% but does not exceed 15%	(b) 5% of current profits.
3. Where it exceeds 15% but does not exceed 20%	(c) 7.5% of current profits.
4. Where it exceeds 20%	(d) 10% of current profits.

There is no statutory obligation to transfer any amount to reserve out of profit, if the proposed dividend does not exceed 10%.

3. State the conditions which are required to be fulfilled before declaration of “Interim Dividend” under the companies Act, 1956.

The dividend paid between the two Annual general meetings of the company is interim dividend. It is the part of profit which is distributed before the accounts are finally passed. The companies Amendment Act, 2000 has introduced section 2(14A) in which dividend includes the interim dividend.

Under section 205(1A), it is authorized that the Board can declare interim dividend, unless it is specifically prohibited on the Articles. According to section 205(1C), the provisions contained, in (section 205, 205A, 205C, 206, 206A and 207) will as far as may be, also apply to any “Interim Dividend”. Hence, the director before declaring an interim dividend must satisfy themselves on the following grounds:-

1. From the date of declaration of interim dividend, the company must be in a position to deposit the amount of dividend and interim dividend in a separate bank account within 5 days.
2. The financial position of the company warrants the payment of such dividend out of the profit available for distribution.
3. The company should prepare an interim account and it must disclose profit which should be sufficient for the declaration of dividend after making appropriate provision for depreciation, bad debts, and transfer to reserve and other contingencies. Then only the proportion of profits which have to be distributed as interim dividend is decided.

4. The Board of Directors of M/s optimistic company ltd. Propose to pay an interim dividend of Rs. 2 per share or Rs. 10 each. Advise the board regarding :

I. The time limit for payment of interim dividend to the shareholders

II. Steps to be taken in case any dividend amount remains unpaid in the books of the company.

(i) Time Limit:-

- a) An interim dividend should be paid within 30 days.
- b) If any amount of interim dividend is unpaid or is not claimed for more than 30 days, then the amount should be transferred to a special account in a scheduled bank called Unpaid Interim dividend A/c. or M/s. optimistic company ltd.
- c) If the amount remains unclaimed in the scheduled bank for a period of 7 years then it shall be transferred to the investors education and protection fund.

(ii) Steps to be taken in case any dividend amount remains unpaid in the books of the company :-

- a) the first step to be taken by the board is to see carefully the adequacy of profit because if there will be inadequacy of profit, the distribution would amount to reduction of capital.
- b) The amount of interim dividend should be deposited in special bank Account.
- c) Full year depreciation should be charged on the assets.
- d) The past year losses should be adjusted against the estimated profits.
- e) A prescribed percentage of the estimated profits should be transferred to the company reserves after providing for current year's depreciation.

5. Answer the following questions:

I. Can the declaration of Board of Directors of interim dividend be revoked?

II. Who is empowered to declare final dividend?

- (i) Interim dividend does not constitute a statutory debt and therefore directors can rescind it by a resolution. The leading case on this is of *Lagunas Nitrate company Ltd. v Henry Schroeder & company*, directors declared an interim dividend payable on a future date but before that date, they passed a resolution postponing the payment of such dividend. Held directors could do so.

Thus while declaring dividend, the board should carefully assess the adequacy of profits. The opinion of the auditors, therefore be obtained in this regard..

- (ii) Board of directors especially the managing Director is empowered to declare the final Dividend.